IPTI Xtracts

Property Tax and Assessment News from Around the World

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Economics professor suggests new tax could discourage property speculation

A type of tax called the risk free rate method (RFRM) is being suggested by University of Auckland Associate Professor of Economics Susan St John as a way to discourage housing speculation.

Under the system, a person's net equity in rental housing – aggregate holdings of all housing minus registered first mortgages – would be treated for tax purposes as if it had been invested at a bank generating a taxable income.

Landlords whose properties were vacant, or who were deducting huge costs against their rentals, would not be able to return tax losses and would be taxed fully on their net equity imputed income, St John said. An RFRM was "perhaps the only way forward".

"A housing elephant is rampaging across New Zealand society creating intergenerational havoc, making already well-off people enormously wealthy and leaving a growing number of families desperately poor, ill-housed, over-mortgaged and increasingly homeless," St John said in an article published in Newsroom.

"Rental housing is increasingly traded as a speculative commodity at the expense of secure housing for all as a fundamental human right."

St John, who is director of the university's Retirement Policy and Research Centre, referred to research by Dr Michael Rehm and doctoral student Yang Yang, from the university's School of Business and Economics.

They looked at rental property purchases in the Auckland region from 2002-2016 and found that nearly every rental property bought in that time had some degree of speculation. The “vast majority” were negatively geared and operating at a loss.

“Housing speculation in Auckland is endemic and its housing market is a politically condoned, finance-fuelled casino with investors broadly betting on tax-free capital gains,” the authors said in a paper published in the International Journal of Housing Markets and Analysis.

They said that despite political leaders voicing their concern at Auckland’s speculation-driven housing bubble, the Government’s main anti-speculation tool was not being used.

That tool was the intention test in the Income Tax Act, which deals with the acquisition of land for the purpose of making profit through resale. Provisions of the test would tax profits made by property speculators at their personal tax rate.

By holstering that key policy tool, politicians fostered housing speculation, the paper said.

St John said the researchers found the vast majority of landlords consistently made losses on their investment properties, which indicated their intention was to make tax-free capital gains. “They are not serious landlords and their houses often poorly-tenanted or empty,” she said.

St John pointed to problems with some of the methods that have been suggested to try to solve the housing crisis, such as a capital gains tax, the bright line test and stamp duty. She said changing loan-to-value ratios for bank lending on investment properties was “only tinkering”.

In any case, she pointed out, the Government had taken a capital gains tax off the table, along with any chance of a comprehensive net wealth tax or land tax.

To prevent an RFRM tax affecting ordinary home ownership, each person could have a net equity exemption of, say, $1 million in the family home, St John said.

She noted an RFRM tax was discussed in a report by a minority of members of the Tax Working Group.

A paper was prepared for the working group on RFRM, which it called the risk free return method of taxation.

It gave an example of how the method would work using a fictitious rental property owner called Sam, who had a 33 per cent marginal tax rate, and $400,000 equity in a rental property, while the risk-free rate of return was put at 3.5 per cent.

Sam’s RFRM tax was worked out by multiplying 400,000 x 3.5 per cent x 33 per cent, which put the tax owed by Sam at $4620.

New Rating Valuations For Marlborough District

Marlborough District property owners will soon receive a 2020 Notice of Rating Valuation in the post with an updated rating value for their property.

The new rating valuations have been prepared for 27,118 properties on behalf of the Marlborough District Council by Quotable Value (QV). They show the total rateable value for the district is now $23,563,000,000 with the land value of those properties now valued at $11,840,000,000.

Rating valuations are usually carried out on all New Zealand properties every three years to help local councils set rates for the following three-year period. They reflect the likely selling price of a property at the effective revaluation date, which was 15 August 2020, and do not include chattels.

On average, the value of residential housing has increased 22.6% since 2017 with the average house value now sitting at $559,000, while the corresponding average land value increased by 36.6% to an average of $262,000.

QV valuer Richard Kolff commented: “The demand for residential housing was buoyant across the region, with most townships in the district seeing increases of between 15-25% overall. Demand for sections has also been strong and as a result of limited supply land values have increased 37% for the district overall.”

“The district has a healthy local economy that is well supported by wine production, agriculture and forestry industries. This has flowed through to the housing market, and combined with very low interest rates and high demand, the market has continued to thrive. Lower value properties have seen the most competition from buyers and has seen the greatest value increases.”

Meanwhile, commercial property values have increased by 5.7%, and property values in the industrial sector have increased by 14.7% since the district’s last rating valuation in 2017. Commercial and industrial land values have also increased by 13.7% and 23.7% respectively.

“Retail and office properties have seen lower increases in value than the residential property market,” said Mr Kolff. “While locals and domestic tourists have been very good at supporting businesses, this has been offset to some degree by online competition for retailers and the start of a post lockdown trend for more people to work from home, resulting in less demand for office space.”

Residential housing value changes since 2017 revaluation levels.

Since 2017, the average capital value of an improved lifestyle property has increased by 16.7% to $864,000, while the corresponding land value for a lifestyle property increased by 18.5% to $399,000.

“Lifestyle properties typically align in value with high-end residential properties and this segment of the market has seen a more modest increase in values than the residential market overall,” Mr Kolff added.

He said the rural market remained strong for vacant land with viticulture development potential and much of this was occurring in Awatere and Wairau Valleys. Values for vineyard properties on the Wairau Plans have been fairly static.

It is helpful to remember the effective rating revaluation date of 15 August 2020 has passed and any changes in the market since then will not be included in the new rating valuations.

This means in many cases a sale price achieved in the market today may be different to the new rating valuation set as at 15 August 2020 and that rating valuations are not designed to be used as market valuations for raising finance with banks or as insurance valuations.

The updated rating valuations are independently audited by the Office of the Valuer General and need to meet rigorous quality standards before the new rating valuations are certified.

New rating values will be posted to property owners after 11 December 2020. If owners do not agree with their rating valuation, they have a right to object through the objection process before 5 February 2021.

For further information, homeowners can go to the Marlborough District Council website at: https://www.marlborough.govt.nz/services/rates/rateable-valuations

The updated website content includes a new Revaluation Smart Map and a rates comparison model, allowing comparison between 2017 and 2020 values.

89 per cent of property experts want land tax not stamp duty

This month's Finder RBA Cash Rate Survey shows an overwhelming preference for an annual land tax rather than "the one-off financial sledgehammer of stamp duty" on property purchases.

Earlier this month, the NSW Government proposed a "once in a generation change of giving home buyers the choice to pay either stamp duty or a new smaller annual property tax".

Eighty-nine per cent of experts who weighed in on this particular issue (24 of 27) were in favour of scrapping stamp duty nationally and replacing it with the annual land tax proposed by the NSW Government.

"Buying a home in Australia is already an expensive affair and stamp duty makes it more so," Finder insights manager, Graham Cooke said.

"It effectively raises the bottom rung of the housing ladder, burdens buyers with a huge up-front tax and inhibits the flow of property sales.

"In an ideal market, you buy when you can afford to and you sell when you want to. Stamp duty forces first-time buyers to save up for longer, and prevents current owners from upselling.

"Axing the tax now also means buyers who are currently saving can get more bang for their buck," Mr Cooke said.

In Finder's June survey, two-thirds of respondents predicted the end of stamp duty by 2021.

Wellington Regional Council mulls 13% rates rise; climate change, transport culprits

Greater Wellington Regional Council says the expectation for action against climate change and other cost pressures will likely lead to a rates increase of more than 13 per cent next year.

It comes as Wellington City Council is working out how to reduce a forecast 23 per cent rates hike.

Both councils completely overhauled their current budgets to keep increases down in the height of Covid-19.

Greater Wellington Regional Council chairman Daran Ponter said no council wanted to be increasing rates.

"Most councils across the country significantly shaved their rates last year, but we can't continue to do that because that will affect the services we provide."

The regional council only pushed up rates by 3 per cent due to Covid-19 and the forecast rates hike next year is partly to compensate for that.

In comparison, rates were increased by 5.9 per cent in 2019.

Next year's increase also takes into consideration the council's purchase of almost 100 electric buses, as well as accommodating new rest and meal break legislation for drivers.

The council is also gearing up for changes to the Resource Management Act and work on water quality.

Ponter said he was keenly aware of big expectations from the community for action against climate change and the role the council plays as a front-line agency in sustainable environmental management and responding to the climate emergency.

But the issue that has the biggest potential to affect rates increases is the most difficult to predict.

The regional council looks after public transport, which has been heavily impacted by Covid-19.

Revenue has taken a hit because of lower patronage. To date, NZTA has picked up the tab and funded the shortfall.

But the regional council is unsure how long this commitment will last for and is making no assumptions.

Current patronage across the network is at about 83 per cent of normal. It's hoped this will continue to track upwards to more like 90 per cent next year.

Even then, the council would still be up to $10 million short of revenue each year.

Ponter said the general rule of thumb was that every $1 million translated to about a 1 per cent increase on rates.

"Either rates would have to go up or the fares, but I'm loath to put the fares up at a time when we're trying to encourage people to get out of cars."

Ponter said decreasing service levels was also a downward spiral for mode shift.

The rates increase has nothing to do with deferred maintenance like what other councils were facing with their water infrastructure, Ponter said.

"There are also no one-off big-budget type things driving this, it's not like we've suddenly decided to build a convention centre."

Ponter confirmed the council was looking at a likely average rates increase of more than 13 per cent for 2021/22.

Public consultation on the 2021-31 Long-Term Plan is expected in March next year.

Revealed: Who pays the highest rates in New Zealand?

Residents in Carterton are paying the highest rates in the country, a new report by the New Zealand Taxpayers' Union and Auckland Ratepayers Alliance has found.

The Ratepayers' Report ranked councils on a series of metrics including residential rates, staffing costs and council liabilities.

It is the fifth report of its kind by the Taxpayers' Union and covers rates in the 2018/19 financial year.

The report found average residential rates in Carterton were the highest at more than $3400, while rates in Central Otago were the lowest at just under $1500.

Taxpayers' Union campaigns manager Louis Houlbrooke said average residential rates were continuing to rise right throughout New Zealand.

"We found that once again, the average rates in New Zealand have gone up by $84."

But the most extraordinary thing, according to Houlbrooke, was the variability between what councils charged.

At the top of the table was Carterton District Council, followed by Auckland Council, Tasman, Western Bay of Plenty and South Wairarapa.

The average residential rates for all of those were above $3000.

Carterton Mayor Greg Lang defended the higher rates saying they reflected investment into infrastructure.

"At the same time we listen to our community, and we ask them all the time what levels of service they would like produced and we get a good steer of the levels that we have," he said.

"They say 'we want a free swimming pool, a free library service' and these are things we provide."

The five lowest were the Central Otago District Council, Grey District Council, Mackenzie District Council, Southland District Council and Otorohanga District Council.

All charged less than $2000.

Central Otago District Council Mayor Tim Cadogan said while lower rates looked good on paper, it could hide failings within council.

He said water meters in the region had made a huge difference to the cost of infrastructure which was one reason rates had been kept low.

A plan to draw down emergency funds to cover anticipated financial hits by Covid-19 had also helped.

But on the other hand, Cadogan admitted the council had been underpaying staff.

"Heading into the long term plan for next year, one of the things that we've identified is that we're actually underpaying staff and that's starting to really show in losing people," he said.

"So it can hide problems rather than be something to celebrate, but at this stage, if that's what the Taxpayers' Union say, well I think a lot of people in this district would be counting that as a win."

A century of capital gains tax avoidance

Sir Michael Cullen forecast in 2018 that it might then be "now or never" for a capital gains tax.

The debate over taxing capital gains in New Zealand started a century ago, and we've been avoiding levying them ever since.

There are signs Inland Revenue (IR) might be getting more aggressive in enforcing these ad hoc rules as the Government responds to rising anger over the country's housing crisis.

Our historic reluctance to explicitly tax capital gains means an odd assortment of arcane rules are now doing the heavy lifting when it comes to taxing the income raised from the buying and selling of property.

And now, advances in IR's computer systems are making it more difficult than ever for these transactions to go unnoticed.

We have a lot of taxes on property. They're just confusing, hard to enforce and came through successive governments who were either unable or unwilling to tax capital gains.

Instead of a broad-based capital gains tax there are several decades-old tax provisions on the books which make you liable to pay income taxes on capital gains under specific circumstances.

They include measures to tax income gained from land if you buy it with the purpose of putting buildings up. Or if you're associated with a property business and sell a piece of land within 10 years of purchase, offload property which becomes more valuable through a zoning change, or subdivide land within a decade of snapping it up.

Almost all of these rules have exceptions built in for owner-occupiers who aren't in the business of buying and selling property. In practice these distinctions aren't so clear-cut as they sound on paper.

The taxes are so complicated many of the accountants and lawyers who deal with them are in favour of a capital gains tax just to simplify things.

Jeff Owens, of Owens Tax Advisors, says IR has always enforced these measures. Something which has sometimes taken buyers and sellers of properties by surprise.

"A lot of lay people have this idea that IR taxes you if you buy a property with the intention of resale.

“Of those nine or 10 different taxing provisions [on land sales] only one of them refers to intention of acquisition.

“Intention is not mentioned in any of the other provisions.”

And there are signs IR's enforcement of these little known provisions might have ramped up and broadened out.

Tax consultant Terry Baucher has often argued a low-yield rental property (where rent earned only covers a small portion of the property’s purchase price) is a signal a buyer is banking on a capital gain from selling the property. Meaning the gains from sale should be taxed.

Recently an IR officer waved this interpretation of the provision in his face for the first time.

“Which is interesting. Someone’s been thinking about it.”

Add this to the news IR is sending out letters reminding tax agents to enforce the bright-line test and you could be forgiven for thinking the newly re-elected Government is putting added pressure on it to enforce these arcane laws as a substitute for a capital gains tax.

Revenue Minister David Parker flatly denies any suggestion he’s doing this. A spokesman says: “The minister has not put pressure on, but he is completely supportive of IR’s efforts because he is not in favour of tax avoidance.”

Parker argues IR got there itself through improvements in the department's computer systems.

Owens explains these improvements allow it to better match property sales with other pieces of data to figure out which transactions might meet the threshold for paying tax under these rules.

It’s up to the taxpayer to prove they don’t owe the tax after the IR highlights these transactions.

“IR clearly has the systems and resources to identify these types of transactions. We have assisted dozens of taxpayers whose land transactions have been flagged as taxable," Owens says.

"If IR asserts a transaction is taxable they may or may not be correct, but it is the taxpayer that must prove otherwise.”

First, there was a capital gains tax – by mistake

Originally income tax legislation passed late in the 19th century didn’t distinguish between money earned through capital gains or wages. Both were theoretically taxable.

However, a paper published in the Auckland University Law Review by Melinda Jacomb in 2014 argues this brief introduction of a capital gains tax to our shores was probably a drafting mistake by legislators.

An error which was rectified within a decade. By 1900 the Income Tax Act explicitly put capital gains out of reach of the tax man.

And it stayed there. While most industrialised nations passed a capital gains tax of some sort between 1911 and 1965, we bucked the trend.

New Zealand first properly considered passing one in 1967, two years after Britain passed theirs.

The New Zealand Taxation Review Committee said at the time: "If it is accepted that any system of taxation should embody the principle of treating equally those who have equal capacity to pay then it is difficult to justify the exemption of capital gains from all forms of taxation while income from effort is taxed in full."

Eventually the capital gains made from property speculation got so great the government decided to go for a more targeted set of taxes on people who bought and sold property by amending the Land and Income Tax Act.

A property speculation tax was also introduced on top of these changes as house prices rose 60 per cent between 1971 and 1974.

The tax rates attached to the speculation tax were higher than anything we've considered in recent history.

Ninety per cent of capital gains would be taxed if property was bought and sold within six months. A number which went down to 60 per cent if the property was held for closer to two years.

Coincidentally, after this legislation was passed our country experienced perhaps its last true housing market crash with house prices stationary as inflation soared.

The oil crash coupled with greater housing density had driven real house prices down by 40 per cent in six years.

Navigating your way around the rules

Six years after those taxes on property speculators were brought in Sir Robert Muldoon's government repealed them.

However, changes to the Land and Income Tax Act stayed on the books and were carried over into the Income Tax Act in 2007.

Owens says these cover quite a few property transactions although they still largely leave owner-occupied properties and rentals untaxed.

They largely target people who can be proven to be in the business of buying and selling property or associated with them in some way. Each rule has its own set of exemptions too.

For example, if you're a builder and buy a rental property then invest in improving it the sale is taxable if the land is sold within 10 years of completing those improvements (even if the house was not part of your business).

Others don't require any association with construction or property-investment related businesses.

The sale of land which is likely to be rezoned can be taxable if it's sold within 10 years of you having bought it even if the owner isn't associated with a property business.

KPMG tax partner Paul McPadden says the rules and their exemptions are so complicated many people are able to navigate their way around them with a bit of planning.

"If they set up the right structures or undertake slight variances in their activities they are sometimes able to take advantage of exemptions or the boundaries of where the law does or doesn't apply."

Changing the rules

These rules are also poorly understood by the public, which makes tweaking them more appealing than embracing a full-blown capital gains tax.

National's bright-line test was a way of hoovering up capital gains not covered by these rules. It made property sold within two years (changed to five years under Labour) automatically liable for income tax unless the family home was involved.

The definition of "associated persons" (which is a feature of these rules) was also widened during a National government in 2009.

Baucher says this change massively expanded the rules to tax a much larger set of people and entities associated with builders and the property industry.

"Basically everything's associated even if you don't think it's associated. So even if you try to make them not associated the rules are so broad that it could only be tax avoidance if you did."

The complex and often inconsistent web of rules is why tax experts conclude things would be a lot cleaner with a simple capital gains tax and it could raise a lot more revenue as well.

Yet politicians are very reluctant to even mention such a tax.

Prime Minister Jacinda Ardern has ruled out the possibility of her ever introducing one citing the extreme unpopularity of the idea and Labour's past history of failed elections campaigning for it.

And as Parker applauds IR for enforcing the bright-line test he is at pains to point out the rule being enforced is "not a capital gains tax".

Baucher says while there's something in our psyche which seems to be resistant to the idea of a capital gains tax, there's probably quite a bit of self-interest in this resistance too.

"One of the great lies that was perpetrated last year in the debate about a capital gains tax was 'it's complicated'," Baucher says.

"As you can tell by what we've just talked about a capital gains tax is really simple by comparison."

Housing Frenzy in New Zealand Exposes Perils of Ultra-Low Rates

A housing frenzy at the bottom of the world is laying bare the perils of ultra-low interest rates.

At a packed auction room in Wellington, New Zealand's capital city, houses are selling for hundreds of thousands of dollars above their government valuations. A young couple hoping to buy their first home -- a basic three-bedroom dwelling built in the 1950s -- are forced to bow out as the bidding approaches NZ$1.2 million ($850,000).

"The housing market at the moment is quite ferocious," says auctioneer Darryl Harper. "Interest rates historically have never been lower, so it's easy for buyers to borrow money."

The red-hot market is causing such concern that Prime Minister Jacinda Ardern's government has taken the unusual step of asking the central bank to do something about it, saying surging prices are "harmful to our aims of reduced inequality and poverty." It's a dynamic that's starting to play out in other countries too, as the record-low rates deployed to battle the coronavirus pandemic drive a rush into bricks and mortar.

New Zealand house prices jumped 9.2% in November from a year earlier to an average of NZ$769,000. In Wellington, a compact harbor city with a shortage of homes for its growing population, prices climbed 5.8% in the past three months alone for an annual gain of 13.5%.

Harper, of local realtor Harcourts, said the prices he's achieving at auction are on average 41% above the government valuations used to levy local council taxes.

The house that Harriette McClelland, 27, and partner Harry Greenwood were bidding for at the Nov. 27 auction -- a modest timber-clad residence in an inner-city suburb -- sold for 66% more than its registered value and about 11 times the median household income.

"All of the houses went for a lot more than we expected," said McClelland. "I think in Wellington it's being driven by the lack of supply and high demand, but obviously low interest rates have really escalated things a lot."

New Zealand's relative success in beating the coronavirus -- it topped Bloomberg's Covid Resilience Ranking -- has boosted its attractiveness as a place to live and given it a head-start on its economic recovery. But with the border still closed to international tourists and students, the Reserve Bank is concerned about rising job losses and the risk of deflation.

It has cut its official cash rate to 0.25% and embarked on quantitative easing to drive down borrowing costs. It wants to get them lower still, and will this month start offering cheap loans to banks to stimulate lending.

That monetary easing has pushed one-year fixed mortgage rates down to 2.5% from more than 4.5% three years ago. Mortgage lending has soared as a result. It jumped the most on record in October to NZ$293 billion, up 7.3% from a year earlier.

Now the overheating property market has become a political issue.

Finance Minister Grant Robertson wrote to Governor Adrian Orr last week, proposing that the central bank start to take house prices into account when it sets monetary policy. That prompted investors and economists to scale back expectations for further RBNZ rate cuts, even though Orr insisted the bank's primary objectives will not change.

"This is a really, really hot housing market," said Dominick Stephens, chief New Zealand economist at Westpac in Auckland. "It's reached prime minister level and there's a lot of political concern. But central banks cannot cheat nature. They must deliver the interest rate that the economy requires to balance inflation and employment over time."

Orr has called on the government to look at tax policy to address the issue.

Ardern has ruled out the introduction of capital gains or wealth taxes, but the government could extend the period in which profits on the sale of investment property are taxable. It could also make changes to tax deductibility of rental property expenses to make them a less attractive investment vehicle.

In the meantime, New Zealand house prices are expected to continue to rise.

Licence to grow gold added to land value

Adjustment means councils will have to reassess methods.

Authorities have decided a $400,000 per hectare licence to grow gold kiwifruit adds value to the land.

Gisborne is the first region to adjust land valuation methods for gold kiwifruit properties to now include the value of the growing licence on the rateable value of the property.

This follows a meeting between the Valuer-General and valuers in August, in which they decided the licence should be included in the Value of Improvements, which requires the "assessment of the value of all work done on or for the benefit of the land".

All councils with gold kiwifruit would have to reassess their methods.

Some Gisborne kiwifruit growers raised initial concerns about what the change would mean for rates, and whether the licence should be included in land value, but no one would comment until there was better understanding of the implications. The New Zealand Kiwifruit Growers were also approached for comment.

A revaluation of Gisborne's horticulture industry was undertaken as part of a three-year district-wide revaluation for rating purposes, with the adjustment to gold kiwifruit valuations adding $200 million alone.

Gisborne District Council revenue team leader Fiona Scragg said a rates remission was in place for horticulture which took into account the licence, infrastructure and value of the crop, and excludes it from the general and targeted road rate.

The other targeted rates are set on a mixture of land value, capital value and other factors, so the increased value wouldn't impact "all" the remaining targeted rates, Ms Scragg said. If the capital value of a kiwifruit property increased less or more than average for that sector, or if the council's finance policies, or budgets changed, then kiwifruit growers' rates would be affected, she said.

According to the valuation, Gisborne's horticulture industry climbed from $820 million in 2017, to close to $1.5 billion in September 2020.

While new orchards had crept across the region, with more than 100 hectares of new kiwifruit blocks, land value had increased by 54 percent.

Gisborne's 8000 hectares of horticulture land was valued at $893m in September 2020, up from $578m in 2017.

Gisborne's horticultural industry — of which about a third is kiwifruit by value — has seen a 79.5 percent increase in capital value over the past three years. The industry also includes apples, grapes, citrus and vegetables.

Lewis Wright managing valuer Ben Inder, who led Gisborne District Council's three-year revaluation, said a big factor for the rise in land values was properties in a prime location, with “superior soil type” and water availability.

“Basically, Gisborne flats are world-class and very sought after by investors locally and nationally for new kiwifruit developments,” he said.

Valuer-General Neill Sullivan said the issue of how to assess gold kiwifruit properties came up earlier in the year, as part of regular discussions with rating valuers.

There was a view that the rating valuation methodology for gold kiwifruit properties may not have been meeting requirements, because the licence to grow the G3 kiwifruit variety was not being assessed as part of the value of improvements, Mr Sullivan said.

He met with rating valutions providers in August 2020 to discuss the definition of Value of Improvements.

“The valuers reached a view that the rating valuation had to include the licence,” Mr Sullivan said.

He accepted this view based on the legislative definition of Value of Improvements.

“Growers must have a licence to farm G3 vines. Without it, the vines would need to be removed,” he said.

“Together the licence and the planted vines generate added value, which is recognised in market transactions.”

The change would mean an increase in the capital value and Value of Improvements rating value for gold kiwifruit properties.

These values would then be used for rating purposes, subject to various councils' rating policies, Mr Sullivan said.

Revaluation information had been sent to the Valuer-General for auditing, and sign off was expected on December 4.

• The public would be notified of revaluation changes on December 9, and owners had until January 29 to put in an objection if they disagree with the new values.