

# Hon Stuart Nash, Minister of Revenue

## Information Release

### Amendments to the tax rules for land

February 2020

#### Availability

This information release is available on Inland Revenue's Tax Policy website at <https://taxpolicy.ird.govt.nz/publications/2020-ir-cab-dev-19-sub-0352/overview>.

#### Documents in this information release

1. IR2019/622 – Tax policy report: Land rules review: tranche 1 (15 November 2019)
2. DEV-19-SUB-352 – Cabinet paper: Amendments to the tax rules for land (11 December 2019)
3. DEV-19-SUB-352 – Regulatory impact assessment: Land tax rules review 2019 - habitual buyers and sellers (19 November 2019)
4. DEV-19-MIN-352 – Minute: Tax rules for land: proposed amendments (11 December 2019)

#### Additional information

The Cabinet paper was considered by the Economic Development Committee on 11 December 2019 and confirmed by Cabinet on 16 December 2019.

#### Information withheld

Some parts of this information release would not be appropriate to release and, if requested, would be withheld under the Official Information Act 1982 (the Act). Where this is the case, the relevant sections of the Act that would apply are identified. Where information is withheld, no public interest was identified that would outweigh the reasons for withholding it.

Sections of the Act under which information was withheld:

9(2)(a) to protect the privacy of natural persons, including deceased people

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## POLICY AND STRATEGY

**Tax policy report: Land Rules Review: Tranche 1**

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<b>Date:</b>	15 November 2019	<b>Priority:</b>	High
<b>Security level:</b>	In Confidence	<b>Report number:</b>	IR2019/622

### Action sought

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	<b>Action sought</b>	<b>Deadline</b>
Minister of Revenue	<b>Agree</b> to recommendations <b>Refer</b> a copy of this report to the Minister of Finance and to the Minister for Land Information	5 December 2019

### Contact for telephone discussion (if required)

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<b>Name</b>	<b>Position</b>	<b>Telephone</b>
s 9(2)(a)	Senior Policy Advisor	s 9(2)(a)
	Senior Policy Advisor	

15 November 2019

Minister of Revenue

## **Land Rules Review: Tranche 1**

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### **Executive Summary**

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1. This report seeks agreement to policy changes relating to the land rules and powers to amend the Land Transfer Tax Statement. This report also seeks agreement for these proposals to go to Cabinet.
2. Tranche 1 of the current land rules review has involved consideration of the following policy changes:
  - Clarifying the rules for deducting holding costs where land that is subject to tax on sale is used for private purposes while it is held.
  - Tightening the rules that relate to habitual buying and selling of homes and business premises to ensure people cannot structure around them to escape paying tax.
3. A draft Cabinet Paper is attached for your consideration. Note that the proposals related to denying deductions for holding costs for privately used land that is taxable on sale may attract public comment.
4. This report also discusses proposals to move the content of the Land Transfer Tax Statement from the Land Transfer Act 2017 to regulations to make changing the Statement easier.

### **Holding costs**

5. Holding costs (e.g. rates, interest, insurance etc) are costs incurred as a result of holding land. There is currently uncertainty about the extent to which holding costs are deductible where land that is taxed on sale is used privately while it is held (e.g. where the sale of a private bach is subject to tax under the bright-line test).
6. We advised you in September on the options for the deductibility of holding costs (see IR2019/519). Our preference was to deny deductions for holding costs entirely where land is used for private purposes (including where vacant land is not used, or intended to be used, for income-earning purposes). We also proposed confirming that the costs of acquisition of, and capital improvements to, land that is taxable on sale should always be deductible in full, despite private use.
7. We have now undertaken full public consultation on the options. Feedback from consultation has been unsupportive of officials' preferred position on the deductibility of holding costs. However, submitters support the proposals to confirm the deductibility of the costs of acquisition and capital improvements.
8. Despite views from submitters, we still consider the original preferred positions represent the best option for deductibility of holding costs.

### **Habitual buying and selling**

9. The land sales rules generally tax gains from the sale of land that is equivalent to trading stock. To limit their scope, the rules contain exclusions to ensure that land

that is not equivalent to trading stock, and is used as a residence or business premises, is not taxed. To ensure that taxpayers do not take advantage of the exclusions where that is not intended, the exclusions do not apply where a person has a regular pattern of buying and selling land that is used as a residence or business premises.

10. Inland Revenue has concerns that the current regular pattern restrictions are not working as intended, and that taxpayers can structure around the regular pattern restrictions. To address these concerns, officials have consulted on proposals to expand the regular pattern restrictions.
11. Taking into account feedback received from submitters, officials propose the following amendments to the regular pattern restrictions:
  - That the regular pattern restrictions be extended to apply where a person, or a group of people, have a regular pattern of buying and selling land that is used as a residence or business premises.
  - To limit the potential for overreach arising from the above changes, that the regular pattern restrictions be limited to apply only in situations where the land was acquired with a purpose or intention of disposal.

### **Land Transfer Tax Statement**

12. LINZ is undertaking work to reduce compliance costs for property transfers. This has included a review of the rules relating to the Land Transfer Tax Statement. Currently changes to the Land Transfer Tax Statement require legislative amendment. To speed up making future changes to the Land Transfer Tax Statement, LINZ is seeking to move the content of the Statement from the Land Transfer Act 2017 to regulations.
13. It intended that this change be included in the next omnibus tax Bill, expected to be introduced in March 2020.

## Recommended action

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We recommend that you:

14. **agree** to amend the rules for the deductibility of holding costs to deny deductions in full to the extent land that is taxed on sale is used privately (including where vacant land is not used, or intended to be used, for income-earning purposes).

Agreed/Not agreed

15. **agree** to amend the rules to confirm that where a land sale is taxable the costs of acquisition of, and capital improvements to, the land should always be deductible in full, despite any private use.

Agreed/Not agreed

16. **agree** to amend the regular pattern restrictions in the main home, residential and business premises exclusions to ensure taxpayers cannot structure to escape tax;

Agreed/Not agreed

17. **note** that the Minister for Land Information has agreed to amendments to the Land Transfer Act 2017 to allow the Land Transfer Tax Statement to be set by regulation;

Noted

18. **agree** that the above amendments be included in the omnibus tax Bill expected to be introduced in March 2020.

Agreed/Not agreed

19. **authorise** the attached Cabinet paper for lodgement with the Cabinet Office by 10am Thursday 5 December 2019;

Authorised and lodged

20. **refer** a copy of this report to the Minister of Finance and the Minister for Land Information for their information.

Referred/Not referred

**Peter Frawley**

Policy Lead

Policy and Strategy

**Hon Stuart Nash**

Minister of Revenue

/ /2019

## Background

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21. As part of the Government's refreshed tax policy work programme, we are reviewing the current land rules, particularly in relation to investment property and speculators, land banking and vacant land. The objective is to recommend ways to improve the efficient use of land, and ensure that the current tax settings are fair, balanced, and encourage and support productive investment.
22. Tranche 1 of this review involves the following policy projects:
  - Clarifying the rules for deducting holding costs where land that is subject to tax on sale is used for private purposes while it is held.
  - Tightening the rules that relate to habitual buying and selling of homes and business premises to ensure people cannot structure around them to avoid paying tax.
23. In September 2019, we updated you on our progress on these issues (see IR2019/489 and IR2019/519). This report provides you with our final recommendations and seeks agreement for these proposals to go to Cabinet.
24. This report also discusses moving the content of the Land Transfer Tax Statement from the Land Transfer Act 2017 to regulations to make changes to the Statement easier.
25. If these amendments are approved by Cabinet it is intended that legislation will be included in the next omnibus tax Bill, which is expected to be introduced in March 2020.

## Holding costs for privately used land that is taxable on sale

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### Problem definition and options

26. Holding costs (e.g. rates, interest, insurance etc) are costs incurred as a result of owning land. There is currently uncertainty about the extent to which holding costs are deductible for privately used land that is taxable on sale (e.g. where a private bach is taxed under the bright-line test). This is because in this scenario, the same expenditure simultaneously relates to both the taxable income from the sale of the land, and the private benefit from the use of the land. This leads to a tension between the principle that expenditure is deductible where it relates to deriving taxable income, and the principle that expenditure that gives rise to a private benefit should not be deductible.
27. This is an issue where there has been uncertainty for some time. It became more prominent when the bright-line test, which brought more privately used land into the tax base, was introduced. It is intended that the proposed amendments will improve clarity in the law in this area.
28. We reported to you on the options for deductibility in September (see IR2019/519). In summary, those options were:
  - **Apportionment:** recognise that holding costs relate to both the taxable gain on sale, and the benefit obtained from the private use of the land and allow a deduction for a portion of the costs that relates to the taxable gain on sale.
  - **Allow full deductions:** recognise that holding costs are costs incurred in deriving assessable income from the sale of the land and allow full deductions.

- ***Deny deductions to the extent of private use:*** attribute the holding costs to the current year use of the property and, therefore, deny deductions where current year use of the land is private.
29. In our earlier report, officials' preference was to deny deductions in full to the extent of private use. While officials recognised that the most conceptually correct option was apportionment, it was considered that option was too complex, and could be said to be inconsistent with other areas of the tax law.
  30. Given the recommendation to deny deductions for private use, our September report also considered options for the classification of unused or vacant land as either private or income-earning use. Officials' preference was that where land is temporarily unused or vacant it should be classified depending on the other use of the land (e.g. vacant days for a private bach should be treated as private use days, and vacant days for a rental property should be treated as income-earning days).
  31. Where land is wholly vacant or unused, officials recommended that it should be classified as private use, unless the owner holds the land as part of a business or income-earning activity, or they notify the Commissioner in the year they acquired the land that it was acquired with a purpose of resale so that any gain will be subject to tax on sale. If the land is subsequently privately used, deductions will be denied from that point.
  32. Finally, it was noted that technical amendments should be made to the rules for the deductibility of the costs of acquisition of, and capital improvements to, land that is taxable on sale. The technical amendments would clarify that those costs would be fully deductible despite private use, and despite being unaware at the time the costs were incurred that the land would be taxable on sale (e.g. a bright-line situation).

## Consultation

33. Officials released a public consultation document discussing the proposed amendments in October 2019.
34. Submitters agree there is a need to provide further clarity in relation to the deductibility of holding costs. They also agreed it would be useful to clarify the rules for the deductibility of the costs of acquisition and capital improvements to land as proposed.
35. However, submitters do not support officials' preferred option to deny deductions for private use entirely. Instead, it was submitted that some deduction should be allowed where holding costs directly relate to the taxable gain on sale of the land.
36. Submitters disagree with officials' position that apportionment is not consistent with current law. They also disagree that an apportionment approach must be complex. They pointed to other parts of the tax legislation where a simplified apportionment approach (e.g. apportioning on a 50:50 or 75:25 basis) has been adopted for mixed private/income-earning use.
37. Finally, submitters also did not support officials' recommendations to treat all unused or vacant land as being used privately unless it is held as part of a business or income-earning activity, or the owner notifies the Commissioner that the land was acquired with a purpose of resale. Submitters considered that where land is wholly unused and is subject to tax on sale its only use is income-earning and so deductions should always be allowed in full.
38. A more detailed summary of submissions is included in Appendix A.
39. Chartered Accountants Australia and New Zealand also wrote to you submitting that, given the importance of these changes, more time should be given to consider all the potential options in more detail.



## Final recommendations

40. In principle, expenditure that relates to deriving taxable income should be deductible. However, allowing deductions in full would be contrary to the principle that deductions should be denied to the extent expenditure provides a private (untaxed) benefit. This suggests that apportionment may be the better option.
41. Officials accept that apportionment is consistent with current law. However, as has been accepted by most submitters, accurate apportionment is complex.
42. Submitters have suggested that a simplified apportionment approach could be applied. However, officials do not consider it is appropriate to use a simplified approach in this context. In this context, there is a risk that expenditure that produces a private (untaxed) benefit could be deductible. Officials consider the better policy is that, to the extent there is private use of land that is taxable on sale, deductions for the holding costs should be denied in full.
43. This would mean, for example, that no deductions would be allowed for holding costs for a bach that was used entirely privately but was taxable on sale under the bright-line test. Conversely, a deduction for half the holding costs would be allowed for a bach that was used privately for six months per year and rented for six months per year.
44. With regard to wholly vacant or unused land, officials continue to recommend their original proposal. Officials consider that if taxpayers have land that is solely acquired with an intention of resale, and there is no private use, they can continue to claim deductions provided they notify Commissioner of that intention.

## Habitual buying and selling

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### Current law and policy framework

45. The land sales rules generally tax gains from the sale of land where the land is held by a person effectively as trading stock (in the same way that a furniture vendor is taxed on the gains they make from selling their furniture). It is not intended that the rules tax capital gains (e.g. gains from selling the furniture vendor's shop or a person's home). However, the rules are drafted quite broadly to ensure that people cannot easily structure around them, which means they can catch some land that is (properly) a capital asset.
46. To limit this potential overreach, the rules contain exclusions. Relevantly, the rules exclude from tax gains from the sale of a person's home (the main home and residential exclusions) or business premises (the business premises exclusion) if they happen to be caught by the broader rules. For example, the land sales rules generally tax all sales of land by a land dealer, but the exclusions ensure the dealer will not be taxed on the sale of their home.
47. To ensure the exclusions are not abused, they are subject to regular pattern restrictions. These restrictions ensure that people who regularly buy and sell land as trading stock cannot use the land as a home or business premise while they own it to escape tax. For example, a person who has a pattern of buying, renovating and selling their homes should pay tax on their gains rather than escaping tax by relying on the residential exclusion.

## Problem definition and proposals

48. While the current law contains regular pattern restrictions to stop people who habitually buy and sell land escaping tax, Inland Revenue has concerns that those restrictions are not working as intended.
49. As currently drafted, taxpayers who habitually buy and sell land can structure around the regular pattern restrictions. Given the recent tightening of the land rules there is a concern that taxpayers have a greater incentive to avoid the regular pattern restrictions by arranging their affairs so they do not have a pattern of buying and selling main homes, residences and/or business premises. This is contrary to the policy intention, and may undermine the integrity of the tax system.
50. There are two issues of concern:
- First, the regular pattern restrictions apply quite narrowly to the activities of a single person, which allows taxpayers to circumvent the application of the regular pattern restrictions by buying and selling land using different but associated persons or entities each time. To resolve this concern, it was proposed that the regular pattern restrictions could be amended to apply where a person, or a group of people, have a regular pattern of buying and selling land that the person, or group of people, occupy as a residence or business premises.
  - Secondly, the current regular pattern restrictions have been interpreted narrowly to apply only where there is a similarity or likeness between the transactions (for example, a pattern of buying land, building a home on the land and then selling). This means that the regular pattern restrictions will not apply where a person does something different to each piece of land. To resolve this concern, it was proposed that the regular pattern restrictions could be extended to apply to any pattern of buying and selling land, with a focus on the regularity of the transactions, rather than on what is done with the land while it is owned.
51. The regular pattern restriction in the main home exclusion for the bright-line test is supplemented by a time-period rule, which states that the main home exclusion will not apply if a person has relied on it twice in the previous two years. To attempt to provide clarity and objectivity, it was also proposed that a similar time-period rule could be added to the residential and business premises exclusions.

## Consultation

52. We released a public consultation document on this issue in September 2019 (see BN2019/500). Prior to releasing the document publicly, we also tested our thinking with some private sector advisors.
53. In general, submitters appear to acknowledge officials' concerns that taxpayers can structure around the existing regular pattern restrictions. However, almost all submitters expressed concerns about the potential for overreach from the proposed amendments and, in particular, that the amendments risk taxing transactions that should not be subject to tax (i.e. sales of genuine homes or business premises).
54. The submitters also disagreed with proposals to amend the regular pattern restriction to the business premises exclusion. They submitted that there was no evidence of any abuse of that exclusion.
55. Submitters could see that a time-period rule may be useful to supplement the regular pattern restriction in the residential exclusion. However, there was concern that a time-period rule would be arbitrary and could not accommodate factors outside a person's control.

## Final recommendations

56. After consideration of the submissions received, officials recommend the following amendments to the regular pattern restrictions:

- **Intention test:** officials recommend adding an intention test to the regular pattern exclusions.

As discussed above, the purpose of the regular pattern restrictions is to ensure that people who regularly buy and sell land as trading stock cannot use the land as a home or business premises while they own it to escape tax. On that basis, officials recommend that the regular pattern restrictions in the residential and business premises exclusions be amended to target their application to situations where the person acquired the land with an intention of disposal.

Officials consider this limitation will bring the law more in line with the policy intention and will address concerns about the potential for overreach from the other proposals.

- **Group of persons:** officials continue to be of the view that the regular pattern restrictions should be extended to apply to a person or a group of persons that undertake buying and selling activity together.

Officials consider that a group of persons will be treated as undertaking buying and selling activity together in the following circumstances:

- For the residential exclusion, a group of people will be undertaking buying and selling activity together if they all occupy all of the properties as their residence, or if the people who occupy all of the properties as their residences controls the trusts or other entities that own the properties.
- For the business premises exclusion, a group of people will be undertaking buying and selling activity together if they are all controlled by the same person or persons (e.g. all the companies have the same shareholders).

- **Regular pattern:** officials continue to be of the view that the regular pattern restrictions should be extended to apply to any pattern of buying and selling land, with a focus on the regularity of the transactions, rather than on what is done with the land while it is owned.
- **Business premises:** while we acknowledge the views of submitters that there appears to be less potential for abuse of the business premises exclusion, officials consider that amendment of the regular pattern restriction in the business premises exclusion is necessary to ensure that taxpayers cannot structure around the restriction by using a group of related companies. The proposed changes will ensure this is the case.

The main concern from submitters appears to be the concern of overreach. Officials consider this concern will be addressed by amending the regular pattern restriction so it only applies where land is acquired with an intention of resale.

- **Time-period rule:** having considered the submissions, officials have decided that a time-period rule such as that included in the bright-line main home exclusion is not appropriate for the residential and business premises exclusions.

In the context of the bright-line test, which taxes sales without consideration of intention, presuming that the exclusion should not apply simply because

there were multiple transactions within a defined period can be justified. However, officials consider that regularity alone should not be enough to give rise to a taxable transaction under the other provisions. Instead, officials consider that the land needs to also be acquired with an intention of resale.

### **Land Transfer Tax Statement**

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57. LINZ is undertaking work to reduce compliance costs for property transfers. This work has followed Cabinet's decision to remove the exemption for providing an IRD number when people transfer a property that is their main home. The removal of the 'main home' exemption is to take effect from 1 January 2020.
58. People buying and selling property are currently required to complete up to three forms: the Land Transfer Tax Statement, the Residential Land Statement, and the Residential Land Withholding Tax Declaration. The Residential Land Statement and the Residential Land Withholding Tax Declaration are both able to be changed without legislative amendment. However, the content of the Land Transfer Tax Statement is prescribed by the Land Transfer Act 2017.
59. LINZ seeks to move the content of the Land Transfer Tax Statement from the Land Transfer Act 2017 to regulations, so that changes to the Statement can be made more easily.
60. This amendment should go into the omnibus tax Bill, expected to be introduced in early 2020.

### **Fiscal impacts**

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61. The amendments to the rules for deductibility of holding costs will prevent taxpayers from taking deductions that they have previously been allowed. Therefore, those amendments will be fiscally positive. However, the impact cannot be quantified.
62. The change to allow full deductions for the costs of acquisition and improvements despite private use is technically revenue negative. However, this change aligns the law with current practice. Therefore, we do not expect any actual revenue loss from this amendment.
63. The amendments to the regular pattern restrictions will stop taxpayers from being able to escape tax by structuring around the rules. Therefore, those amendments will also be fiscally positive. However, the impact cannot be quantified.

### **Administrative implications**

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64. Inland Revenue has a property compliance programme that will be responsible for the administration of the proposed new rules, including monitoring compliance. It is expected that the proposed amendments for holding costs and habitual buying and selling can be managed within the existing baselines. The proposals are technical in nature and will have no impact on Business Transformation or existing business and system processes. There will be some minor changes required to existing communication products, but all communication will be undertaken using existing communication platforms. Therefore, no additional funding is required to support these changes.

### **Application dates**

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65. The proposal clarifying that acquisition and capital improvement expenditure is always deductible for land that is taxable on sale should apply from 1 April 2008,

being the commencement date of the Income Tax Act 2007. All other proposals in this report should apply from the date of enactment.

### **Next steps**

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66. A draft Cabinet paper and draft Regulatory Impact Assessments are attached. We invite you to consider these and provide feedback on the draft Cabinet paper.
67. The final Cabinet paper will need to be lodged with the Cabinet office by 10am Thursday 5 December 2019 for consideration at the DEV Committee meeting on 11 December 2019. Once Cabinet approval has been received officials will begin drafting the necessary changes to the Income Tax Act and the Land Transfer Act for inclusion in the next taxation Bill, currently scheduled for introduction in March 2020.

## **Appendix A – Holding costs – Summary of submissions**

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68. Nine submissions were received on the proposals for the deductibility of holding costs. The main points made in those submissions are summarised below.
69. Chartered Accountants Australia and New Zealand (CA ANZ) submitted that this issue is complex and is likely to have far reaching conclusions. Therefore, they submitted that sufficient time should be allowed to appropriately consider all the relevant matters and to undertake further detailed analysis, including consideration of other options. Jim Gordon Tax Limited (JGT) also raised similar concerns.

### **Deductibility**

70. All submitters who commented on the proposal to deny deductions for all holding costs where there is any private use disagreed with that proposal (New Zealand Law Society (NZLS), Findex NZ Limited (Findex), Tandem Group Limited (Tandem), Blackmore Virtue & Owens (BVO), CA ANZ, KPMG, Ernst & Young Limited (EY), JGT). The Corporate Taxpayers Group (CTG) did not comment on the main proposal but noted that the issue of the business/private boundary should not be an issue for members of the group.

### **Comments on policy justification**

71. Many of the submitters disagreed with the reasons provided for preferring denial of deductions.
72. Findex submitted that disallowing deductions completely is inconsistent with current tax law. Findex submitted that it is inequitable for tax law to deem the gain on what is essentially a private asset to be taxable income and then deny any deduction for costs incurred in relation to deriving that income on the basis the expenditure is private.
73. EY submitted that where the land tax rules recharacterise otherwise capital account land into revenue account land (e.g. the bright-line test) the same recharacterisation should be extended to holding costs which were previously treated as private in nature.
74. Tandem submitted that unless some of the gain is excluded from tax it is unfair to disallow any of the expenditure on the basis of private use.
75. KPMG noted that, as a matter of principle, some holding costs for privately used land that is taxable on sale should be allowed as a deduction. KPMG said a general prohibition on deductions for holding costs at the time of sale (particularly for interest which, absent rules allowing general deductibility, would be included in the cost of an item) does not accord with commercial reality.
76. EY submitted that in the absence of an adequately workable apportionment approach, it is not apparent why the entirety of the holding costs should be non-deductible. EY submitted that the proposed approach unjustifiably favours the principle underpinning the private limitation over the principle of net taxation.
77. EY submitted that disallowing deductions does not adequately address the fact that the New Zealand income tax system seeks to tax only "net gains". If a taxpayer derives assessable income, then the framework suggests that related costs ought to be deductible. The wholesale denial of a deduction for holding costs ignores the fact that the taxpayer has incurred costs in relation to holding land and therefore over-calculates the applicable gain made on sale.
78. KPMG submitted that while there are genuine policy reasons for disallowing some holding costs, to the extent of private use of the land, there is no basis for

disallowing all of the expenditure. The fact that other parts of the Act may not take the correct approach (which is not necessarily accepted) is a poor policy reason for not applying the correct approach in this situation.

79. CA ANZ submitted that a suggestion that other areas of the tax law that do not require apportionment should be changed does not take into account the fact that there is a direct nexus between, for example, rental income derived and the costs incurred in the period.
80. Findex noted that the inappropriateness of the proposed approach is illustrated by the fact that it would deny deductions for a person acquiring property with an intention to renovate and sell, where that expenditure has a clear nexus with deriving assessable income.
81. KPMG also submitted that the argument that denying deductions will save taxpayers from having to find records of their costs is not a justified reason. In practice these costs will not be difficult to track, and if compliance costs from tracking expenditure is excessive, taxpayers do not have to claim them. It should be up to taxpayers to decide the compliance costs they are willing to bear, not the Government.
82. JGT submitted that no positive policy justification has been provided for preferring the no deductions option, and instead this position is reached by default with superficial and insufficient analysis.

### ***Apportionment***

83. Findex and KPMG agreed that apportionment would be the most accurate approach.
84. NZLS, Findex and JGT noted that apportionment is consistent with current legislation and well-established case law. NZLS pointed, as an example, to the mixed-use asset rules.
85. NZLS submitted that apportionment does not need to be difficult to calculate or administer. They suggest that apportionment may be easily and fairly implemented by measuring the private benefit based on market rental attributed to the land during the periods of private use. NZLS submitted there are online algorithms that can assist in determining this.
86. Other submitters accepted that accurate apportionment would be complicated (Findex, KPMG, CA ANZ).
87. However, Findex noted that while apportionment is complex, the Courts have stated that absolute accuracy is not required. Findex submitted that rejecting apportionment because of complexity and because a simplified approach is inaccurate is not consistent with existing and proposed tax law. Findex and KPMG noted that there are many examples in the Act of situations where accuracy has been sacrificed for simplicity, including the entertainment expenditure deduction rules, the motor vehicle deduction rules, and the proposed new rules for deductions for telecommunication tools used principally for employment duties.

### ***Consistency***

88. CA ANZ submitted that there should be a consistent approach for all revenue account property, which should result in tax only being paid on the actual gain on disposal (after taking into account the costs of acquisition, capital improvements and holding costs). This should not be different where tax is payable under the bright-line test.
89. EY suggests that the current proposals ignore the horizontal inequity that results if holding costs associated with land that is held with an intention of resale are

deductible but where land is caught under the bright-line test deductions are prohibited by any private use.

### **Other options**

90. Submitters suggested there are other options for the deductibility of holding costs that have not been adequately considered.
91. Findex submitted that an approach where accuracy is sacrificed for simplicity would be appropriate (e.g. a 50/50 apportionment such as in the entertainment expenditure rules).
92. KPMG also suggested that, balancing the need for simplicity and certainty for taxpayers with some denial of costs to reflect the private benefit, a 50% apportionment approach would be reasonable. KPMG noted that while this will not be precisely right for any single situation, denying all deductions would be worse.
93. CA ANZ suggested that an alternative to accurate apportionment is to allow deductions at the time of disposal for all appropriate holding costs capped to the sales proceeds to recognise that holding costs in part may include a private benefit element. CA ANZ submitted that this approach is practical and relatively simple and places taxpayers in the economically correct position by only subjecting the actual gain to tax. CA ANZ also noted that this approach would stop taxpayers from holding onto land for more than five years so that they are not taxed on a gain that is far in excess of what they actually derived.
94. EY submitted that deductions should be allowed to the extent that the proceeds from the sale of the land are caught under the land tax rules, but deductions should be deferred to the time of realisation of the gain, unless current year income is derived from the land. Taxpayers claiming such deductions should be required to provide supporting disclosures to appropriately evidence any costs claimed. EY submitted that deductions should either be ring-fenced to other income from land or capped at net-zero to prevent the creation of carry-forward losses. EY submitted that this type of rule would support the integrity of the tax system and ensure the principle underpinning the private limitation is not excessively eroded.
95. JGT suggested that full deductions should be allowed and the land-owner should be deemed to receive rental income equal to the market value of the private usage.
96. BVO suggested that it is possible to find a simple solution to provide some concession to taxpayers who are taxed under the bright-line test. BVO suggested that the amount of profit that is taxable could be reduced for each year of ownership as is the case for sales subject to the rezoning rule.
97. NZLS, CA ANZ and EY submitted that any option that allows some deductibility would require clarification that the approach will not override the current mixed-use asset rules and will not allow a deduction where one has already been taken under other rules.

### **Vacant land**

98. NZLS broadly agreed with the treatment of vacancy, and that the mixed-use asset rules should continue to apply. KPMG also submitted that it seems reasonable to rely on the mixed-use asset rules where they apply.
99. However, most submitters disagreed with the proposals relating to vacant land. In particular, they disagreed that wholly vacant land should be treated as private unless expressly held for an income-earning purpose (Findex, KPMG, EY, CA ANZ, JGT). Findex noted that if a person never used or occupied land, but the subsequent



sale is subject to tax, holding costs should be deductible on the basis that the only “use” of the land is income-earning.

100. JGT submitted that holding costs should be deductible where wholly vacant land is on revenue account, because tax is paid on net income, which requires deduction of expenses.
101. EY submitted that the preferred approach is overly simplistic and ignores the fact that land which is held vacant, or property which is held unused, may not generate any private benefit to the owner at that point in time.
102. EY also submitted that it is difficult to reconcile why periods of vacancy in a bright-line house should be treated differently to a house which was declared as on revenue account at acquisition. CA ANZ noted there is no justification for having a different approach where land is acquired with an intention of resale versus under the bright-line test.
103. JGT submitted that there is no justification given for denying deductions outside of the limited circumstances where land is held as part of an income-earning activity. EY also submitted that the object of deeming vacant land to be used privately is unclear. EY submitted that the tax system should not be used to incentivise taxpayers to either use or sell their land through denial of deductions.
104. KPMG submitted that it is not reasonable to expect taxpayers to inform the Commissioner at the time of purchase of the land that it was acquired solely with an intention of sale. CA ANZ and JGT also noted that there is no justification for the proposed new information requirement for revenue account vacant land. JGT also noted that it is not clear how taxpayers will make this notification.

### ***Alternative approaches***

105. Consistent with suggestions for deductibility generally, CA ANZ suggested that the correct approach for vacant land is that all holding costs should be deductible, capped at the sale price where there is actual private use.
106. Similarly, KPMG suggested that where there is any actual private use of vacant or unused land a 50% deduction should be allowed, as they suggested for fully private use land.

### ***Definition of vacant land***

107. EY submitted that it has not been suggested how vacant land will be defined.
108. JGT submitted that it is not clear what would happen where there are two uses of the land in an income year in situations where the mixed-use asset rules do not apply (e.g. land used privately for part of the year, used as a long-term rental for part of the year and vacant for part of the year). JGT also submitted that there is not enough consideration of incidental use (e.g. parking a trailer on a section that is revenue account property), or partial use (e.g. where part of a larger block of land that is on revenue account is used for private purposes). JGT noted that the document suggests this type of private use will result in deductions being denied which must be wrong.
109. CTG also noted that there needs to be further clarity around when vacant land is held for income earning purposes (e.g. land that is deliberately vacant around an industrial plant should always be considered held for income-earning purposes).

### What are holding costs?

110. EY submitted that the consultation document did not provide sufficient analysis of what is considered a 'holding cost'. EY submitted that repairs and maintenance, including refurbishment and significant landscaping improvement costs, are all arguably capital improvements and should be deductible. However, costs that are associated with the use of the land and do not provide any enduring benefit, such as lawn mowing, should not be deductible. EY submitted that the boundary should be defined by reference to costs that are necessary for land to be held by a taxpayer (including interest, rates and insurance) versus costs that are incurred merely to improve the current utility of the land for its owner with no enduring benefit.
111. CA ANZ submitted that holding costs should include interest expense, lease payments in respect of leasehold land, and repairs and maintenance (undertaken to retain the value of the property). CA ANZ submitted that holding costs should not include costs directly associated with private use (e.g. power and utility costs). CA ANZ also submitted that there are reasonable arguments for including rates and property insurance as deductible expenditure, as those costs would be deductible for purely revenue account property.
112. KPMG submitted that there could be reasonable arguments for distinguishing between different types of costs. Interest and repairs and maintenance expenditure with a sufficient nexus to a taxable sale should be included as deductible holding costs, but costs such as rates and insurance that are periodic in nature should be outside the scope of the proposed rules because they expire when they are incurred and have less of a nexus with the taxable sale of land.

### Private use vs income-earning use

113. CTG submitted that the proposals are being made on the basis that there is a clear distinction between private and income-earning use. However, CTG noted that there are often grey areas where land is used for both at the same time, and that there needs to be clear guidance to distinguish between private and income-earning use.
114. JGT submitted that there was insufficient consideration of how incidental use (e.g. parking a trailer on a section that is revenue account property), or partial use (e.g. where part of a larger block of land that is on revenue account is used for private purposes) will be treated. JGT submitted that such use should not impact on the deductibility of holding costs.

### Holding costs for different entities

115. There was generally support for the proposal that land held in companies should be treated differently to land owned by individuals, partnerships, trusts or look-through companies (CTG, NZLS, CA ANZ, EY). NZLS, EY and JGT agreed that there are already rules to disincentivise company ownership of privately used land.
116. However, EY did not support the broad asymmetry that arises by allowing companies deductions for interest, but not other entities. EY were particularly concerned about this in respect of vacant land, where the proposals would mean that a company could have full deductions because there cannot be private use, and individuals and other entities would get none.
117. EY also noted that focusing on private benefit could be said to be unfair in the context of look-through companies and trusts, where private use by some owners/beneficiaries gives rise to a detriment for all.

**Amendments to rules for deductions of acquisition and improvement costs**

118. There was general agreement with the proposals to amend the rules for the deductibility of acquisition and improvement costs to override the general permission and private limitation (NZLS, Tandem, CA ANZ, EY).
119. However, Findex and JGT suggested that it was not necessary to override the general permission because they submitted the general permission already allows for a deduction.



In Confidence

Office of the Minister of Revenue

Chair, Cabinet Economic Development Committee

## **AMENDMENTS TO THE TAX RULES FOR LAND**

### **Proposal**

1. This paper seeks agreement to a number of amendments to the tax rules for land that require changes to the Income Tax Act 2007 and the Land Transfer Act 2017.
2. If approved, I propose including the necessary legislative amendments in the next omnibus tax Bill scheduled for introduction in 2020.

### **Executive Summary**

3. As part of the Government's tax policy work programme the rules around the taxation of land are being reviewed, particularly in relation to investment property and speculators, land banking, and vacant land.
4. This paper recommends a number of amendments to the tax rules for land and that they be included in the next omnibus tax Bill. In particular, this paper seeks agreement to changes regarding the deductibility of acquisition and capital improvement costs for land that is taxable on sale, the rules that restrict the use of the home or business premises exemptions by habitual buyers and sellers of land, and to make it easier to change the content of the Land Transfer Tax Statement.

### ***Acquisition and capital improvement expenditure***

5. There is uncertainty around the extent to which the costs of acquisition of, and capital improvements to, land that is taxable on sale are deductible if it was not clear when the costs were incurred that the sale of the land would be taxable (e.g. a property taxable under the bright-line test). This paper recommends clarifying that these costs are always deductible in full when taxable land is sold.

### ***Habitual buyers and sellers of land***

6. The land rules generally exempt from tax the sale of a person's home or business premises. To prevent these exemptions from being abused they are subject to regular pattern restrictions. The restrictions ensure that people who have a regular pattern of buying and selling their home or business premises cannot use the exemptions to avoid tax.
7. Given the recent tightening of the land rules there is a concern these restrictions may not be working as intended and could be structured around. This paper recommends amending the regular pattern restrictions to ensure taxpayers cannot structure around them.

### ***Land Transfer Tax Statement***

8. This paper recommends that the content of the Land Transfer Tax Statement be moved from the Land Transfer Act 2017 to regulations. This change will make it easier to amend the Land Transfer Tax Statement, for example where changes would reduce compliance costs for property transfers.

### **Background**

9. As part of the Government's tax policy work programme the rules around the taxation of land are being reviewed, particularly in relation to investment property and speculators, land banking, and vacant land. The objective of this review is to recommend ways to improve the efficient use of land, and ensure that the current tax settings are fair, balanced, and encourage and support productive investment.
10. The review of the tax rules for land is ongoing, however this paper seeks the Committee's agreement to a number of policy changes from work undertaken to date.

### **Acquisition and capital improvement expenditure**

11. The current rules may not allow the costs of acquiring land and making capital improvements to the land to be deducted if it was not clear at the time the expenditure was incurred that the land would be taxable on sale (e.g. land subject to tax under the bright-line test). This would mean that a person who acquires a bach for \$500,000, uses it entirely privately and sells it after four years for \$600,000 may need to pay tax on the \$600,000 sale price rather than the \$100,000 gain.
12. It was always intended that the costs of acquisition and capital improvements should be deductible. As such, taxpayers returning income under the bright-line test for sales of privately used land are generally claiming deductions for the acquisition and capital improvements expenditure.
13. I therefore recommend that the rules be clarified to make it clear that acquisition and capital improvement expenditure should always be deductible for land that is taxable on sale.

### **Consultation**

14. Submitters on an Inland Revenue consultation document agreed with the proposal to clarify that acquisition and capital improvement expenditure for land that is taxable on sale will always be deductible.

### **Financial implications**

15. Allowing deductions for the costs of acquisition of, and improvements to, land, where the gains from the sale are taxable is not forecast to have any fiscal impact. This is because this proposal aligns the law with current practice.

### **Habitual buyers and sellers of land**

16. The rules taxing the sale of land exempt the sale of a person's home (the main home and residential exclusions) or business premises (the business premises exclusion) if they would otherwise be subject to tax. For example, all sales of land by a land dealer are prima facie subject to tax but the exclusions ensure the dealer will not be taxed on the sale of their home.

17. To ensure the exclusions are not abused, they are subject to regular pattern restrictions. These restrictions ensure that people who regularly buy and sell land cannot hide behind the exclusions to escape tax. For example, a person who has a regular pattern of buying, renovating and selling their homes should pay tax on their gains rather than being able to escape tax by relying on the residential exclusion.
18. The regular pattern restrictions are an important base maintenance measure. However, with the tightening of the land rules, officials are concerned that taxpayers now have greater incentives to structure around the current regular pattern restrictions to escape paying tax.
19. There are two main issues with the current regular pattern restrictions that enable taxpayers to structure around them. Firstly, the restrictions apply narrowly to the activities of a single person. This allows taxpayers to circumvent the application of the regular pattern restrictions by buying and selling land using different but associated persons or entities each time. To address this issue the regular pattern restrictions should be extended to also apply to a group of persons that undertake buying and selling activities together.
20. The second issue with the regular pattern restrictions is that the restrictions have been interpreted narrowly to apply only where there is a similarity or likeness between the transactions (i.e. a pattern of buying land, building a home on the land and then selling). This means the restrictions would not apply where a person does something different to each piece of land they buy and sell. This issue would be addressed by extending the regular pattern restrictions to apply to any pattern of buying and selling land, with a focus on the regularity of the transactions, rather than on what is done with the land while it is owned.
21. I therefore recommend that the regular pattern restrictions be amended to ensure taxpayers cannot structure around them to avoid tax.
22. To prevent any unintended overreach from extending the regular pattern restrictions, the restrictions from the residential exclusion and the business premises exclusion should be limited to only apply when the land was acquired with an intention of disposal. This intention test would ensure that the regular pattern restrictions are in line with the policy intent and do not tax land that was genuinely a person's home or business premises.

### **Consultation**

23. Inland Revenue officials consulted in September 2019 on their concerns with the regular pattern restrictions and proposed solutions.
24. In general, submitters acknowledged the concern that taxpayers can structure around the regular pattern restrictions. However, submitters expressed concerns about the potential for overreach from the proposed amendments and, in particular, that the amendments risk taxing transactions that should not be subject to tax (i.e. sales of genuine homes or business premises). The proposal to add an intention test to the regular pattern restrictions should address submitters' concerns around potential overreach.

### ***Financial implications***

25. The proposed amendments to the regular pattern restrictions are likely to be fiscally positive. However, the fiscal benefit is unquantifiable.

### **Land Transfer Tax Statement**

26. People buying and selling property are currently required to complete up to three forms:
  - 26.1 the Land Transfer Tax Statement;
  - 26.2 the Residential Land Statement; and
  - 26.3 the Residential Land Withholding Tax Declaration.
27. Land Information New Zealand is interested in options for streamlining the land transfer process including these forms.
28. The content of the Land Transfer Tax Statement is largely prescribed by the Land Transfer Act 2017. Making any changes to streamline this form would require legislative amendment. Conversely, the Residential Land Statement and the Residential Land Withholding Tax Declaration are both able to be changed without legislative amendment.
29. The Minister for Land Information recommends that the content of the Land Transfer Tax Statement be moved from the Land Transfer Act 2017 be moved to regulations. This will make it easier to amend the Land Transfer Tax Statement, for example where changes would reduce compliance costs for property transfers. I support this amendment being included in the next omnibus tax Bill.

### ***Consultation***

30. During feedback from consultation earlier this year regarding the removal of the main home exemption, a key theme was that the Land Transfer Tax Statement could benefit from simplification and streamlining. Officials will update key stakeholders on the proposal in this Cabinet paper following Cabinet decisions. This paper also seeks approval for officials to consult with these key stakeholders on drafting details of the proposed change.
31. Statistics New Zealand has been informed of this proposal.

### ***Financial implications***

32. There are no financial implications from moving the content of the Land Transfer Tax Statement to regulations.

### **Legislative Implications**

33. Implementing the proposals in this paper requires changes to the Income Tax Act 2007 and the Land Transfer Act 2017.
34. If approved, I propose including the legislative changes resulting from these recommendations in the next omnibus tax Bill currently scheduled for introduction in March 2020.



35. The proposal clarifying that acquisition and capital improvement expenditure is always deductible for land that is taxable on sale should apply from 1 April 2008, being the commencement date of the Income Tax Act 2007. All other proposals in this paper should apply from the date of enactment.

### **Impact Analysis**

36. The Impact Analysis Requirements apply to the proposals in this Cabinet paper relating to habitual buyers and sellers and, therefore, the *Land tax rules review 2019 – habitual buyers & sellers* Regulatory Impact Assessments (RIA) has been prepared and is attached to this Cabinet paper.
37. The Quality Assurance reviewer at Inland Revenue has reviewed the *Land tax rules review 2019 – habitual buyers & sellers* RIA and considers that the information and analysis summarised in it **partially meets** the quality criteria of the Regulatory Impact Analysis framework.
38. As identified in the Key Limitations or Constraints on Analysis section there is no data to support the current scale of the problem or the impact of the proposed changes if they were enacted. However, the RIA sets out the rationale for why the status quo is an issue and why a regulatory change is preferred. The reviewer considers that the information in the RIA is as complete as could be expected and identifies the main risks and uncertainties.
39. The Regulatory Quality Team at the Treasury has determined that the regulatory decisions sought in relation to deductions for acquisition and capital improvements costs of land that is subject to tax on sale and moving the content of the Land Transfer Tax Statement from the Land Transfer Act 2017 to regulations are exempt from the requirement to provide a Regulatory Impact Assessment as they have no or minor impacts on businesses, individuals or not for profit entities.

### **Human Rights**

40. The proposals in this paper do not impinge on rights and freedoms under the New Zealand Bill of Rights Act 1990 or the Human Rights Act 1993.

### **Gender Implications**

41. There are no gender implications arising from these proposals

### **Disability Perspective**

42. No disability issues arise from these proposals

### **Other Consultation**

43. The Treasury has been consulted on this Cabinet paper.
44. The Ministry for Housing and Urban Development has been informed.

### **Publicity**

45. I will make an announcement on the contents of the next omnibus tax Bill, including these proposals, when the Bill is introduced. A commentary on the Bill will also be released at this time. Inland Revenue will include details of the new legislation in a *Tax Information Bulletin* after the Bill is enacted.

### **Proactive Release**

46. I propose to proactively release this Cabinet paper, associated minutes, and key advice papers within 30 working days of Cabinet making final decisions.

### **Recommendations**

The Minister of Revenue recommends that the Cabinet Economic Development Committee:

#### ***Acquisition and capital improvement expenditure***

1. **Agree** that the costs of acquisition and improvements to land that is taxable on sale are always deductible in full;
2. **Note** that agreeing that the costs of acquisition and improvements to land that is taxable on sale are always deductible in full would not have a fiscal impact as it would align the law with current practice;

#### ***Habitual buyers and sellers of land***

3. **Agree** to amend the regular pattern restrictions in the main home, residential and business premises exclusions from the land tax rules, to ensure taxpayers cannot structure around them to escape tax;
4. **Note** that agreeing to amend the regular pattern restrictions would likely have a minor positive but unquantifiable fiscal impact;

#### ***Land Transfer Tax Statement***

5. **Agree** to amend the Land Transfer Act 2017 to allow changes to the Land Transfer Tax Statement to be made by regulation;

#### ***Legislative vehicle***

6. **Agree** that the legislative amendments to the Income Tax Act 2007 and the Land Transfer Act 2017 required to give effect to the changes recommended in this paper be included in the omnibus tax Bill scheduled for introduction in March 2020;
7. **Invite** the Minister of Revenue to instruct Inland Revenue to draft the necessary amendments to give effect to the changes to the Income Tax Act 2007 recommended in this paper;
8. **Invite** the Minister for Land Information to instruct the Parliamentary Counsel Office to draft the necessary amendments to give effect to the changes to the Land Transfer Act 2017 recommended in this paper;
9. **Authorise** officials to consult with stakeholders on the draft version of the amendments recommended in this paper to ensure they achieve the policy intent;
10. **Agree** to delegate authority to the Minister of Revenue to make decisions on the detailed design of the changes recommended in this paper; and

**Proactive Release**

11. **Note** that this Cabinet paper, the associated Cabinet minute, and key advice papers will be released on Inland Revenue's website.

Authorised for lodgement

Hon Stuart Nash  
Minister of Revenue



# Impact Summary: Land tax rules review 2019 – habitual buyers & sellers

## Section 1: General information

Purpose
<p>Inland Revenue is solely responsible for the analysis and advice set out in this Regulatory Impact Assessment (RIA), except as otherwise explicitly indicated. This analysis and advice has been produced for the purpose of informing key policy decisions to be taken by Cabinet.</p>
Key Limitations or Constraints on Analysis
<p>There are a number of limitations or constraints. These are:</p> <ul style="list-style-type: none"> <li>• There is no data to confirm that the issues the policy proposals are intending to address are currently a problem. Instead, officials have identified a gap in the current legislation that may be exploited by taxpayers considering recent and ongoing changes to tighten the rules for taxing land disposals. On that basis, officials consider that it is important to address these issues at this time.</li> <li>• Options have been limited to considering making the current framework more effective. Officials did not consider options that would tax more categories of land.</li> <li>• The lack of data on the scope and scale of taxpayer practices and structuring makes it difficult to determine which options best address the problem.</li> <li>• The lack of data means that no qualitative impact analysis is possible. However, problem definition and solutions were subject to targeted and public consultation.</li> </ul>
Quality Assurance Reviewing Agency:
<p>Inland Revenue</p>
Quality Assurance Assessment:
<p>The Quality Assurance reviewer at Inland Revenue has reviewed the <i>Land tax rules review 2019 – habitual buyers &amp; sellers</i> RIA and considers that the information and analysis summarised in it <b>partially meets</b> the quality criteria of the Regulatory Impact Analysis framework.</p> <p>As identified in the Key Limitations or Constraints on Analysis section there is no data to support the current scale of the problem or the impact of the proposed changes if they were</p>

enacted. However, the RIA sets out the rationale for why the status quo is an issue and why a regulatory change is preferred. The reviewer considers that the information in the RIA is as complete as could be expected and identifies the main risks and uncertainties.

**Reviewer Comments and Recommendations:**

The reviewer's comments on earlier versions of this RIA have been incorporated into this version.

**Responsible Manager (signature and date):**



Peter Frawley  
Policy Lead  
Policy and Strategy  
Inland Revenue  
19 November 2019

## Section 2: Problem definition and objectives

### 2.1 What is the policy problem or opportunity?

This RIA considers proposals to tighten the rules that apply where people regularly buy and sell land that is used mainly as a home or business premises while it is held by them.

#### *Current situation*

The land sales rules contained in part CB of the Income Tax Act 2007 tax gains from the sale of land when the land is held by a person effectively as trading stock (in the same way that a furniture vendor is taxed on the gains they make from selling their furniture). It is not intended that the rules tax gains on capital assets (e.g. gains from selling the furniture vendor's shop or a person's home). However, the rules are drafted quite broadly to ensure that people cannot easily structure around them, which means they can catch some land that is inherently a capital asset.

To limit this potential overreach, the rules contain exclusions. Relevantly, the rules exclude from tax gains from the sale of:

- a person's main home, where land sales are subject to tax under the bright-line test<sup>1</sup> (the main home exclusion)
- a person's residence, where land sales are subject to tax because the land was acquired with an intention of disposal, or where the owner or an associated person is in a business involving land (the residential exclusion)
- a business premises, where land sales are subject to tax because the land was acquired with an intention of disposal, or where the owner or an associated person is in a business involving land (the business premises exclusion).

For example, the land sales rules tax all sales of land by a land dealer, but the exclusions ensure the dealer will not be taxed on the sale of their home.

To ensure these exclusions are not abused, they are subject to regular pattern restrictions which stop the exclusions applying where a person has a regular pattern of buying and selling land used as a main home, residence or business premises. The regular pattern restriction in the main home exclusion for the bright-line test is also supplemented by a time-period rule, which states that the main home exclusion will not apply if a person has relied on it twice in the previous two years.

These restrictions ensure that people who regularly buy and sell land effectively as trading stock cannot rely on the exclusions to escape tax.

#### *Why is the current situation a problem?*

Given the recent tightening of the land rules<sup>2</sup> there is a concern that taxpayers can avoid the regular pattern restrictions by arranging their affairs so they do not have a pattern of buying and selling main homes, residences or business premises. This is contrary to the policy intention.

<sup>1</sup> The bright-line test taxes gains from the sale of residential land acquired and sold within five years.

<sup>2</sup> Including the introduction of the bright-line test and the new residential rental ring-fencing rules that only allow deductions to be offset against income derived from land (e.g. rental income).

The risk is that the government is missing out on tax revenue from those that are effectively making trading profits from the buying and selling of land, but are relying upon the main home, residential or business premises exclusions to escape tax. Over time there is a risk that greater numbers of investors may become involved in trading homes and business premises to take advantage of the tax-free gains. We are unable to estimate the size of the current tax gap or how this could change with increased investor activity.

The general anti-avoidance rule (GAAR) will continue to effectively override other provisions of the tax legislation to deny the tax benefits of an arrangement where a more than incidental purpose of the arrangement is to obtain a tax benefit. In some circumstances the GAAR could be invoked where a taxpayer has structured their affairs in such a way that they have avoided establishing a regular pattern of purchase and sale of home or business premises.

However, in many circumstances the GAAR may not be the most effective tool to counter such structuring. It is considered preferable for there to be clarity and transparency in the underlying law to give certainty to both taxpayers and Inland Revenue.

*What is the underlying cause of the problem?*

Officials have concerns that the current regular pattern restrictions are not working as intended. This undermines the integrity of the tax system by allowing people to take advantage of the exclusions in circumstances where this was not intended.

As the restrictions are currently drafted, taxpayers who are undertaking regular buying and selling activity can structure around the regular pattern restrictions in one of two ways.

Firstly, the regular pattern restrictions apply quite narrowly to the activities of a single person. This allows taxpayers to circumvent the application of the regular pattern restrictions by buying and selling land using different persons or entities each time (for example, the first property is purchased by the person, the second is purchased by their partner, the third by their family trust).

Secondly, the regular pattern restrictions have been interpreted narrowly to apply only when there is a similarity or likeness between the transactions (for example, a pattern of buying land, building a home on the land and then selling). This means that the regular pattern restrictions will not apply where a person does something different to each piece of land. For example, the first property is bought, lived in and sold, the second is renovated while it is lived in and sold, or the third is a bare section where a house is built and occupied then sold.

*Why does it need to be addressed now?*

The Government has indicated that people who engage in property speculation will come under increasing scrutiny. This is why a review of the land rules was added to the Government's Tax Policy Work Programme earlier in the year. One of the aims of this review is to consider ways to improve the integrity of the tax system.

*How much confidence is there in the evidence and assumptions for the problem definition?*

While there is currently no data, to the extent that there is currently a gap in the current land rules, it is reasonable to assume that some investors will look to exploit the existence of tax-free gains.

*Other context*

The issues considered in this RIA have been identified as part of a review of the current land tax rules undertaken by Inland Revenue. As part of this review, other regulatory changes



have been identified, including:

- clarifying the extent to which holding costs (such as interest, rates and insurance) should be deductible when the gain from the sale of private use land (such as a bach) is taxable; and
- moving the requirements of the Land Transfer Tax Statement (a form filed with Land Information New Zealand (LINZ) when people buy, sell or transfer property) from the Land Transfer Act 2017 to new secondary regulations operated by LINZ to provide a more flexible way to make any future changes to the form.

A second tranche of the land review is planned which will include consideration of the following:

- extending the bright-line test to farmland and commercial properties;
- extending Residential Land Withholding Tax to New Zealand residents;
- reviewing the re-zoning rule;
- reviewing the land tax frameworks;
- considering the introduction of a vacant land tax; and
- various compliance and administration matters.

## **2.2 Who is affected and how?**

The group of people potentially affected by tightening the rules are taxpayers who regularly buy land to be used mainly as a home or business premises and then sell that land.

The proposed regulatory changes seek to clarify and support, rather than depart from, existing policy in the area by ensuring that the regular pattern restrictions apply to people who regularly buy and sell land to stop them escaping tax.

## **2.3 Are there any constraints on the scope for decision making?**

The Government announced in April 2019 that it would not be proceeding with a capital gains tax, but that other initiatives to improve the fairness of the tax system would be considered, including tightening the rules around land speculation and working on ways to counter land banking.

## Section 3: Options identification

### 3.1 What options have been considered?

This RIA deals with proposed regulatory changes to tighten the rules that relate to regular buying and selling of homes and business premises to ensure people cannot escape paying tax by relying on the exclusions where that was not intended. The proposals have arisen in the context of the review of the current land tax rules, to meet the Government's objectives of improving the efficient use of land, and ensuring that tax settings are fair, balanced, and encourage and support productive investment.

All options are assessed against the following criteria:

- a) **Integrity of the tax system:** the tax rules should operate so as to collect revenue where intended.
- b) **Effectiveness:** the tax rules should produce the right amount of tax at the right time; the potential for tax evasion and avoidance should be minimised while keeping counteracting measures proportionate to risks involved.
- c) **Fairness:** the tax rules should not be arbitrary and should be fair to different taxpayers.
- d) **Certainty and simplicity:** the tax rules should be as clear and simple as possible so that taxpayers who attempt to comply with the rules are able to do so.

Increasing the integrity of the tax system is a primary objective of these changes. However, it is necessary to balance this objective against ensuring that the rules are effective, fair and balanced, and that they provide certainty and simplicity for taxpayers.

#### Group of persons or entities

The current regular pattern restrictions apply when a single person (which includes a company, trust or other entity type) has a pattern of buying and selling. This limited application gives rise to a risk that taxpayers can structure around the regular pattern restrictions by using other persons or entities to carry out each transaction, rather than carrying out multiple transactions on their own.

#### *Option 1: Status quo*

The first option is to maintain the status quo, so the regular pattern restrictions continue to apply only to the actions of a single person.

This option undermines the integrity and effectiveness of the tax system because it allows taxpayers to structure around the rules to avoid tax. It also unfair as it benefits those taxpayers who are willing and able to structure around the rules.

However, remaining with the status quo could be said to be a simpler option, and would avoid the need for more complex rules.

#### *Option 2: Extend the regular pattern restrictions to groups of people*

The second option is to expand the regular pattern restrictions to apply to groups of people, as follows:

- For the residential exclusion, a group of people will be undertaking buying and selling activity together if they all occupy all of the properties as their residence, or if the people who occupy all of the properties as their residences control the trusts or other entities that own the properties.
- For the business premises exclusion, a group of people will be undertaking buying and selling activity together if they are all controlled by the same person or persons (e.g. all the companies have the same shareholders).

This option will protect the integrity and effectiveness of the tax system by ensuring that people cannot structure to avoid their tax obligations. It will also ensure that taxpayers pay their fair share of tax.

However, these changes will introduce further complexity to the rules.

### **Similar activities**

The current regular pattern restrictions have been interpreted as only applying when there is a similarity or likeness in the transactions. There is a concern that this allows taxpayers to structure around the regular pattern restrictions by carrying out different activities on each piece of land so there is not sufficient similarity or likeness in the transactions.

#### *Option 1: Status quo*

The first option would be to maintain the status quo.

This option undermines the integrity and effectiveness of the tax system because it allows taxpayers to structure around the rules to avoid tax. It is also unfair as it benefits those taxpayers who are willing and able to structure around the rules.

#### *Option 2: Focus on regularity of transactions*

The second option is to amend the rules to capture patterns of buying and selling, with the focus being on the regularity of the transactions, rather than on the similarity or likeness of what is done on the land.

This option will protect the integrity and effectiveness of the tax system by ensuring that people cannot structure to avoid their tax obligations. It will also ensure that taxpayers pay their fair share of tax.

This option will reduce complexity and add clarity to the legislation by simplifying the factors that must be satisfied before the restriction will apply.

### **Intention test**

The residential and business premises exclusions currently apply both:

- when a person acquired land with a purpose or intention of disposal or for business involving land; and
- for disposals of land within 10 years when a person is associated with a person who carries on a business involving land.

Therefore, it is possible that the current regular pattern restrictions could result in a person who is associated with a land dealer being taxed on the sale of their home or business premises because they have been forced to move for family or business reasons several times over a couple of years.

It has been proposed by submitters that the regular pattern restrictions could be limited to situations where the land has been acquired with a purpose or intention of disposal.

*Option 1: Status quo*

The first option is to maintain the status quo and continue to apply the regular pattern restrictions to situations where a person is associated with a person in a business involving land.

In the context of the other proposed amendments, this option has the potential to be unfair, because it risks capturing sales of genuine homes and business premises. The potential for unfairness undermines the integrity of the tax system, and heightens the risk of tax avoidance and evasion as taxpayers seek to escape a tax they consider unfair.

However, retaining the status quo could be seen as being simpler as it applies the same rules to all taxpayers who are subject to the exclusions.

*Option 2: Introduction of intention test*

The second option is to limit the application of the regular pattern restrictions to situations where the owner of the land acquired it with an intention of disposal.

This option improves the integrity of the tax system in that it helps to ensure the rules only operate to collect revenue where intended. It also improves the effectiveness and fairness of the tax system by only taxing true revenue gains.

The introduction of a further limitation will, however, add some complexity to the rules.

**Amending the business premises regular pattern restriction**

The business premises exclusion applies only where the owner of the land mainly uses the land to carry on a substantial business. Because the business premises exclusion is limited in this way, it has been suggested by submitters that it is already hard to structure around and does not require amendment to cover activities by a group of people.

*Option 1: Status quo*

The first option is to maintain the status quo.

This option is simple because it will not require complex grouping rules.

However, this option risks allowing taxpayers to structure around the regular pattern restriction, which reduces the integrity and effectiveness of the tax system. It could also be argued that not amending the business premises exclusion if the residential and main home exclusions are amended (as proposed above) would be unfair in that it would allow those owning land for business purposes advantages over those owning land for residential purposes.

*Option 2: Amend the business premises regular pattern restriction*

The second option is to amend the regular pattern restriction in the business premises exclusion to apply when a person, or a group of people or entities that are all controlled by a person or group of persons, regularly buy and sell land used as business premises.

This option would improve the integrity, effectiveness and fairness of the tax system by ensuring that taxpayers cannot avoid tax by using separate entities to carry on buying and selling activities where those activities would be subject to tax if they were carried on by one

person alone. By doing so, it will better ensure that the right amount of revenue is collected over time.

This option also improves clarity for taxpayers by clearly indicating activity that should be subject to tax.

This option will, however, not be simpler because it will require relatively complex rules to capture the intended group of people or entities.

### **Time-period rule**

The regular pattern restriction in the main home exclusion for the bright-line test is supplemented by a time-period rule, which states that the main home exclusion will not apply if a person has relied on it twice in the previous two years. This time-period does not appear in the residential and business premises exclusions. To attempt to provide clarity and objectivity, a similar time-period rule could be added to the residential and business premises exclusions.

#### *Option 1: Status quo*

The first option is to maintain the status quo and have no time-period restrictions in the residential and business premises exclusions.

This option is simple but leaves uncertainty in the rules because the current rules are subjective making them harder to apply.

However, this option is more likely to maintain the integrity of the tax system by ensuring that transactions would not be subject to tax simply due to volume. In doing so, it would also ensure that the rules are perceived to be fair.

#### *Option 2: Add time period restrictions*

The second option is to add time-period restrictions (i.e. the exclusions will not apply if they have been used twice in two years) to the residential and business premises exclusions.

This option could add clarity to the rules because it would introduce an objective test to apply. However, introducing an extra provision decreases the simplicity of the rules.

However, this option could reduce the integrity of the tax system as it risks taxing sales of genuine homes and business premises merely due to the level of transactions undertaken with no consideration given to the person's intention.

### 3.2 Which of these options is the proposed approach?

Officials consider that the following amendments to the regular pattern restrictions are the best options to resolve the issue:

#### **Group of persons or entities**

*Recommendation: Option 2 - Extend the regular pattern restrictions to groups of people*

The regular pattern restrictions should be extended to apply to a person or a group of persons that undertake buying and selling activity together:

- For the residential exclusion, a group of people will be undertaking buying and selling activity together if they all occupy all of the properties as their residence, or if the people who occupy all of the properties as their residences control the trusts or other entities that own the properties.
- For the business premises exclusion, a group of people will be undertaking buying and selling activity together if they are all controlled by the same person or persons (e.g. all the companies have the same shareholders).

This will protect the integrity and effectiveness of the tax system by ensuring that people cannot structure to avoid their tax obligations. It will also ensure that taxpayers pay their fair share of tax.

#### **Similar activities**

*Recommendation: Option 2 - Focus on regularity of transactions*

The regular pattern restrictions should be extended to apply more broadly to any pattern of buying and selling land used as a residence or business premises. It should not matter whether properties were simply bought and sold, or whether any building or renovation work occurred while the person owned the land. What should be relevant is that there are “regular” transactions (that is, the transactions occur at sufficiently uniform or consistent intervals).

This will ensure that the regular pattern restrictions are no longer restricted to applying only where there is a similarity or likeness between the transactions (for example, a pattern of buying land, building a home on the land and then selling). This will increase the integrity of the tax system.

#### **Intention test**

*Recommendation: Option 2 - Introduce intention test*

The regular pattern restrictions in the residential and business premises exclusions should be targeted so they only apply where the person acquired the land with an intention of disposal.

Expanding the regular pattern restrictions gives rise to an increased risk that they could catch ordinary residential transactions that occur for family reasons, and small businesses who are upgrading as their business grows because the person is, or is associated with, a person in a business involving land. Officials consider that the regular pattern restrictions should be limited to ensure that people who regularly buy and sell land effectively as trading stock cannot use the home or business premise exclusions to escape tax.

This option improves the integrity of the tax system in that it helps to ensure the rules only operate to collect revenue where intended. It also improves the effectiveness and fairness of the tax system by only taxing true revenue gains.

### **Amending the business premises regular pattern restriction**

*Recommendation: Option 2 - Regular pattern restriction in the business premises exclusion should be amended*

The regular pattern restriction in the business premises exclusion should be amended to apply to activities by a group of people or entities.

Under the current rules, a single person cannot escape tax by using land acquired as trading stock as a business premises while they hold it. This outcome should not be able to be structured around by using a group of entities controlled by a person. The proposed changes will ensure this is the case.

The main concern raised by submitters appeared to be the concern of overreach. Officials consider that this risk is mitigated by limiting the regular pattern restrictions, so they only apply when land is acquired with an intention of resale.

### **Time-period rule**

*Recommendation: Option 1 - Status quo*

A time-period rule such as that included in the bright-line main home exclusion is not appropriate for the residential and business premises exclusions.

In the context of the bright-line test, which taxes sales without consideration of intention, presuming the exclusion should not apply simply because there were multiple transactions within a defined period can be justified. However, regularity alone should not be enough to give rise to a taxable transaction under the other provisions. Instead, it is important that the owner also has an intention of disposal.

## Section 4: Impact Analysis (Proposed approach)

### 4.1 Summary table of costs and benefits

Affected parties ( <i>identify</i> )	Comment: nature of cost or benefit (eg ongoing, one-off), evidence and assumption (eg compliance rates), risks	Impact <i>\$m present value, for monetised impacts; high, medium or low for non-monetised impacts</i>
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#### Additional costs of proposed approach, compared to taking no action

Taxpayers who regularly buy land, use it as a main home, residence or business premises and then sell it, structuring the transactions around the regular pattern restrictions as the legislation is currently drafted	Will need to return the disposal of land for tax purposes. There will be an increase in income tax paid, however, this is difficult to quantify  Possible decrease in number of houses purchased, renovated and then sold within a short space of time	Cannot be quantified  Cannot be quantified
Regulators	It is expected that the changes can be managed as part of Inland Revenue's business as usual legislative change. Therefore, no additional funding is required to support this change.	Nil
<b>Total Monetised Cost</b>		Increase in income tax paid but unable to be quantified
<b>Non-monetised costs</b>		Possible decrease in houses being renovated; possible decrease in number of houses being sold (unquantifiable)

#### Expected benefits of proposed approach, compared to taking no action

Wider government	The policy changes will be fiscally positive. However, the impact cannot be quantified.	Increase in tax (unable to be quantified)
<b>Total Monetised Benefit</b>		Increase in income tax paid but unable to be quantified
<b>Non-monetised benefits</b>		N/A



## 4.2 What other impacts is this approach likely to have?

There are no other identified impacts of this approach.

## Section 5: Stakeholder views

### 5.1 What do stakeholders think about the problem and the proposed solution?

#### Consultation document

Officials issued a consultation document “Habitual buying and selling” in September 2019 setting out the issues and proposing possible solutions and asked for taxpayers’ views on the proposals. Prior to releasing the document publicly, officials also tested their thinking with some private sector advisors.

#### Feedback

In general, submitters appear to understand officials’ concerns that taxpayers can structure around the regular pattern restrictions, and most supported changes in the area. However, almost all submitters expressed concerns about the potential for overreach from the proposed amendments and, in particular, that the amendments risk taxing transactions that should not be subject to tax (i.e. sales of genuine homes or business premises).

Submitters also disagreed with proposals to amend the regular pattern restriction in the business premises exclusion. They submitted there was no evidence of any abuse of that exclusion.

Submitters could see that a time-period rule may be useful to supplement the regular pattern restriction in the residential exclusion. However, there was concern that a time-period rule would be arbitrary and could not accommodate factors outside a person’s control.

Submitters’ views and concerns were taken into account by officials in forming the preferred views discussed above. In particular, officials addressed submitters’ concerns around overreach i.e. that the proposals risk taxing the sale of homes or business premises for genuine reasons. In response to those concerns, officials propose to target the regular pattern restrictions to situations where there is an intention of resale.

## Section 6: Implementation and operation

### 6.1 How will the new arrangements be given effect?

The proposals will require amendments to the Income Tax Act 2007 which could be included in the omnibus tax Bill scheduled to be introduced in early 2020.

The changes should apply prospectively, i.e. only properties acquired and sold after the application date would be taxable. However, properties acquired before the application date would be able to be considered for the purposes of determining whether a taxpayer has a regular pattern.

Inland Revenue will release details of the Cabinet decision once it is made and further detail will be provided in a commentary released when the Bill is introduced and will also be included in the Tax Information Bulletin after the Bill is enacted.

Inland Revenue will be responsible for the ongoing monitoring and enforcement of the rules.

## Section 7: Monitoring, evaluation and review

### 7.1 How will the impact of the new arrangements be monitored?

Inland Revenue undertakes regular review of land transactions via its Property Compliance Programme (PCP), which is aimed at ensuring that those involved in property dealing or speculation pay their fair share of tax. Inland Revenue undertakes regular reporting to government as part of the PCP.

Inland Revenue is also developing a Data Intelligence Platform (DIP) to enable right-time interaction and appropriate risk-based interventions, by identifying affected customers, understanding customer behaviours and needs, and highlighting areas of compliance focus as well as policy weakness, including how these matters relate to land. The DIP will be able to pull in relevant sources of data and can be used to identify certain types of customer groups, build customer profiles and understand the problem in a wider context. However, as with any other information system it will be dependent upon the personnel, data available and cases run in order to deliver its potential value.

The DIP will continue to be developed to further refine Inland Revenue's ability to target particular transactions including assisting Inland Revenue in monitoring whether the exclusions are operating as intended, and educating taxpayers on the matter as appropriate.

### 7.2 When and how will the new arrangements be reviewed?

Inland Revenue would closely monitor the effectiveness of the proposed changes as part of the PCP programme.

The final step in the Generic Tax Policy Process is the implementation and review stage, which involves post-implementation review of legislation, and the identification of remedial issues. A post-implementation review could occur around two years after the tax year that the amendments first apply.

Any recommended changes identified from the review would be considered for potential inclusion on the Government's tax policy work programme.





# Cabinet Economic Development Committee

## Minute of Decision

*This document contains information for the New Zealand Cabinet. It must be treated in confidence and handled in accordance with any security classification, or other endorsement. The information can only be released, including under the Official Information Act 1982, by persons with the appropriate authority.*

### Tax Rules for Land: Proposed Amendments

**Portfolio**                      **Revenue**

On 11 December 2019, the Cabinet Economic Development Committee:

#### Acquisition and capital improvement expenditure

- 1        **agreed** that the costs of acquisition and improvements to land that is taxable on sale always be deductible in full;
- 2        **noted** that the change referred to in paragraph 1 above would not have a fiscal impact as it would align the law with current practice;

#### Habitual buyers and sellers of land

- 3        **agreed** to amend the regular pattern restrictions in the main home, residential and business premises exclusions from the land tax rules, to ensure taxpayers cannot structure around them to escape tax;
- 4        **noted** that the change referred to in paragraph 3 above would likely have a minor positive but unquantifiable fiscal impact;

#### Land Transfer Tax Statement

- 5        **agreed** to amend the Land Transfer Act 2017 to allow changes to the Land Transfer Tax Statement to be made by regulation;

#### Legislative implications

- 6        **agreed** that the legislative amendments to the Income Tax Act 2007 and the Land Transfer Act 2017 required to give effect to the above paragraphs be included in the omnibus tax Bill scheduled for introduction in March 2020;
- 7        **invited** the Minister of Revenue to issue drafting instructions to Inland Revenue to draft the necessary amendments to give effect to the changes to the Income Tax Act 2007 proposed in the paper under DEV-19-SUB-0352;
- 8        **invited** the Minister for Land Information to issue drafting instructions to the Parliamentary Counsel Office to draft the necessary amendments to give effect to the changes to the Land Transfer Act 2017 proposed in the paper under DEV-19-SUB-0352;

- 9 **authorised** officials to consult with stakeholders on the draft version of the amendments proposed above to ensure they achieve the policy intent;
- 10 **authorised** the Minister of Revenue to make decisions on the detailed design of the above proposals.

Janine Harvey  
Committee Secretary

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**Present:**

Hon Kelvin Davis  
Hon Phil Twyford  
Hon Dr Megan Woods (Chair)  
Hon David Parker  
Hon Nanaia Mahuta  
Hon Iain Lees-Galloway  
Hon Jenny Salesa  
Hon Kris Faafoi  
Hon Shane Jones  
Hon Julie Anne Genter  
Hon Eugenie Sage

**Officials present from:**

Office of the Prime Minister  
Officials Committee for DEV

**Hard-copy distribution:**

Minister of Revenue