

20 December 2006

Tax change boost for NZ property sector

On 12 December (earlier than expected), the Government passed the Taxation (Annual Rate, Savings Investment, and Miscellaneous Provisions) Bill, included in which were provisions to change the taxation of investment income for collective investment vehicles in New Zealand.

The legislation is part of the government programme to remove taxation distortions between direct investment and portfolio investment, and to prepare the ground for the introduction of KiwiSaver.

The changes have a material impact on net/post-tax distributions to unit/shareholders in listed property vehicles (LPVs).

Key changes

- > Domestic investors will now benefit from 'tax shields' within LPVs, e.g. depreciation, resulting in an effective tax rate to the unitholder equal to the effective tax rate of the LPV. (Under the current taxation regime, investors in property vehicles do not benefit from tax shields; the unit/shareholder is fully taxed at his marginal tax rate on the property vehicles' distributions).
- > Investors' tax liability will be capped at 33%, benefiting investors at the top 39% tax rate.

The proposed changes effectively remove the tax distortion that previously existed between direct investment in property (which can fully access tax shields) and investment through collective investment vehicles (which currently cannot).

The proposed changes also tilt the ground in favour of Portfolio Investment Entities (PIEs), as the tax rate is capped at 33%, further reducing the tax liability for individuals in the top tax rate (those earning \$60k+ pa). Non-resident investors are likely to be in a neutral or marginally better-off position.

Additional detail

- > The new regime will result in most investors (other than non-taxpayers) being taxed at their marginal tax rate on the taxable income derived by the LPV as opposed to the gross income. Effectively, the benefit of tax allowances, such as depreciation, will pass through to investors (and conversely, the cost of depreciation clawback on the sale of assets will fall to investors, as is currently the case). Any capital gains derived by the LPV that are distributed will pass through to investors with no further tax liability.
- > This compares with the current regime whereby investors are taxed on all distributed income. In essence, this means that investing in listed property will see this investment treated as though the individual directly owns the buildings, with the vehicles merely being the intermediary that allows for this.
- > LPVs can elect to participate in the new regime from 1 October 2007, and most believe they will qualify as PIEs from this date.
- > There is no impact on non-taxpayers (e.g. charities); there is minimal impact on offshore investors; and there are varying levels of impact on onshore investors, with investors on a 39% marginal tax rate receiving greater benefit than those investors on a 19.5% marginal tax rate. However, investors on a 19.5% tax rate are still able to utilise surplus imputation credits against their other income.
- > The new tax treatment of LPVs will bring New Zealand in alignment with international peers, including Australia, UK, USA, Japan, Hong Kong, and Singapore.

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