Tax Issues for Real Estate Agents

Introduction

This booklet is not intended to be a comprehensive guide and its purpose is to provide real estate agents with an overview of the tax issues on the purchase and sale of properties, as well as cover the tax issues that real estate sales agents will face in meeting their personal tax obligations.

For detailed advice on any transaction we recommend that you consult a qualified accountant or taxation expert.

Contents

1 Goods and Services Tax

- Common GST problems we encounter on property sale agreements
- How you can avoid common GST problems
- GST issues you need to be aware of

2 Income Tax issues on the sale of rural properties

3 Tax issues on the sale of commercial properties

4 Your personal tax obligations

6 Interacting with the Inland Revenue Department and resources available at the Inland Revenue Department

Goods and Services Tax

We often see problems caused by purchase and sale agreements where the purchaser and/or seller are unaware of the GST implications of the transactions.

The following examples are the main problems we come across:

1 On the $450,000 sale of a block of land, the seller did not think about the GST consequences and on the sale agreement placed the sale price at $450,000 inclusive of GST. Instead of getting $450,000, after payment of GST they only got $391,304, so a loss of $58,696.

2 A lifestyle property was sold to an unregistered purchaser for $750,000 including a house valued at $300,000. The sale agreement said plus GST if any. A week out from settlement the purchaser found out that the actual cost was $67,500 higher, due to GST being calculated for the settlement statement.

3 The sale of business turned out not to be a going concern and GST had to be added to the sale price. This resulted in the purchaser having to go and get additional finance to cover the GST cost.

4 A person purchases a residential property for $540,500 to subdivide it and build three houses on it for sale. The person did not register for GST. As a result the purchaser missed out on a GST refund of $70,500 being a second hand goods claim on the property.

To avoid these problems we recommend that the following be done:

1 Always check with the vendor whether the property they are selling is subject to GST. This is especially important for the following property sales:

- Rural property
- Lifestyle properties
- Properties that are likely to be a holiday home
- Commercial properties
- Businesses
- Where the seller appears to be a property developer

2 Where the seller or purchaser is GST registered always discuss the GST implications with the seller and purchaser. If you are unsure of the GST implications, refer them to an accountant or lawyer.

3 Get the seller and purchaser to contact their respective accountants for the necessary tax advice, and where the vendor/purchaser give you permission; email the unsigned sale agreement to their respective accountants for their input.

GST issues you should be aware of:

1 If the sale includes land and both the purchaser and vendor are GST registered, the sale will be zero rated for GST purposes (i.e. no GST will be added to the sale price) unless the purchaser is intending to use the property as a private residential property.

2 For a sale of a business (that does not include land) to be zero rated the following needs to apply:
   a. Both the vendor and the seller need to be GST registered and;
   b. The business is capable of being carried on by the purchaser at settlement date (i.e. there is everything needed for the purchaser to trade from the moment they take over the business) and;
   c. There is a written agreement that the sale is the sale of a going concern for GST purposes.

3 On the sale of a lifestyle block or rural property that is subject to GST the houses will normally be exempt from GST as they are being used as dwellings.

4 If a GST registered person/entity purchases property from a non-registered person/entity that they will use within their business for a GST-able activity, they will be able to obtain a GST claim for the purchase price under the second hand goods rules (Provided the purchase is not from an associated person).

Income tax issues on the sale of rural properties

In the rural sector it is especially important that the vendor and purchaser engage their accountants in the process as they will have significant exposure to income tax effects resulting from the sale/purchase of rural property.

The following are the major tax issues you should be aware of:

1 The following items included in the sale will be taxable to the vendor:

- Silage, hay, and harvested crops;
- Livestock;
- Sale of small sundry equipment, shed and animal health supplies
- Depreciation recovered on buildings and equipment (e.g. milking and shearing plant, effluent pumps, irrigators, water tanks) sold with the property
- Standing timber. I.e. trees that have a value as timber or firewood if felled when they mature.

The vendor is likely to want to minimise the value of the above items while the seller will want to maximise the values assigned to these items. Inland Revenue expects that the above items to be reflected at a true market value. If the Inland Revenue Department investigates and find values that do not reflect market value, they will adjust the values and recalculate the taxable income.

2 Unless unharvested crops are valued and recorded in the sale agreement they will not be taxable income to the vendor, or a deductible cost to the seller. If there are crops close to harvest it is normal practice for a value to be placed on the crops and the value recorded in the sale agreement. The value is normally negotiated between the purchaser and vendor.

3 The purchaser will be able to continue to depreciate any unexpired development expenditure. Development expenditure will include the following:

- Races, tracks and airfields
- Water supply system
- Effluent disposal system
- Preparation of land for farming including land and swamp clearing
- Pasture establishment
- Wells, water bores and dams
- Power and telephone lines
- Feed platforms, feeding yards, sheep dips and self-feeding silage pits
- Supporting frames for growing crops

4 The purchaser will be able to continue to amortise the tax book value of any listed horticultural plants. The main categories of listed horticultural plants you may come across would be kiwifruit, blueberries, nut trees, fruit trees, and rubus berries.

5 If settlement date is 365 or more days after signing of the agreement or the property value is over $1,000,000 the property sale will be caught under the financial arrangement rules (i.e. part of the sale price will be treated as interest). This can be avoided if the following lowest price clause is included in the sale agreement:

The parties agree that the Purchase price recorded in this Agreement does not include any capitalised interest and that the "lowest price" for the purposes of section EW32(3) of the Income Tax Act 2007 is equal to the Purchase price, and the parties will file their tax returns on that basis.

The vendor, after discussion with their accountant, should provide you with a schedule of values for buildings, equipment, livestock, shares and development schedule to put into the purchase agreement. On the next page is an example of the schedule that the vendor's accountant would provide.

Property Name

Schedule of Sale Components
Exclusive Of GST Where Applicable

Housing and Curtilage				
Main Dwelling and Garage			350,000	
Main Dwelling Chattels			10,000	
Curtilage			60,000	
				420,000
Farm Buildings				
Implement Shed			10,000	
Barn			2,000	
Dairy Shed			350,000	
				362,000
Plant and Equipment				
Milking Plant			150,000	
1 Electric Fence Unit			1,000	
Effluent Irrigator			2,000	
Effluent Pumps			3,500	
Water Tanks (2)			2,400	
				158,900
Unexpired Development Expenditure		DV Rate		
Land Contouring		5.00%	25,000	
Effluent Pond		5.00%	5,000	
Water Reticulation		5.00%	10,000	40,000
Shares	Number	$/Share		
Fonterra Shares	120,000	$6.10	732,000	
				732,000
Supplements	Tonnes	$/Tonne		
Grass Silage	100	$210	21,000	
				21,000
Livestock	No	$/Head		
Mixed aged friesian cows	240	1,950	468,000	
Rising 2 year friesian cows	60	1,500	90,000	
Rising 1 year friesian cows	60	600	36,000	
				594,000

Tax Issues on the Sale of Commercial Properties

1 Goods and Services Tax

If the vendor is not registered for GST, but the purchaser is GST registered, provided the vendor and purchaser are not associated, the purchaser can make a second hand goods claim for GST on the purchase of the property.

2 Depreciation and tax value of buildings, fit-out and chattels

Under the Income Tax Act, buildings are not depreciable property while chattels and fit-out can still be depreciated.

While buildings can no longer be depreciated, it is still important that it is valued in the sale agreement, as there may be depreciation recovery issues for the vendor.

It is important to purchasers that all chattel and fit-out items are identified and valued in the purchase agreement. If they are recorded and valued in the sale agreement, they can depreciate them for income tax purposes.

As with farm buildings, the Inland Revenue Department will expect the building value be at market value. If the Inland Revenue Department find that unrealistically low values have been used, they will recalculate depreciation recovered based on a realistic market value for the building, chattels and fit-out.

3 Financial Arrangement tax rules

As with farm sales, if the sale value is over $1,000,000 or settlement is 365 or more days away a lowest price clause will need to be included in the agreement (The clause is shown in the farm properties section)

Your Personal Tax Obligations

1 If your commission received including GST is over $60,000 per annum, you will need to register for GST. If you need to register for GST we recommend that you register on a six monthly payments basis

2 If you are receiving GST on your commission income, you are required to pay the GST component to the Inland Revenue Department

3 The real estate firm is required to deduct withholding tax off your income at the rate of 20% of the GST exclusive income, unless you obtain a certificate of exemption from the Inland Revenue Department. To obtain an exemption from withholding tax you need to have a good tax payments history with the Inland Revenue Department. The request to get a withholding tax exemption can be done online at the following address:

https://interact2.ird.govt.nz/forms/coe/

4 Unless you can prove that the use of your car is 100% business use, you need to keep a log book for three months every three years and calculate your business use % based on this. Unless you keep a log book you will not be able to claim your vehicle expenses for GST purposes and your claim for income tax expenses will be limited to 25%. Please note that unless your home is also a place of work, you will not be able to claim for your travel from home to your place of work;

5 The following work related expenses are claimable for GST and income tax purposes:

- Business % of vehicle costs (including insurance and depreciation);
- Home office costs;
- Cell phone costs for your work cell phone;
- 50% house phone rental and 100% business tolls provided your home phone is used for business;
- Internet costs if you do business work at home. Please note that a private apportionment will be required as the internet will be used for private purposes as well;
- Stationery and office supplies;
- Client gifts;
- 50% entertainment costs;
- Advertising costs;
- Depreciation on computer, I-pad, phones and associated equipment used in the business;
- Business insurance;

- Real estate registration fees;
- Other costs associated with gaining real-estate commission.

Please note that except for protective clothing, clothes are not claimable unless they are uniforms that incorporate the logo of the real estate business. Likewise hairdressing costs are not claimable as they are private in nature.

6 You will need to keep your financial records for a minimum of 7 years. To ensure accounting costs are minimised it is important that you keep your records as tidy and as complete as possible. Our recommendation is you keep separate folders for bank statements, income invoices and for expense invoices, and file your records chronologically;

7 We recommend that you use one of the following systems to maintain your accounting records:
- Excel Cashbook (We have a free cashbook template if you need one)
- Xero (Pricing starts at $27.50 per month)
- MYOB Essentials (Pricing starts at $23 per month)

8 Depending on your accountant your annual accounting fees (Excluding GST) are likely to be:

Annual financial statements and tax return	$700-$2,000
GST return preparation	$150-$300 per return

These costs do not include accounting software costs.

It pays to shop around and the price range is quite high. In general the larger the accounting firm you go to, the higher your accounting fee will be.

Interacting with the Inland Revenue Department

We recommend that you register with the IRD to use the online services, so that you can file your GST and PAYE returns online with the Inland Revenue Department.

In addition to filing your PAYE and GST returns electronically, there are also the following online services through your online account with the Inland Revenue Department:

- Send emails to the Inland Revenue Department (due to waiting times when using the phone, this is a more efficient way to communicate);
- Look at your tax accounts to see what you currently owe Inland Revenue, and whether payments have been processed properly by the Inland Revenue Department;
- See what tax returns are due soon;
- Receive email reminders for GST and PAYE returns due;

Setting up for an online account with the Inland Revenue Department can be found at the following web page:

http://www.ird.govt.nz/online-services/ir-online-services-register.html

Inland Revenue Department Resources at www.ird.govt.nz

We recommend that you download and read the following guides

IR375 – GST Guide

IR335 – Employers Guide

IR830 - Working in the real estate industry

The Inland Revenue website can be searched for a wide range of information on tax issues.

About Virtual Business Solutions Limited

Virtual Business Solutions Limited provides a wide range of services to small and medium sized business by helping them grow and improve their enterprise, gain efficiencies and increase profitability. We also provide business valuations across any industry sector, and quantify how you can increase the value of your business.

The relationship we have with our clients is different to those of larger traditional firms. They are more personal and our independence means we can focus on doing the right thing for our clients.

Virtual business Solutions Limited is made up of three professionals with many years of experience:

Gabriela Newman – Phone 021 224 5678

Gabriela specialises in business valuations as well as management accounting involving business owners and managers looking at operational performance to meet future strategic and operational needs. It is based on information from processes, technologies, suppliers, customers and competitors.

She also specialises in accounting systems and software implementation and support, and is a MYOB Consultant.

Matthew Whitbread-Edwards – Phone 027 447 8257

Matthew is a Chartered Accountant who specializes in taxation, business structuring and financial reporting as well as implementing accounting systems to enable business owners to focus on the key performance indicators to enable them to develop and grow their business. He also has significant experience in the evaluation of business proposals including preparing budgets and financial projections. He has a wealth of experience with Rural Cash Manager, Xero and MYOB.

Steve Nickson – phone 027 2013981

Steve specialises in helping organisations improve their performance through the analysis of existing problems and development of plans for improvement.

He provides objective advice, expertise and specialist skills with the aim of creating value, maximising growth or improving the business performance of his clients.

He provides business valuations, succession planning, change management assistance, technology implementation, strategy development, innovation and growth strategies, mentoring and operational improvement services.