Inland Revenue
Te Tari Taake

Property Compliance Programme

Presentation to Tauranga Property Investors Association

Presenter:
Harish Singh
14 July 2014

Our Purpose Today

- Talk briefly about the Property Compliance Programme (PCP)
- Talk about PCP's current focus - investigations
- Talk about tax rules relating to property investors
- Dispel some myth about property
- Give examples of reasons people give for selling their so called "investment properties"

Property Compliance Programme

- The Government was concerned with non-compliance in the area of property taxation- funding provided to Inland Revenue in May 2007

- Inland Revenue established the Property Compliance Programme ("PCP") in June 2007 as a 3 year initiative to enforce and improve compliance in the area of property taxation

- May 2013 Budget – Government announced annual funding of $6.65 million dollars to pursue property investment tax compliance

Who are we?

- PCP National Project HQ – Manukau, Auckland
- 5 Investigations teams across 8 sites nationally
- 1 Collections team – Takapuna
- Dedicated legal special interest group

……. Plus support and involvement from other units and staff

Risk Based Focus

Current Focus: Investigations (audit)

Some examples of current and on-going risks:

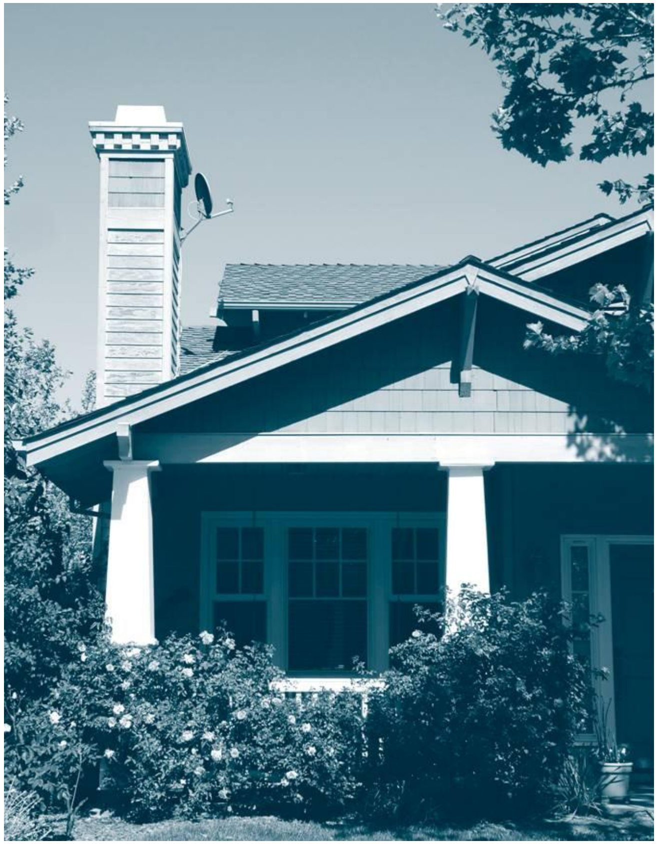
- Traders and speculators
- Speculation in new developments (e.g. new developments in the Auckland region and nationwide)
- Off the plan sales
- Land banking

Risk Based Focus

- **Residential rental**
  - Depreciation Recovered
  - Repairs and Maintenance
  - When rental property investors become property dealers??????

Our focus on property transactions

- Isn't new
- Part of our regular audit work
- A growing risk
- A key priority – with increased funding



Tax has to be paid on all income earned

- Proceeds from property sales can be taxable income in some circumstances

- Buying and selling property to make a profit means tax should be paid on that income

Property Investor

- Collective term for speculators, dealers and investors.
- Different treatment under tax laws
- Category you fall in? – not determined by what property is called or how activity is described
- Example: Property marketed as follows- a “rental investment” with strong “capital gain” potential

Rental Property Investor

- Characteristics:
  - Property purchased for on-going rental income
  - Not with any firm intention of resale
  - Will investigate and analyse future revenue streams -yield
  - Investment based soundly on return from rental income
  - Buy and hold strategy

Rental Property Investor

  - Tax payable on net rental

  - Any gain on sale is incidental

- However: owning rental property does not automatically exclude you from paying tax.

- Investment Strategy from investor to dealer:
  - Tax situation will change
  - Properties prior to change may not be affected

Property Speculator

- Persons who:
  - buy and sell land with the intent or purpose of making a profit without necessarily developing or improving the land, and
  - relying instead on chance, trend or volatility of the property market to provide financial gain
- Can be one-off purchase and sale of a property
- Length of time property held does not matter if intention was for resale

Dealers

- Similar to a speculator , buying properties for resale
- Difference – established a pattern of buying and selling properties
- Dealing – appears simple enough but no "hard and fast rule" as to what number and frequency of property purchased and sold

Mythbusters!!

- “Property gains are tax free in New Zealand”
- “I am OK if I only sell one property a year”
- “I am always exempt from tax if I live in it”
- “Provided I hold it for 10 years I am ok”

Myth 1 - "Property gains are tax free in New Zealand"

- Broadly – nine categories of land disposal that give rise to taxable income:
  - Purpose or intention of resale
  - A business relating to land that covers dealing, developing or erecting building
  - A dealer's other land (tainting provisions)
  - A developer's other land
  - A builders other land
  - Development or division commenced within 10 years
  - Major development or division
  - Rezoning changes
  - Landfills
  - Legislation – CB 6 to CB 14 of the Income Tax Act 2007

Myth 2 – "I am OK if I only sell one property a year"

- Tax is payable if property acquired with the **intention or purpose** of resale

- Can be a one-off purchase

- We work out intention by:

  - Listening to what you tell us
  - Looking at your actions to see if it supports what you have said
    - Analysing the buy/sell pattern
    - Statements made to bank managers or advisors
    - Any plans made at the time of the discussions
  - Consider the totality of the circumstances before making a decision

Determining Intention

- Determined at the time property is acquired
- Purpose or intention of selling land must exist at the time land was acquired – gains to be taxable
- Purpose or intention must be definitive in some way
- The purpose or intention of selling does not have to be the dominant purpose or intention of acquiring land
- If intention of sale is vague or a general hope that it would a good investment, not likely to be taxable

Determining Intention

- A simple recognition that land may need to be disposed of at some future date does not amount to a purpose or intention
- Fact – Nearly everyone buying a property will sell it at some stage
- Most people hope that their property will gain in value
- Increase in the value of residential properties is common of such purchases
- This alone isn't enough to make any profits taxable

Having more than one reason for buying a property

- People can have more than one reason for buying a property, and for selling one

- In principle we take into account all of your reasons for buying a property

Example 1- Intention

- Joe and Gail buy a second property as a rental. They also hope, in the long term, to sell the property for a profit.

- Seven years later, they decide to sell the property and make a substantial gain from the property. Is the gain taxable?

  - Unlikely to be taxable as there was no firm intention of disposal at the time property was acquired.

  - This is a simple recognition that property will be sold in the future and hopefully for a gain.

  - However, we would consider the totality of the circumstances before a decision is made e.g. association (tainting provisions), documents to support their intention etc.

Example 2- Intention

- Would the treatment be different if the property was sold in 18 months instead of 7 years?
  - Again we would have to consider the totality of the circumstances before a decision can be made
  - There might be a genuine reason for the property sale, e.g. job loss, sickness etc.
  - However, if the reasons given does not add up, i.e., their stated intention at the time the property was acquired also becomes questionable.
  - That is why each case has to be considered on it’s own merits.

Example 3 - Intention

- Jack and Jill buy a second property in 2000 with the hope it will quickly gain in value for an on-sale. They rent it out in the meantime.

- The value of the property has not risen as quickly as they had hoped but the property is eventually sold in 2013. A substantial gain is made from the sale. Is this gain taxable?

  - The gain will be taxable as it was acquired with the intention of resale.

  - The intention of resale does not have to be the dominant purpose.

  - There was a definite plan to sell the property as soon as the value of the property reached an acceptable level.

  - In this case, it took longer than expected, however, this does not prevent the gain from being taxable.

  - This example also shows that there is no time limit between the purchase and sale date, i.e., there is no ten year rule.

Myth 3 – "If I hold it for 10 years I am ok"

- If property acquired with the intent of resale:
  - No time limit between date of purchase and date of sale;
  - There is no 10 year rule
  - E.g. property bought with intent of resale, however property market dips and is rented instead
  - Property sold after 16 years and substantial gain made – Taxable as intent was resale for gain

Myth 3 – "If I hold it for 10 years I am ok"

- Gains become taxable from disposal of land within 10 years of acquisition if the land is:
  - A dealer's other land (or a person associated with them)
  - A developer's other land (or a person associated with them)
  - A builder's other land (or a person associated with them)
  - Above usually referred to as tainting provisions
  - Also any undertaking and scheme which is not necessarily in the nature of a business and commenced within 10 years of acquisition of land (s CB 13)
- However, if land is disposed after 10 years in the above circumstances, gain is not taxable.

Myth 4 - "I am always exempt from tax if I live in it"

- Residential exclusion – applies to prevent the gains from being taxable if certain conditions are met:
  - Applies to land with a dwelling house on it
  - Dwelling is occupied mainly as a residence by the taxpayer or any member of their family living with them
  - Or by one or more beneficiaries if owned by a trust
  - Merely residing in the property will not be sufficient to satisfy the exclusion if occupation was incidental to the purpose of disposal
- **Does not apply** if person has a regular pattern of acquiring and disposing or erecting and disposing of dwelling house
- Cannot be claimed by a company

From Rental Investment to Property Dealing

- Chris owns 10 rental properties in Green Bay Auckland which he purchased over the last 12 years for long term rental investment.

- The yield from one of the properties he purchased 3 years ago is not meeting his expectation so Chris decides to sell this property.

- Chris makes a nice gain from this property. Is this gain taxable?

  - No, as Chris acquired the property for rental purposes, no intention for resale.

  - Chris does not have a pattern of buying and selling either.

Example 1 – Rental Properties

- Chris decides to use the funds from the previous property to buy a property in an area which has strong capital growth. His intention is to rent the property out and sell it when prices in the area meet his expectations.

- 4 years go by and there is strong sales in the area so Chris decides to sell this property. Is the gain taxable?

  - Yes, one of Chris's intention was resale
  - This does not have to be the main or dominant reason for the purchase.
  - It does however have to be more than a vague intent.

Example 2

- Jason owns 10 rental properties in Rolleston, Christchurch which he purchased over the last 12 years for long term rental investment.

- The rental yield from one of the properties he purchased 3 years ago is not meeting his expectation so Jason decides to sell this property.

- Jason makes a nice gain from this property. Is this gain taxable?
  - No, as Jason acquired the property for rental purposes, no intention for resale.
  - Jason does not have a pattern of buying and selling either.

Example 3

- Jason decides to use the funds from the sale of the previous property to buy 2 further rental properties . His intention is to rent the properties out and has no firm intention to sell them.

- 4 years later due to price growth in the area, he decides to sell these properties.

- Jason purchases 2 further rental properties. One of these properties is sold 2 years later and the other property is sold 3 years later.

- **Are the gains taxable?**

Example 3 Continued

- Yes, even though Jason never had an intent of resale when he purchased any of the properties. He has developed a pattern of buying and selling properties. Jason is now deemed to be a dealer.

- When is the pattern established? This is decided on a case by case basis, it maybe established after the 2nd property is sold and in some cases, maybe after the 3rd property.

- Usually the gain from the 1st property is not taxable.

- Rental properties purchased prior to the pattern being established will not be taxable on disposal.

- However, even strictly rental properties which were acquired after the establishment of the dealing activity are taxable if sold within 10 years in addition to any purchased for the trading activity.

Sale of Investment Properties

- Increase in the sale of so called "investment properties"
- Statistics NZ : On average -
  - Rental investment properties – held for 10 years
  - Family home – 7 years
- Tell us the truth: we will utilise all resources available to us during our audits

Examples – Reasons given

- Person A - bought and sold a bare section after 6 months (and an $80k profit)
  - Not sold for profit because “turned out to be unsuitable for a 4 bedroom home”
  - Investigation found subsequent purchaser built a 4 bedroom home on the same land.

Examples – Reasons given

- "I sold it because it was a two story home and my wife didn't like the stairs" - Upon investigation discovered same person had purchased another house a few months later that also had two story with stairs

- "I sold it because it was only two bedrooms and it was not suitable for a family of four":

  - Did he not know he had a family of four?

  - Why then were two further properties purchased also two bedroom houses?

  - Taxpayer has bought and sold 18 in 3 years, none with the intent of resale!

- " I sold it because my girlfriend did not like the view of the Buddhist Temple from the house"

Using the IR Website

- Step 1 - Internet – go to Google
- Step 2 – Type – Residential property tax NZ
- Step 3 - The 1st result should take you to the IR property website http://www.ird.govt.nz/property/
- This should take you to the PCP's home page on residential property shown on the next slide
- Income tax decision tree is available here – click on little house with the question mark (?) next to it

Residential property

Whare nohoanga

Property glossary ▸

Do you have to pay tax on your property?

Rental property

Find out about taxes, what you can claim and what happens when you sell your rental property.

Find out more ▸

Avoid common mistakes

Find out what the most common property tax mistakes are and how to avoid making them.

Find out more ▸

Investment property

Find out about taxes, what you can claim and what happens when you sell your investment property.

Find out more ▸

Selling property

Find out what you need to consider when selling your investment property, rental property, or the family home investment property.

Find out more ▸

Buying property

Find out what you need to consider when buying a property, buying and selling regularly, or buying an investment apartment.

Find out more ▸

Family home

Find out about receiving income from boarders, and whether selling your home is ever taxable.

Find out more ▸

myIR
Secure Online Services
Login
Forgot login | Register
Why myIR?
Mobile web app

Make a payment

For tax agents
Public consultation
Technical tax area
Getting it right
Demos and videos

Get it done online
All online services ›

Work it out
All calculators and tools ›

Forms and guides
All forms and guides ›

Tax and your property transactions IR361

Contact us
All contact info ›

Guides

- ***IR 264*** – tax rules for residential rental income
- ***IR 313*** – buying and selling residential property
- ***IR 314*** - paying tax on property bought and resold
- ***IR 361*** – Tax and your property transactions
- http://www.ird.govt.nz/property

Questions?

- Thank you