



## Government cashes in on the Property Market

Following on from our earlier article on the 9<sup>th</sup> March 2007 titled “Inflation – It’s the property market” are two further articles relating to the property market and the Governments attempts to slow it down.

**If you are, or intent to, purchase, sell, develop or transfer any property or operate as a builder then these are must read articles**

**The first article could have serious implications for you, across many areas– changing tax laws and creating non-level playing fields just to achieve a governments fiscal policy is never a good idea.**

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## Using tax law to quell the property market

Proposed changes to the tax law surrounding the taxation of property, seen more designed to assist the government crackdown on an over heated property market rather than in achieving equitable income tax law.

One of the major proposed changes in relation to property is the change in the definition of associated persons.

Currently there are 4 separate definitions of associated persons in the Income Tax Act. The IRD’s view is that the definition relating to property is deficient (ie we are missing out on too much tax) and the recommended changes are intended to standardize the definitions by using the most wide-ranging definition (ie increase the tax take as much as possible).

People (particularly sub dividers, builders and traders) who own both trading and long term properties can avoid the long term properties being taxable by owning these in an entity that is not associated to the trading activities. This is quite a common, legitimate and legal situation. With the gains on the long-term land being tax-free.

This will, however, all change if the proposed changes become law - it will become very difficult to break an association with a with the result being that once you are carrying on a tainted activity, **all** your property becomes tainted, end of story. This is a fundamental change that will affect many people – some fairly, more unfairly.

For example, a partner in a partnership owns a rental property and sells it within 10 years of purchase. Under the proposed changes the gain would end up taxable if one of their other partners were a property developer in their private capacity.

This is a ridiculous result as in many cases the partner would not even be aware of what activities their other partners may be involved in outside the partnership – particularly where there are numerous partners, in some cases spread across the country.

Under the proposed changes it will not be possible for a person to separate their property trading activities from their long-term investment properties. This will mean that most long-term properties would attract tax if sold within 10 years.

If the rules were applied evenly across all areas this change may seem plausible, but they are not. Shares are not subject to associated party rules meaning a person can have both trading and long term share holdings, with the trading activities not tainting the long term holdings for tax purposes.

To date the government has not said why property holdings are treated differently from other investments such as shares. Maybe it has something to do with the proposed Kiwi saver scheme and the governments desire to have people saving for retirement in investments other than property – or is it is that investments like shares are easier to tax than property.

It seems like another government- led initiative to help take the heat out of the housing market.

The proposed changes are recommendations only and they will be subject to a submissions process meaning the public can make submissions up to the 11<sup>th</sup> May 2007 – which in itself is a very short time frame compared to timeframes for other changes eg Smacking Bill which seems to go on forever.

The Government plans to bring in the new legislation in November 2007, to take effect in the 2008/09- income year (ie from the 1<sup>st</sup> April 2008)



## IRD recover \$120m from Property Audits

Recently the Reserve Bank governor Dr Alan Bollard implied that if the IRD was more aggressive in the policing of tax laws surrounding property transactions, it could help dampen the overheated property market. His comments came after he again lifted the official cash rate in an attempt to curb the domestic economy.

The buoyant economy, ease of bank lending and the dramatic rise in property values have increased the profits and tax “leakage” associated with property transactions.

The IRD have said that those people buying property should contact their accountant to ensure they are aware of their taxation obligations and requirements.

Tax avoidance on property sales has become one of IRD's priorities after years of increasing property price, and Michael Cullen has indicated the department could get more funding this year to help stem the problem and increase the governments tax take.

The number of IRD investigators working on property audits had more than trebled in the past four years and this area was now considered one of the "highest risk" areas.

According to the IRD the problem was minimal in 2003 but in 2005, after the department began focusing on rapidly developing areas such as Queenstown, more than \$120m in unpaid and or underpaid taxes were recovered last year, with property audits being one of IRD's top three priority areas, with the IRD being extremely busy and vigilant in this area.

While we do not have a general capital gains tax, people who buy/sell, build or subdivide property for the intent of profit are liable for tax on that profit - a fact commonly overlooked by most people – The tax law surrounding land transactions is some of the most complex, in-depth and most misunderstood and underestimated in our tax law.

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