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Residential land withholding tax
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Residential land withholding tax – officials’ issues paper

Introduction

1. The New Zealand Law Society (Law Society) appreciates the opportunity to make submissions in respect of *Residential Land Withholding Tax – An Officials’ Issues Paper* (Issues Paper) dated August 2015.
2. The Issues Paper proposes to introduce a residential land withholding tax (RLWT) as a mechanism for supporting the collection of tax imposed under the Taxation (Bright-Line Test for Residential Land) Bill (Bill).
3. Under the proposed bright-line test contained in the Bill, income tax is to be paid on any gains from the sale of residential property that is bought and sold within two years, with certain exceptions. For the bright-line test to be effective, the Government considers that it needs to have an appropriate administrative mechanism for collecting the tax – particularly where the vendor of the property is not in New Zealand.
4. The Issues Paper proposes to introduce a requirement for RLWT to be withheld on the sale of residential land in New Zealand where the vendor of the residential property is both an “offshore person” and taxable under the bright-line test. It is proposed that the obligation for collecting RLWT be imposed by a conveyancer or solicitor to the property transaction and paid by that conveyancer/solicitor to the Commissioner of Inland Revenue (the Commissioner).
5. Officials have requested feedback on the suggestions outlined in the Issues Paper in relation to who should be required to undertake the withholding of RLWT and how the process may work in practice. These submissions concentrate on these two areas.

The Withholding Agent

6. The tax system aims to minimise the compliance burden it places on taxpayers. Officials have proposed that as a starting point, the withholding obligation will fall on the conveyancer or solicitor (the conveyancing agent) involved in the property transaction, rather than the vendor or purchaser themselves.
7. Under the proposed RLWT regime, a conveyancer or solicitor involved in the transaction (the withholding agent) would be required to withhold and pay the required amount to the Commissioner unless one of the following circumstances apply:
 - a. The vendor is not an offshore person.
 - b. The sale of the property would not be taxable for the vendor under the proposed bright-line test because:
 - i. The vendor acquired the property being sold before 1 October 2015; or
 - ii. The vendor acquired the property being sold after 1 October 2015, but the vendor has owned the property for two or more years.
8. In order for the withholding agent to determine whether or not they are required to withhold RLWT it is intended that they be entitled to rely on a statement provided by the vendor, unless they know it to be false.
9. It is proposed that the withholding agent would have the following obligations:
 - a. Register as an RLWT withholding agent with the Commissioner.
 - b. Confirm whether the vendor is eligible for an exception from withholding.
 - c. Obtain the vendor's acquisition price to calculate the rate at which RLWT is to be deducted.
 - d. Withhold the correct amount of RLWT at settlement.
 - e. Pay the withholding amount of RLWT to the Commissioner.
 - f. Provide the required information in a form approved by the Commissioner at the time of payment to the Commissioner.

Who should have the withholding obligation?

10. Officials have proposed that the withholding obligation would fall on the conveyancing agent involved in the property transaction, rather than the vendor or purchaser. The reason for this is that a conveyancing agent already has professional obligations to discharge in relation to the conveyance of the property and the obligation to withhold RLWT would more naturally form part of those obligations. Further, conveyancing agents have systems and trust accounts needed to manage the funds involved in the settlement of property, which is important in terms of ensuring the integrity of the withholding process.
11. Officials have stated that placing the obligation on the purchaser would be very difficult both in terms of compliance and administration. They also consider that placing the obligation on

the vendor does not make sense because it would defeat the purpose of ensuring the RLWT is paid as part of the settlement process.

12. The Law Society agrees that placing the withholding obligation on either the purchaser or the vendor would be difficult in terms of compliance and administration. The only way it could have potential application is if the requirement to withhold RLWT and make the requisite disclosure formed part of the contractual obligations between the parties. This however would require a significant re-drafting of the standard form Agreement for Sale and Purchase which may not be warranted for the number of cases that are likely to result in the payment of RLWT. Further, for practical purposes it most likely would result in a purchaser or vendor authorising their respective agent to attend to the payment, rather than doing so themselves. It is very difficult to envisage a situation where a vendor would be comfortable leaving the responsibility to the purchaser. The more likely scenario is that the purchaser's solicitor would be required to provide an undertaking on settlement to apply the portion of the proceeds of sale withheld, to the payment of RLWT on the vendor's behalf.

Purchaser's conveyancing agent as withholding agent

13. For the reasons set out below, the Law Society does not support the proposal to make a purchaser's conveyancing agent a withholding agent for the purposes of RLWT. If a withholding obligation is to be imposed, it is recommended that the obligation would be more correctly imposed on the vendor's conveyancing agent.
14. New Zealand's withholding tax regime commonly requires the payer of an amount to withhold a portion of that payment and pay it to the Commissioner. The reason for this approach is that it ensures that the relevant tax is paid out of the amount due before the recipient gets control of the funds.
15. As stated in the Issues Paper, generally, the amounts of tax withheld are on account of the recipient of the payment. The examples given include the payment of PAYE by an employer and RWT/NRWT by a bank. In both of these examples, however, there is a clear contractual relationship between the payer and the payee. In the case of an employer, the employer has a direct contractual relationship with the employee to pay the employee salary/wages in return for services performed. In the case of a bank and a payee, the payee is generally a customer of the bank who has invested their funds with the bank. In both cases, the funds from which payment is being withheld, belong to the payee.
16. The position differs in the context of an Agreement for Sale and Purchase. In the case of a vendor and a purchaser's conveyancing agent, there is no direct relationship, contractual or otherwise, between them. Any funds held by the purchaser's conveyancing agent are held by that agent on trust for their purchaser client. The purchaser's conveyancing agent is only authorised to release the payment of those funds on direct instructions from their purchaser client. The funds are required by law to be held in trust by the purchaser's conveyancing agent, and remain the property of the purchaser until such time as they are legally required to release them and the purchaser authorises their agent to release them.
17. Settlement funds do not legally become the property of the vendor, nor are they held in the vendor's agent's trust account as the property of their client, until such time as settlement is

completed. On settlement, the funds are transferred to the vendor's solicitor's trust account and are disbursed in accordance with the vendor's solicitor's settlement obligations and undertakings.

18. Conveyancing agents have a clear contractual relationship with their own clients, and an obligation to act in that client's best interest. That relationship however does not extend to the other party's client. Therefore until such time as the settlement funds legally move from the purchaser to the vendor, any funds held by the purchaser's conveyancing agent are held by them on trust for their client, not the vendor.
19. By imposing an obligation on to the other party's conveyancing agent, issues of conflict of interest could arise. For example, if there was a dispute which could only be resolved by the purchaser withholding funds in their solicitor's trust account until the matter is settled, the purchaser's solicitor could not then use those same funds to meet an obligation to pay the vendor's liability for RLWT as they would be in breach of their obligation to their own client.
20. It is also unclear whether the professional indemnity insurance held for example by the purchaser's conveyancing agent would cover a situation where the conveyancing agent paid RLWT in error and a claim was brought against that agent by the vendor, as there is no direct solicitor/client relationship between the purchaser's conveyancing agent and the vendor. As such, the purchaser's conveyancing agent could be exposed to liability without recourse to adequate insurance protection in the case of a genuine mistake or error.
21. Officials have identified a number of advantages in placing the primary obligation to withhold on the purchaser's conveyancing agent, including that the purchaser's conveyancing agent is an appropriate party to 'clip the ticket' (pay the withholding tax) before the recipient (the vendor) gets control of the funds.¹ Officials consider the person 'clipping the ticket' should be "the person with the least to gain from failing to comply with the rules".² The proposal to place the primary obligation on the purchaser's conveyancing agent which, where there is non-compliance, could result in significant penalties or sanctions for the withholding agent, extends the concept of ensuring "the person with the least to gain from failing to comply with the rules" too far.
22. The ultimate tax liability arising under the bright-line test belongs to the vendor, not the purchaser. The Law Society submits that imposing the withholding obligation on the purchaser's conveyancing agent imposes an unfair burden on that agent and exposes them to a risk for which they may well have no protection.

Withholding Agent entitled to rely on statement from vendor

23. It is proposed that in determining the requirement to withhold RLWT the withholding agent be entitled to rely on the information supplied by the vendor, *unless the agent knows it to be false*. Given there is no professional relationship between the purchaser's agent and the vendor, it is hard to envisage any situation where the purchaser's agent would be possessed of the requisite amount of knowledge to assess whether or not the information they are

¹ *Residential Land Withholding Tax – An Officials Issues Paper*, at [3.8], p10,

² *Ibid.*

provided by the vendor is false. It brings into issue, who would have the burden of proving that the information was correct or incorrect?

24. Section 78F of the Goods and Services Act 1985 has been proposed as a precedent for the form of disclosure that the vendor would be required to give to the withholding agent. Section 78F however provides that the “supplier” (being the person with the obligation to take a tax position with respect to whether a transaction should be standard or zero rated for GST purposes) is entitled to rely on the information provided by the purchaser. In that case it is the supplier who ultimately bears responsibility for the position taken by them. For RLWT purposes, officials propose to impose the same type of obligation on a person/entity who is not the taxpayer and who has no direct relationship with the person providing the information they are entitled to rely on. As there is no direct relationship between the vendor and the purchaser’s agent, it is difficult to see how the purchaser’s agent could take an action for the supply of wrongful or false information which ultimately leads to the withholding agent facing a penalty or sanction for failing to correctly withhold RLWT.
25. The provisions of Section 78F are duplicated in the standard Agreement for Sale and Purchase, which therefore provides a vendor with recourse in contract against the purchaser if the information provided by the purchaser is incorrect. Even if a similar provision in relation to RLWT was included in the Agreement for Sale and Purchase, only the parties to the Agreement would be entitled to rely on that provision to seek any remedy in contract.

Funds are held in New Zealand

26. The Issues Paper states that one of the advantages of placing the primary obligation to withhold on the purchaser’s conveyancing agent is that the funds are likely to flow through a New Zealand solicitor’s trust account. As such, there would be funds in New Zealand from which RLWT can be withheld.
27. It is not clear whether there are many (or indeed, any) instances where an offshore vendor has engaged an offshore solicitor or conveyancing agent to carry out a conveyancing transaction in New Zealand.
28. In order for an offshore solicitor or conveyancing agent to be able to carry out a conveyancing transaction in New Zealand, they would need to be registered with Land Information New Zealand (LINZ) and be authorised to certify and sign LINZ e-dealings. While it is possible for off-shore solicitors to do this, it is unclear how many, if any, have undertaken or would undertake the registration process. It is more likely than not that any overseas solicitor or conveyancing agent would engage a conveyancing agent in New Zealand to act on behalf of their overseas client.
29. It is generally the case that the vendor’s conveyancing agent will be in New Zealand and that funds would be paid to that vendor’s conveyancing agent’s New Zealand trust account. It is submitted that the instances of an offshore vendor using an offshore lawyer and thereby the risk of the funds not being in New Zealand, would be relatively small and of insufficient risk to warrant the imposition of the withholding obligation on the purchaser’s conveyancing agent.

Costs of Compliance

30. Placing the withholding obligation on the purchaser or purchaser's conveyancing agent would significantly increase costs for the purchaser. The Law Society recommends that the cost of compliance should sit with the taxpayer on whose behalf withholding tax is being paid. If the withholding obligation is to be imposed on the purchaser or purchaser's conveyancing agent, the cost of compliance should be passed onto the vendor. That is, the purchaser's agent should be entitled to charge the vendor for the cost of compliance and have those costs deducted/met from the proceeds of sale.
31. Where the cost of compliance is placed on the purchaser and/or purchaser's conveyancing agent, it is unlikely that the purchaser could claim those costs as a deductible expense. In contrast, any costs associated with the vendor's tax compliance obligations could be claimed as a deductible expense by the vendor.
32. As noted earlier, the Law Society does not support the proposal to make a purchaser conveyancing agent a withholding agent for the purposes of RLWT. If a withholding obligation is to be imposed, it is recommended that the obligation would be more correctly imposed on the vendor's conveyancing agent. Accordingly, the Law Society recommends that the compliance burden and cost of compliance should legally be borne by the taxpayer, being the vendor, not the purchaser. As such, it follows that the compliance obligation would better sit with the agent of the vendor, not the agent of the purchaser.

Ability to Assess Information

33. The vendor's agent is in a far better position than the purchaser's agent to obtain all the information required from their client to assess the vendor's offshore status and liability for tax. It is also likely (although not always the case) that the vendor's agent may well have acted for the vendor when the vendor acquired the property.
34. The vendor may not wish to disclose certain information to a person they do not have a professional relationship with and who is not bound by obligations of confidentiality on the disclosure of information. For example, in the case of a trust, the vendor may not wish to disclose (for reason completely unrelated to tax) to anyone other than its own advisor, who the beneficiaries of the trust are.
35. The vendor's solicitor has the obligation to make payments from the vendor's funds before disbursing the balance to the vendor. The vendor's solicitor in most instances will have provided numerous undertakings to the vendor's mortgagee and the purchaser's solicitor as to the payment of the mortgage, and cost that are to be apportioned on sale such as rates. The vendor's solicitor therefore has an obligation to ensure they hold sufficient funds in the trust account of their client to meet all obligations and undertakings before the vendor's agent can release the e-dealing, in particular the discharge of mortgage.
36. The vendor and the vendor's conveyancing agent have a direct relationship. Therefore in the event that the vendor's conveyancing agent fails to make a RLWT deduction and payment, due to incorrect information provided to them by their client, they have a direct contractual relationship pursuant to which they can seek appropriate remedies. Further, the liability of the agent may be covered by their professional indemnity policy.

Fulfilling RLWT Obligations

37. The main objective of the RLWT is to collect tax liabilities arising under the proposed bright-line test and in particular, from foreign investors. It is intended that the RLWT should mirror the concepts and definitions used in the proposed bright-line test where possible and practical.
38. It is proposed that the withholding agent would be required to withhold and pay RLWT to the Commissioner on the sale of residential land, unless the vendor qualifies for either of two exceptions being:
 - a. They are not an offshore person;
 - b. The bright-line test does not apply to the sale of the property as a result of the two-year holding period being exceeded.

Definition of an offshore person

39. The definition of an offshore person is to be consistent with the definition proposed under the Taxation (Bright-Line Test for Residential Land) Bill.
40. It is unclear from the proposed definition of an offshore person who is a resident individual as to what constitutes a “residence class visa”. The Law Society recommends that the term be clarified by direct reference to a specific definition in the Immigration Act 2009 and the types of visas that qualify as resident class visas.
41. There also needs to be clarification as to who is excluded from the definition of an offshore person. The Issues Paper proposes that the following persons be excluded from the definition of an offshore person:
 - a. Citizens, unless they have not been in New Zealand within the last three years;
 - b. Residents (by which we take to mean persons who hold a residents class visa) that have not been within New Zealand for the last year.
42. In the case of citizens physically present in New Zealand at any time in the specified three year period, even if it was for one day, it is not clear whether that presence would exclude them from the definition of an offshore person. It is also not clear in the case of residents, whether their presence in New Zealand for the specified “last year” requires them to be physically present for 365 days of that year or just one day in order for them to be excluded from the definition of an offshore person. It is recommended that terms such as “residency class visa” and the requirement for physical presence in New Zealand be clarified so it is clear what presence in New Zealand would exempt a person from being an offshore person.
43. In the case of a non-individual that is a trust, the definition appears to be excessively wide. In order to assess whether a trust is an offshore person, analysis of the residence status of the following persons/entities is required:
 - a. The “governing body” (i.e. the trustees);
 - b. The beneficiaries;

- c. Persons who hold the position to amend or control the amendment of the trust deed;
 - d. Persons who have the right to control the composition of the trust's governing body (i.e. the trustees).
44. In essence, it is a four-fold test which requires obtaining details of the residence status of each person or entity that holds one or more of the position outlined above. In the case of beneficiaries, it may be extremely difficult to obtain details of each beneficiary's citizenship, residency status and movements in and out of New Zealand in the specified periods.
45. It is not clear in the case of a trust whether the details of every person or class of persons named or included as a beneficiary (all being people/entities that have a beneficial interest or entitlement) would be required. The pool of persons or entities that would be required to be identified could be significant. It is quite foreseeable that there are trusts where the trustees and persons who hold the powers referred to above are not offshore persons but 25% or more of the persons who hold a beneficial interest, purely by virtue of the fact they are named in the Deed of Trust as a beneficiary or class of beneficiary, could be offshore persons.
46. By way of example, a husband and wife who are both New Zealand citizens have settled a trust in New Zealand. Both hold the power of appointment and both together with another New Zealand citizen act as trustees. The beneficiaries of the trust comprise of the couple's four children, all of whom are New Zealand citizens. Three of the children live in New Zealand, but one child has lived in the United Kingdom for the past four years and has not returned to New Zealand during that time. Based on the proposed definition of an "off-shore person", if the bright-line test were to apply to the sale of residential property by the trustees, RLWT would be required to be deducted, even though the majority of the named beneficiaries are not off-shore persons and none of the trustees is an off-shore person.
47. In some cases, obtaining details of a beneficiary's off-shore status could be close to impossible, as it would require detailed knowledge of their citizenship and residency status as well as their movements in and out of New Zealand for the past one to three years as the case may be. For trusts with a particularly wide class of beneficiaries, it is submitted that this is a particularly onerous and complex task and has significant room for error.
48. In the case of trusts, it is recommended that the definition be simplified to eliminate the requirement to carry out extensive investigations into each and every person or entity that has a beneficial interest in the trust. It is recommended that the definition of an "off-shore person" be simplified so that it is more in line with the tax rules relating to the taxation of income of trusts by reference to the residence of the settlor (as contained in Part HC Income Tax Act 2007).

When does the withholding obligation arise?

49. It is proposed that the obligation to withhold RLWT arises on the day the contract is settled. The Law Society agrees with the proposal that the obligation for RLWT is triggered at settlement, however for the reasons stated below, it may not always be the case that there are sufficient funds available to make the withholding payment. Therefore, while settlement may be the trigger for the withholding obligation, it may be preferable that the time in which

the payment is required to be made be extended to a specified time period from settlement (for example, within 30 days of settlement).

50. There may be situations where on settlement the entire purchase price (or balance thereof where a deposit has already been paid) is not paid and therefore it is not possible for the withholding agent to meet on the day of settlement both the withholding obligation and the various settlement undertakings. Where the conveyancing agent cannot meet its withholding obligations it is proposed that the withholding agent could be exposed to penalties imposed by the Commissioner for failure to withhold. This could result in the withholding agent being put into a situation where they are either in breach of their obligations to the Commissioner or they are in breach of their professional duties to their client, the purchaser's conveyancing agent and, in some cases the vendor's mortgagee.
51. Assuming settlement triggers a liability to account for RLWT, it is recommended as outlined above, that the payment be made within a specified time period of settlement occurring.

Discharge of other obligations upon settlement

52. The Law Society does not agree that RLWT should take priority over the payments that are required to be made pursuant to the contract. In the case of the repayment of the vendor's mortgage, the vendor's conveyancing agent is required to provide undertakings to the bank that he/she will not release the discharge of mortgage until he/she is in possession of funds required to repay the loan secured by the mortgage and makes payment. If the payment of RLWT would result in there being a shortfall of funds, then the vendor's agent cannot act in breach of his/her undertaking and therefore settlement cannot occur. As settlement cannot occur, there is no requirement to account for RLWT.
53. The requirement to pay RLWT from settlement funds in priority to any other payments required under the contract could result in the vendor being unable to settle and therefore in default. In such cases the purchaser would have rights under contract to pursue the vendor for default. The Law Society recommends that the obligation to withhold RLWT and the priority of RLWT over other settlement obligations be reconsidered.
54. It is recommended that the requirement to account for RLWT is triggered by settlement, however the payment of RLWT should not take priority over payments legally required to be made on settlement, such as prepayment of loans secured against the property and/or other payments required to be made pursuant to the contract such as the payment of rates and body corporate levies.

Dispute resolution and liability for unpaid RLWT

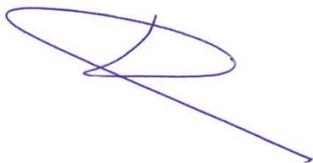
55. There may well be situations where the vendor's conveyancing agent does not withhold and pay RLWT. At least three situations can be envisaged:
 - a. The conveyancing agent acts in good faith but is wrong. This would arise when the vendor supplies the vendor's conveyancing agent with incorrect information concerning, for example, residency.

- b. There is a genuine dispute: for example the conveyancing agent concludes that the land in question is not residential land, and Inland Revenue subsequently disagrees with that conclusion.
 - c. The conveyancing agent, for no good reason, does not withhold and pay RLWT.
56. The Law Society submits that the following consequences should arise in each situation:
- a. Where the conveyancing agent establishes that he or she acted in good faith but was wrong, the liability for the unpaid RLWT rests on the vendor not the conveyancing agent.
 - b. Where there is a genuine dispute, the liability for the unpaid RLWT rests on the conveyancing agent, but either the conveyancing agent or the vendor can commence the Part IVA disputes process by issuing a NOPA within the standard taxpayer two month response period from the receipt of the notification from Inland Revenue of a disputable decision that RLWT was payable. This incentivises the conveyancing agent to make conservative judgments as to whether RLWT applies, but provides a mechanism for the conveyancing agent (who primarily bears the cost of paying RLWT which has not been withheld) and/or the vendor (who would probably be contractually liable to the conveyancing agent and/or have the ultimate tax liability) to pursue a genuine dispute.
 - c. Where the conveyancing agent, for no good reason, does not withhold and pay RLWT, the appropriate sanction is debt collection and civil late payment penalties. An additional sanction for flagrant or repeated non-compliance would be to lodge a complaint to the relevant regulatory body (a standards committee of the New Zealand Law Society or New Zealand Society of Conveyancers, or the Legal Complaints Review Office).

Conclusion

57. This submission was prepared with assistance from the Law Society's Tax Law Committee. If you wish to discuss this further, please do not hesitate to contact the committee's convenor Neil Russ, through the committee secretary Jo Holland (04 463 2967 / jo.holland@lawsociety.org.nz).

Yours sincerely



Mark Wilton
Vice President