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Property Tax and Assessment News from Around the World

NEW ZEALAND – February 2019

Capital Gains Tax: Automated mass valuations could be used to value Kiwi properties

Every Kiwi house and commercial property may need to be valued en masse by a computer programme under a capital gains tax, leading to warnings of a flood of objections from homeowners.

The mass valuation - already termed "V-Day" by pundits - could take place on April 1, 2021, the proposed date when the Government might bring the tax in.

While family homes would be exempt, most people would likely pay a CGT tax rate of 33 per cent on affected investment properties, farms and baches.

The tax would be charged on the gain in price a property sells for compared to its value at April 1, 2021.

With an estimated 1.88 million private dwellings in the country - not counting businesses - valuers CoreLogic have suggested the mass valuations be done by an automated process, similar to how councils value ratepayers' homes.

But Nigel Dean - a former Government valuer now with Colliers - said automated valuations were too inaccurate and he expected a flood of objections from property owners.

He pointed to how he helped a client object to a valuation by Auckland Council in which the council agreed to drop a commercial property's value from their original automated estimate of $5.8 million to $4m.

Dean said the $1.8m price difference showed government valuation models had been "utterly corrupted" over the years because few properties were inspected in person.

"This is no reliable basis upon which to base a tax which the working group says is 33 cents in the dollar ... it's hogwash," he said.

Dean's comments come as property owners across the country anxiously await more details about the tax - including whether the Government plans to introduce it or not.

In addition to concerns about how high the tax rate would be, many homeowners also worry whether the tax will bring in added accountancy and compliance costs.

But, while the Tax Working Group on Thursday recommended bringing the tax in by 2021, Finance Minister Grant Robertson earlier said the Government had not yet made any decisions.

It would instead seek technical advice before making announcements in April about what it would do and how any future measures, such as property valuations, might be implemented.

Matthew Gilligan, managing director of accountancy firm Gilligan, Rowe and Associates, said he thought it was fair to introduce a tax on property.

However, Gilligan — who owns more than 30 properties in Auckland, while his firm represents about 9000 clients — said a capital gains tax would be overly complicated and called for a simpler tax to be introduced.

Investors would not only be hit with costs in complying with the tax but would also "play games" by trying to inflate their 2021 property valuations as much as possible and thus minimise any tax on future rises in value, he said.

This would in turn put pressure on the Government's tax department to spend money policing the tax.

"We were joking before at seminars that a vote for Labour is a vote for Gilligan, Rowe because it is just a tax consultants' dream to bring in a CGT," Gilligan said.

However, CoreLogic head of research Nick Goodall said an automated mass valuation could be done at no cost to individual property owners, with the Government instead paying for the valuations.

When handling objections or wanting a reappraisal, the Government could also employ a similar system to that which banks already use, he said.

This would involve setting up a panel of independent valuers, who were then randomly assigned jobs inspecting the properties of those who objected to their original valuation.

This could maintain the independence of the valuations and prevent investors from cherry picking valuers, who might inflate their property valuations, Goodall said.

Shane Jones labels QV's performance 'grossly unsatisfactory'

Shane Jones is planning to have words with the Quotable Value (QV) board about its shocking expenditure and financial forecast.

He is a shareholding minister in the property valuation company and is taking advice from Treasury after a annual review and auditor-general's report.

The audit found expenditure outside what was deemed "reasonable" under the QV guidelines - notably the purchase of alcohol - as well as hotel accommodation, flights and food that did not have the right documentation.

It also found a number of apparent breaches including paying directors' fees in excess of the approved level by $4098.

Mr Jones said the QV annual review was "grossly unsatisfactory".

"The advice that I'm seeking is what improvements, what communication should be entered into ASAP with the board."

QV is also facing another decline in revenue. It's down $2.37 million on the previous financial year, following a pattern of decline or limited growth since 2011.

"It's a bit of a puzzle where there's been a frenetic level of property activity and the earnings haven't been as flash as perhaps we as shareholder ministers would like," Mr Jones said.

"But I've got every confidence that once we make the necessary improvements it will function as it should. And it is absolutely wrong and inexcusable for that pattern of behaviour to have gone on for so long."

National MP Hamish Walker said the responses he was given by the board members during the annual review were unacceptable.

"It wasn't until further questioning that they admitted there were some breaches that did occur over the past 12 months, and then they went on to suggest that they had a disagreement with the auditor.

"Well the auditor is an independent body that undertakes audits of all sorts of public organisations, and if the auditor disagrees with your organisation that is very serious."

Mr Walker said Mr Jones should have acted quicker to curb the problems at QV before they made it to public hearing.

"The fact that one of his own government MPs at the select committee raised the fact that the annual report was basically useless ... well the minister needs to front this and front it pretty quick."

Terry Baucher says the minority view in the Tax Working Group's final report means we could get an extension of the taxation of capital just to residential property investment

When hearing the lamentations about the purported cost and harshness a capital gains tax ("CGT") will bring, I think of Paul. Dying of cancer he applied to his UK pension scheme for an early payment. Paul died before it arrived, but his widow still got to pay the tax on the transfer.

I am reminded of Judy and Wayne, hard-working specialist nurses living in Auckland, who also transferred their UK National Health Service pensions to New Zealand. They too got a tax bill for their troubles even though it would be five years at the earliest before they could withdraw any cash. Judy and Wayne could not even withdraw funds to pay the $50,000 tax bill. So, in order to meet the bill, a pair of highly skilled nurses in a sector and city with chronic shortages, sold up and moved to the South Island. A real triumph of tax policy.

Nothing the TWG proposes in its final report will be anywhere near as penal as the present rules for taxing foreign superannuation schemes. Or, for that matter, the financial arrangements and foreign investment fund ("FIF") regimes that will also remain in place. Amidst some of the frankly hysterical reaction these important details have been overlooked.

The TWG proposes extending the range of assets that will be specifically taxable on disposal. It's therefore not a CGT in the sense of a specific part of the Income Tax Act covering all capital transactions. Rather it is, to borrow a phrase, a backstop, applicable if the transaction isn't taxed elsewhere.

I do not read too much into the minority report by three of the TWG members. It is unusual but should not be a surprise: tax experts by their very nature are an argumentative bunch at the best of times and are as divided over the issue as the general public. What is interesting about the minority view is that all three, including long-time CGT sceptic Robin Oliver, support taxing disposals of residential property.

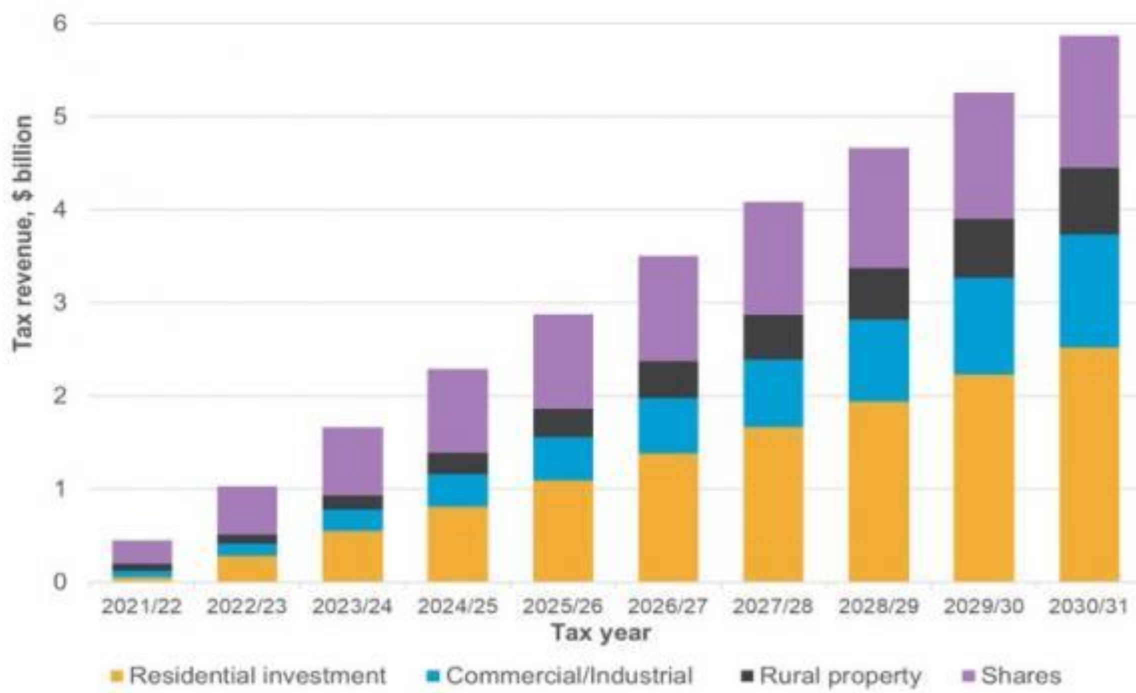
That, together with comments in the report that the Government doesn't have to accept all the TWG's proposals about extending the taxation of capital, opens the door for a partial extension only on residential property investment.

The issue will dominate politics between now and next year's election and the Government will need to decide quickly if the relevant legislation is to be in place before the proposed start date of 1 April 2021. In this context, Inland Revenue's capability to deliver will be tested, which prompted Michael Cullen to remark that it might need support from countries that have CGT regimes to help get the legislation ready. He and the report also stressed the need of ensuring Inland Revenue is properly resourced and keeps its most skilled staff, which according to Cullen isn't happening at the moment.

Although a CGT is the preferred option, the TWG report does consider the use of a deemed return method similar to the fair dividend rate applicable under the FIF regime. Table 5.1 of the report suggests that the deemed return method could immediately raise more tax than adopting the CGT approach depending on the deemed rate of return applied:

($ million)	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30	2030/31
3.5% rate	998	1,015	1,148	1,241	1,343	1,444	1,555	1,665	1,794	1,922
1.7% rate	148	105	188	230	263	304	354	394	443	501

According to the TWG, the projected revenue from a CGT over the first ten years rises from $400 million in the first year to $5.9 billion by 2030/31.



After ten years CGT would represent 1.2% of GDP and a not insignificant 4.2% of total tax revenue.
That raises an interesting point about how a Government might react if a downturn affected tax receipts from CGT. This was a very real problem for California and New York State in particular in the wake of the Global Financial Crisis. The deemed return method's predictability of tax receipts is one reason why it might still be an option.

As noted above the broadening of the taxation of capital income doesn't replace existing rules such as the FIF and financial arrangements regimes. With regard to the FIF rules, the TWG recommends that the FDR method should be retained. It does consider the present 5% rate should be able to be adjusted frequently as economic conditions change. However, the TWG considers the current ability for individuals and trusts to adopt the alternative comparative value (CV) method if it is lower than FDR as;

"anomalous and inconsistent with the idea behind taxing a risk-free return. It also potentially creates a bias in favour of non-Australasian shares because taxpayers are subject to a maximum 5% rate of return but can elect the actual rate of return if it is lower…. If the FDR rate is ultimately lowered from 5%, the Group recommends removing the ability to choose to apply the CV option only in years where shares have returned less than 5%"

Such a move would increase the tax payable by individual investors unless the FDR rate was set at a level which was fiscally neutral. But it highlights the complexity which will still remain if a CGT approach is adopted.

Volume II of the report has the design details of the proposed CGT. Two areas of the design have provoked a fair amount of commentary, the treatment of inflation and the proposed valuation day approach.

At first sight the criticism regarding the proposal to adjust for inflation seems reasonable. But as the interim report noted the tax system doesn't adjust for inflation generally at the moment. Furthermore, as Cullen noted at the briefing the amount taxed under a CGT approach is often lower than that payable under an annual accrual-based approach.

For example, compare the totals taxable between a CGT approach and under the foreign investment fund fair dividend rate method. Assuming $100,000 is invested, which grows at 5% per annum and is sold after four years under CGT, the taxable gain will be $21,551. This is less than the total of $22,628 taxed under the FDR method (generally no income is taxed under FDR in the year of acquisition).

	CGT	FDR
Cost 2022/23	100,000	
2023/24	105,000	5,250
2024/25	110,250	5,513
2025/26	115,763	5,788
2026/27	121,551	6,078
Total Gain	$21,551	$22,628

The TWG proposes that under the CGT approach only gains arising from the date of implementation will be taxed, the so-called "Valuation Day" method which both Canada and South Africa adopted when they introduced their respective CGT regimes.

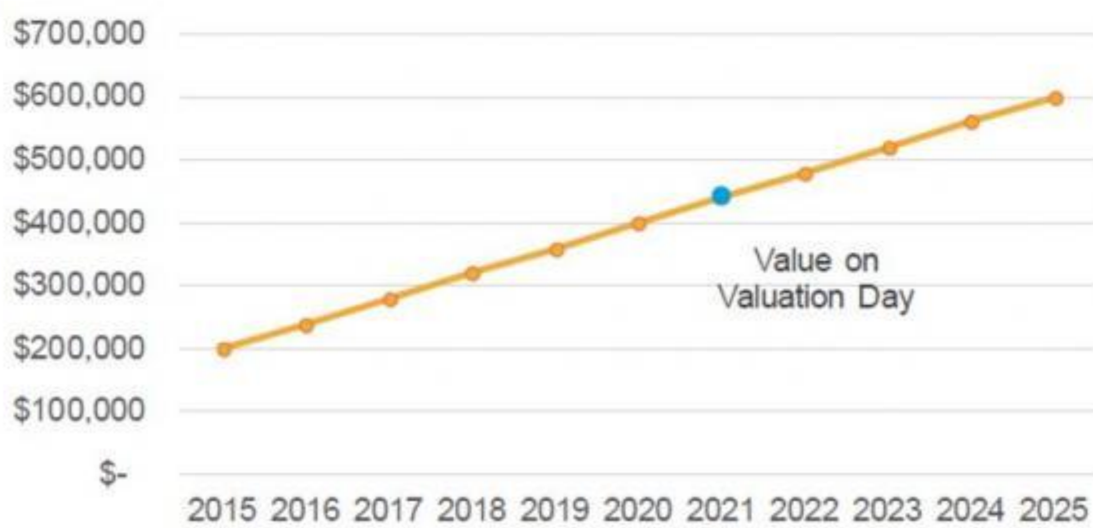
The potential compliance costs involved have been criticised so the TWG proposes taxpayers should have five years from implementation (or to the time of sale if that is earlier) to determine a value. They also suggest a couple of default methods for assets held on Valuation Day. These are either the straight-line basis or the median method, helpfully illustrated below.

John purchased a small trucking business on 1 April 2015 for $200,000. On 31 March 2025, John sells the business to Paul for $600,000 (i.e. a $400,000 gain).

As a result of the extension of the taxation of capital gains, John will have to pay tax on the capital gain he has derived since Valuation Day (1 April 2021) from the sale of the business (i.e. for the last four years he has owned the business).

Applying a straight-line approach, John will have to pay tax on 4/10th of the gain on sale (i.e. $160,000).

Straight-line method



The median rule determines the deductible cost as the median or middle value of actual cost (including improvement costs), the value on Valuation Day, plus improvement costs, and the sale price.

In 2014 Scott bought a rental property for $500,000. On Valuation Day the property was valued at $450,000. Scott sold the property six years after Valuation Day for $850,000.

Applying the median rule:

Cost = $500,000
Valuation Day value = $450,000
Sale price = $850,000

The median value is $500,000. Therefore, Scott is able to deduct $500,000 from the sale price of $850,000, giving rise to a $350,000 taxable gain.

Without the median rule, Scott would have a taxable gain of $400,000 (i.e. sale price of $850,000 - price on Valuation Day of $450,000) despite only making a gain of $350,000 over the whole period he owned the property.

There is, as you'd expect, a wealth of detail in these proposals including some anti-avoidance provisions to prevent "bed and breakfasting" as a means of accessing losses. Some losses will be ring-fenced but in general most capital losses should be able to be offset against other income.

There's plenty more elsewhere to consider in the report such as the proposals for KiwiSaver and the surprising suggestion that the Government "give favourable consideration" to exempting the New Zealand Superannuation Fund from tax. I'll cover these and other snippets separately

Capital gains tax plan for lifestyle property owners could affect tens of thousands

The desirability of living on a lifestyle block has suddenly lost its gloss going by Real Estate Institute NZ calculations on the high number that would be caught by the capital gains tax proposed by the Tax Working Group.

Under the proposal, land larger than 4500sqm would not be subject to the family home capital gains tax exemption.

REINZ chief executive Bindi Norwell said the institute data showed 92 per cent of lifestyle blocks sold in New Zealand last year were bigger than 4500sq m.

The median size of lifestyle properties sold in that time was 20,000sq m. There are 178,778 properties classified as "lifestyle" in New Zealand.

"If this is indicative of a normal year's sales, then going forward a similar portion of the market is likely to have to pay CGT on the portion of their land that is greater than 4500sq m," Norwell said.

The Tax Working Group proposes CGT would apply to profit after the sale of residential property, businesses, shares, all land and buildings except the family home, and intangibles such as intellectual property and goodwill. The tax rate would be set at the income-earner's top tax rate, likely to be 33 per cent for most. It's proposed CGT would apply after April 1, 2021.

The Tax Working Group's proposals have been widely condemned as punitive. National has called them "an attack on the Kiwi way of life" and business groups say the costs would outweigh the benefits.

Working group member and PwC tax partner Geof Nightingale says the true potential picture of a lifestyle property CGT isn't reflected accurately on social media.

He says "you get into very arbitrary territory" when designing a capital gains tax which excludes the family home and having to define what a family home is.

"The working group landed on 4500sq m because that is the current definition of land that goes with a house that presents for GST purposes when for example, a farm is sold.

"The working group also said 4500sq m was just a suggestion [when] you define what amount of land is reasonable for the occupation and enjoyment of the actual house - in some cases it might be less or might be more.

"That is going to be an area of real interest in submissions if the Government takes forward any of this proposal. What is the family home and what land comes with it is going to be the debate."

Nightingale said using the REINZ's median lifestyle block size of 20,000sq m as an example, it would mean the house included on 4500sq m of land would not be subject to a capital gains tax.

"But the 15,500sq m round it would potentially be subject to capital gains tax on any gain that related to that land."

In the hope of showing the "true potential impact rather than the discourse that's emerging on social media that once you're over 4500sq m the whole thing is taxed", Nightingale offered the following example.

"Let's say I bought a lifestyle property out at Helensville 10 years ago for $1 million, and it sits on 10,000sq m - so it's a four-bedroom house on 10,000sq m of land.

"If this [CGT] comes in on the first of April 2021, let's say that lifestyle property is now worth $2.5 million total, which is not unrealistic after this time.

"Along comes the valuer and says the value of the house and 4500sq m of land is actually $2 million and the value of the other 5500sq m of land left is half a million dollars.

"Then the cost base of your capital gains tax for those assets becomes half a million dollars."

"Let's say in 2023 that lifestyle property holder sells the whole block for $3 million. They are then going to have to apportion that $3 million.

"The valuer might say now the house is worth $2.2 million and the 5500sq m of land under capital gains tax is $800,000 proceeds.

"The cost base is established when the asset is transitioned into the regime of half a million dollars so you have a taxable gain now of $300,000 and that is going to be taxed at your marginal rate."

Nightingale said while the property owners were never going to say that was a good idea, the example showed the true potential impact.

REINZ's Norwell suggested it was possible the Government might retract the proposal to tax lifestyle properties on profit at sale or change the parameters once it knew just how many people would be affected.

"And you may find if it [CGT] does come in a number of people will sell their properties ahead of the date. Some properties will have been in families a number of years - it'll be heart-wrenching."

Norwell said a CGT could have what it called "the mansion effect".

"They will invest everything in their own properties and not put it into other assets. They'll have all their eggs in one basket and over-capitalise. In terms of an investment portfolio, that's probably not the best thing."

Average housing values in Auckland are lower than they were 12 months ago says QV, with value growth in other regions slowing

Average residential property values in Auckland were almost 1% lower in January than they were in January last year, according to the latest valuation data from Quotable Value.

It was the second month in a row that average values in Auckland have been lower than they were 12 months earlier.

The latest value declines were evident in most parts of Auckland, with average values being lower January than they were 12 months earlier in all districts except Rodney.

The biggest decline was in coastal suburbs of the North Shore where average values in January were down 3.4% compared to January 2018.

Average values in Rodney, central Auckland and Manukau Central and North West went against the trend and posted slightly higher average values than a year earlier, while average values in the Gulf Islands were unchanged.

QV Auckland property consultant James Steele said the Auckland market was quiet although first home buyers were still active.

"Buyers are benefiting from some bargains although these tend to be properties which do not appeal to the owner-occupier market and are often snapped up by those deal hunting investors left with good equity or borrowing capacity," he said.

"On the supply side, we are seeing significant infill construction which is expected to continue based on the number of building consents currently being issued."

In most other centres average values in January remained ahead of where they were a year earlier, although the rate at which values were rising had eased back in many places.

"Main centres such as Dunedin and Wellington are seeing a slight drop in the rate of quarterly value growth compared to previous months," QV said in its report for January.

"Wellington City, in particular, has typically seen higher growth of between 1.9% and 3.9% over the the previous five months, however this figure dropped to 1.0% in January."

The highest rates of average value growth over the 12 months to January tended to be in smaller towns and rural districts, with Wairoa, north of Napier, having the country's highest average annual growth rate of 32.8% followed by Kawerau with 30.7%.

Business debate: Should NZ introduce a capital gains tax?

Ahead of next Wednesday's Tax Working Group report release, the chief economist of one of our biggest banks and New Zealand's landlord chief go head to head over capital gains tax.

The gulf is wide in this business debate, with the economist saying the tax would improve housing affordability but the landlord boss saying it will make no difference.

FOR: Dominick Stephens, chief economist, Westpac

A capital gains tax would improve housing affordability, would lead to a higher rate of home ownership, would help remove the heavy skew we have towards land-based investments, and would eventually lead to a more diverse national balance sheet. It would also improve incentives to engage in paid work if income tax was reduced.

Property is more lightly taxed in New Zealand than other forms of investment. Treasury and the Inland Revenue estimate that property investors pay 29.4 per cent of their after-inflation returns in tax, whereas bank depositors and owners of dividend-paying shares pay 55.7 per cent.

Income from investment in taxed whereas capital gains are tax-free. Bank deposits yield only income and are therefore taxed heavily. By contrast, property investments return little in the way of taxable net income and more in the way of capital gain, which is tax-free.

This has made property investment incredibly popular and that popularity has been one factor pushing house prices higher.

Another quirk of New Zealand's tax system is that property investors enjoy more favourable tax treatment than heavily indebted owner-occupiers. Property investors enjoy tax deductions for mortgage interest and property maintenance whereas owner-occupiers do not.

If the tax system has affected the price of property and the rate of home ownership in New Zealand, it stands to reason that further changes to the tax system could once again alter both.

The Tax Working Group is considering the possibility of a capital gains tax that would exempt the family home but would apply to other properties including rentals.

A property tax would be calculated as a percentage of the value of the property including the land and the house - equivalent to the 'capital value used to determine rates in much of New Zealand.

AGAINST: Andrew King, executive officer, NZ Property Investors Federation

Property, or any asset, should not be subject to capital gains tax. Property is perceived to be more lightly taxed in New Zealand compared to other assets, but actually, rental property is taxed more heavily than other assets with a higher marginal effective tax rate because of local government rates.

Rental property is also seen to have tax advantages over home buyers and this has led to a reduction in the rate of home ownership since the early 1990s. However, the removal of Government assistance for first home buyers in the early 90's is the more likely reason for falling homeownership rates.

The perception that rental property is tax-advantaged has led the Government to consider changing the law so that rental property owners cannot offset rental property losses on other income they may earn. However, claiming expenses against taxable income is a tax law that exists for all investments and businesses. Rental property pays tax on gross income less expenses just like every other business or investment. Occupier/owners do not have an income stream from which to deduct their expenses. When buying a home they receive the benefit of accommodation instead.

The two situations are completely different. Just because a rental provider can claim expenses from their rental income, this does not make buying a property easier for them compared to an occupier/owner.

IRD data shows that the rental property industry pays tax on approximately $1.5b of net rental income each year. A capital gains tax will increase rental prices, but it will not lower house prices.

Pot and property tax pose double dilemma for PM

What do the cannabis and tax policy debates have in common?

Well, some might say you need a puff of the former to make the later bearable.

To be fair, I also know economists who only get excited about cannabis law reform when there's tax is involved.

Regardless, both issues look set to dominate the political landscape for the next 18 months.

Both, in my view, look like good ideas in theory.

But both get more difficult when you actually sit down to implement a workable and politically viable policy.

For starters, both issues will have to be framed to clear a Winston Peters-shaped hurdle.

Being difficult isn't a reason for Governments not to do things - unless it gets them kicked out of power so they're unable to do anything at all.

So the giant headache both issues create for Prime Minister Jacinda Ardern tops my list of similarities.

The National Party is champing at the bit to campaign on a very unsubtle attack line - a vote for Labour is a vote for more tax and more weed.

That's unfair. The cannabis referendum is a Green Party initiative that Labour doesn't have to take a definitive stance on.

Then there's the science that suggests reforming drug laws and regulating the use of marijuana actually minimises harm.

But that hasn't stopped the Nats appointing Paula Bennett as their drugs Czar.

Expect to see her using her considerable stash of "middle-New Zealand charisma" to present the friendly face of the anti-reform argument.

The binding nature of the referendum allows her to put the onus for any change on the whole Government – not just the Greens.

This presents a big opportunity for National to go after Labour by default.

On that basis I'd expect to see the PM back away from the debate.

The Greens are geared up for the fight. If decriminalisation comes to pass, it will have to do so without Ardern as a cheerleader.

I'll leave the marijuana debate there too, although the economic angles on it are fascinating.

Tax policy is more pressing because Sir Michael Cullen's Tax Working Group has delivered its verdict.

Due to be made public on February 21, it is expected to recommend a comprehensive capital gains tax.

And National is on the front foot here too.

Leader Simon Bridges this week unleashed a tax policy that addresses the unsexy issue of inflation adjusted bracket creep.

It could put $430 a year back in the pockets of middle-income earners, he says (in much sexier language).

As Finance Minister Grant Robertson was quick to point out, the plan was short on detail about where they'd find the money to cover costs, without cutting spending.

But essentially the rough policy draft gives Bridges a strong campaign line (we're giving money back) to contrast with the a new and controversial capital gains tax (CGT).

In reality the Working Group's proposal is required to be revenue neutral – so it's not a tax grab.

It may even mean lower taxes for many lower- and middle-income workers.

But a CGT would fundamentally alter the balance of the tax burden away from workers and towards those holding investment assets - many of whom are older Labour voters.

A CGT is something many economists and tax experts favour for reasons of fairness and to encouraging investment in more productive asset classes than property.

But the Nats will be counting on the nuances of tax policy being lost on the bulk of voters.

The Labour leadership team has fought and lost elections running with a CGT policy.

I'm sure they believe deeply in the economic and social value of this reform but they now face a stark and difficult choice between pragmatism and idealism.

It would be the biggest reform of New Zealand's tax system in generations and dramatically raise the stakes for the next election.

It's a reform which could ensure this Government's place in the economic history books.

The easier option would be to walk away from it, to make the case for more incremental changes to the existing system - but I don't think that why the likes of Robertson and Ardern got into politics.

Their other option is to take some time, soften the edges and then hope they've still got the political capital to sell a bigger vision next year.

The proposal is expected to have the CGT set at the marginal tax rate with few if any concessions or exemptions.

That would make it one of the toughest regimes in the Western world - which might actually be strategically useful.

Ardern has time to soak up the initial burst of outrage from opponents then spend some time softening the proposal.

The final policy could be presented as much cooler, calmer and more reasonable - relatively speaking.

Counter to this is the risk that watering down a CGT still leaves you with the political downside but with a more complicated system to implement and less revenue for a pay-off.

There are no easy choices.

The last Government proved that a mix of charisma and cautious incremental change can be a very successful formula.

But selling truly transformative policies is much tougher. It requires deep strategic thinking and impeccable execution.

It leaves little room for error.