

PROPERTY LAW AND EQUITY REFORM COMMITTEE

REPORT ON LAND TAX CHARGES

WELLINGTON NEW ZEALAND

REPORT OF THE
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PRESENTED TO THE MINISTER OF JUSTICE
IN MAY 1985

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The Hon G.W.R. Palmer
Minister of Justice

INTRODUCTION

1. In 1982, this Committee sought and obtained from your predecessor a reference to investigate a problem which could arise for purchasers of land which is affected by a charge for land tax.

2. The problem may be illustrated thus:

The Bubble Company owns a tract of land which it subdivides and sells to purchasers of individual residential lots. It becomes insolvent, and fails to pay land tax finally due in November 1981. The Commissioner of Inland Revenue imposes a charge on all the land in June 1982, notwithstanding that a large number of lots are already registered in the names of the purchasers. The purchasers are obliged to pay the tax, and (having paid the Bubble Company the full price) are left with a valueless right to sue the insolvent company for the money so expended.

3. The problem could not easily have been avoided by due diligence on the part of solicitors acting for the purchasers because:

- (i) Purchasers completing their transactions before 1 July 1981 would not even have known the rate of land tax applicable (it doubled in 1981);
- (ii) Purchasers completing their transactions between July 1981 and June 1982 would not be in a position to find out from the Inland Revenue Department whether there were land tax problems, primarily because the Department would not disclose the tax position without the Bubble Company's authority; but also because the Department would not know whether the company was liable to tax until it filed a return (due by 7 May), or whether it had defaulted until the due date for payment (7 October) (this date could be postponed into the following year if the company did not file a return and its liability had to be investigated);
- (iii) The fact that the company may be liable for land tax would not necessarily be known to the purchasers' solicitors, since it might depend on aggregating holdings of other lands of which the solicitors would be unaware;

- (iv) Even if the purchasers' solicitors were alerted to the risk and insisted that up to two years' equivalent land tax (4 percent of the capital value of the land) be retained in trust until the Commissioner's right to charge the land lapsed, there would still be the risk that, technically, the Commissioner's charge secured all land tax payable by the company, and not just the proportionate part relating to the land purchased. In any event, as will be seen, the purchasers' legal right to such a retention is dubious, at least until such time as the tax payer has made default in payment.
- (v) The guaranteed search note procedure (s.172A Land Transfer Act 1952) does not provide protection for the purchaser.

It is therefore quite likely that the purchasers would have no rights, or only very limited rights, of indemnity from their solicitors.

- 4. The Committee is of the view that it is wrong in principle that such a "cloud" should hang over the security of title of an innocent purchaser, when in every other respect he can rely on a clear land transfer register and due enquiries made by his solicitor. In the following sections of our Report, the current rights and liabilities are analysed; the practical implications for both the purchaser and the Commissioner are discussed; and comparable New Zealand provisions explored, before concrete proposals for reform are put forward.
- 5. The Committee has made some attempts to ascertain the extent of the problem, not only through very helpful discussions with officers of the Inland Revenue Department, but also by enquiring of law practitioners whether they are aware of cases in which practical injustices have occurred. It has to be admitted that very few such cases have been put to us. While on the one hand this may perhaps indicate that the issue could be left alone, on the other it suggests that the revenue would not be greatly affected if some more equitable method of adjusting the claims of the Commissioner and purchasers from the taxpayer were to be found.

LEGAL ANALYSIS

- 6. It may be helpful to begin by sketching the relevant provisions of the Land Tax Act 1976. All references to "the Act" and all section references are to that Act unless otherwise stated.
- 7. Land Tax is an annual tax payable by every person on all land of which he was the owner at noon on the 31st March preceding the year of assessment (s.10(2)). Residences built on less than 4,500 square metres (1 acre) and farm land are exempt along with certain other classes of land (s.27). The tax is assessed, levied and payable at such rate or rates as are fixed from time to time by an Annual

Taxing Act (s.10(3)). Therefore, unless and until an Annual Taxing Act is passed in the subsequent year (i.e. financial year) an owner has no liability in respect of his land holdings on 31st March.

8. Land tax is due on 7th October in each year (s.46). Additional tax is payable if any tax is unpaid at the expiration of one month after the due date i.e. 7th November (s.47).
9. When land tax has been assessed and has become due and payable in respect of any land and the taxpayer has made default in payment thereof the Commissioner may "thereupon or at any time thereafter" demand payment of the tax from:
 - (a) any person who is at the time of the demand the owner at law or in equity of the estate or interest in respect of which the tax was assessed, as the successor in title of the taxpayer;
 - (b) any person who is at the time of demand a tenant of the land, holding under the taxpayer or his successor in title;
 - (c) any person who is at the time of demand a mortgagee of the estate or interest in respect of which the tax was assessed. (s.49(1)).
10. Under s.50(1) land tax which has been assessed (by an Annual Taxing Act) and has become due and payable in respect of any land "shall be a charge on the land in respect of which it is payable". The charge is created automatically when a default occurs. Notwithstanding that the charge is unregistered it has priority over all mortgages, charges or encumbrances. Moreover, "the land on which any charge is created ... shall continue to be subject to the charge notwithstanding any disposition of the land". (s.50(2)). In the case of land registered under the Land Transfer Act 1952 this provision is clearly an exception to the indefeasibility of the registered proprietor's title where he has become registered in respect of land which is or becomes the subject of an unregistered charge for the land tax due by his predecessor in title.
11. By virtue of s.49(1), any purchaser of the land is also personally liable to pay the tax, upon demand by the Commissioner. That liability is specifically limited, however, to a proportionate part (as assessed by the Commissioner) of the tax due on all the lands of the taxpayer. (s.49(2)). No similar limitation is specifically imposed by s.50 on the extent of the Commissioner's charge against the land, and it is not entirely clear whether it can be read into s.50 by a process of construction.

12. Because the purchaser may be rendered personally liable for the vendor's tax by demand made on him when he is the legal or equitable owner of the land as successor in title to the taxpayer, it is doubtful that he qualifies for the protection of a guaranteed search note under Section 172A of the Land Transfer Act 1952, even if the land tax charge is registered during the second operative period (i.e. within two months of settlement). To obtain compensation from the Crown he must show that he suffered loss because of the adverse registration, but he could already be made liable under s.49 quite apart from the charge. Therefore the registration of the charge causes him no loss. Furthermore, a charge registered after the expiry of the second operative period plainly could not be the subject of a compensation claim.
13. A land tax charge lapses "at the end of the year next following the year of assessment" unless at that time the tax is secured by a charge registered against the title. (s.50(5)). It does not appear, however, that the Commissioner's right to rely on the personal liability of an owner as successor in title ceases when the charge lapses provided that the Commissioner has already made a demand under s.49. But the Commissioner may not make a fresh demand after that time. (s.50(6)). The time is extended if owing to the failure of the taxpayer to furnish a complete return of the land owned by him a correct assessment of land tax has not been made.
14. Within the time limit referred to in the preceding paragraph the Commissioner may register the charge by depositing a certificate with the District Land Registrar. No disposition of the charged estate or interest is registerable while a charge is registered. (s.50(3)).
15. A person who pays land tax assessed against the taxpayer pursuant to a demand by the Commissioner is entitled to recover the amount from the taxpayer. (s.408 Income Tax Act 1976 as imported into the Land Tax Act 1976 by s.51 thereof).

PRACTICAL IMPLICATIONS

(i) The Commissioner

16. At present land tax is payable where the total land value (i.e. unimproved value) of all land of the taxpayer at noon on the previous 31st March exceeds \$175,000.00.
17. In response to a request by the Committee the Inland Revenue Department has supplied the following data:

	<u>1980</u>	<u>1981</u>	<u>1982</u>
Revenue Collected	\$10.73m	\$11.59m	\$33.77m
Land Tax Returns filed	2299	2568	2432

Arrears at 31st March	\$643,000	\$698,000	\$1,319,00
No. of arrears debtors	93	93	109
Charges Registered	198	32	196

The Department has also advised that land tax collected for the 1983 and 1984 years was \$34.44m dollars and \$36.20m dollars respectively. It has not been able to supply additional information for those years.

18. The Department commented on these figures as follows:

"Approximately 25 percent of the arrears debtors set out above will involve recovery from a purchaser, mortgagee or tenant of the land under s.49. The Department does seek to claim outstanding land tax from purchasers of land, irrespective of whether the vendor is solvent or insolvent. The Department takes the view that the ability of a purchaser to pursue a breach of warranty claim against a vendor is a matter to be resolved between those two parties alone, and should not involve the Department."

19. No breakdown has been given by the Department detailing respective recoveries from purchasers, mortgagees and tenants. It may be that a substantial proportion of the 25 percent referred to is recovered from mortgagees whose position in relation to land tax is in many respects similar to that which pertains commonly in respect of rates assessed against the mortgagor's land.
20. Clearly the imposition of a liability on purchasers and tenants is an effective revenue collection device, although the amount of tax which might be lost if the present rules were to be changed would be quite small in relation to the total revenue collected from the tax. The question for the Committee is whether the present rules operate fairly. The difficulty which has given rise to the reference to the Committee occurs when the taxpayer has disposed of his land to a purchaser and has subsequently become insolvent.
21. It is worth observing at this point that the number of properties which are subject to liability to land tax and where there is more than a merely theoretical risk of a default by the taxpayer is really very small. Not many persons holding over \$175,000.00 worth of commercial and industrial land (excluding the value of buildings) become insolvent. Therefore only a handful of the many property transactions involving that class of property settled each year gives rise to the problem which has been referred to the Committee. Probably because of this factor there is no settled practice among solicitors regarding land tax enquiries prior to settlement. If such a practice were to develop significant costs might be involved for the parties and their solicitors. The cost of the administrative burden which would be thrown on the Department might exceed the revenue ordinarily recovered from purchasers and tenants.

(ii) The Purchaser

22. If the sale of a property is settled after 7th October it would in theory be possible for an assessment to be obtained from the Department and for arrangements to be made on settlement for all land tax liability of the vendor to be discharged. (This assumes that a correct return has been lodged by the vendor.) Unfortunately, it appears from comments from a Departmental officer that most returns are not able to be processed until the last quarter of the financial year.
23. If the sale is both entered into and settled in the period between 1st April and the enactment of the Annual Taxing Act the Department is not in a position to issue an assessment. No tax liability exists. The dates of enactment of the Annual Taxing Acts in the last few years were as follows:

<u>1980</u>	30th September
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<u>1981</u>	26th August
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(In this year there was an increase in the rate of tax from 1 percent to 2 percent. The increase was applied so as to relate to the assessment issued in that year in respect of land held at the previous 31st March).

<u>1982</u>	28th September
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<u>1983</u>	23rd September
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<u>1984</u>	21st September
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24. Once the budget has been announced it is, of course, possible to be fairly sure of the rate that will apply for that year. But prior to the budget even that estimate cannot be made with certainty because of the possibility that there may be a change in the rate of tax or in the level at which it becomes payable. A vendor who has not previously been liable for tax may become so by an amendment to the Land Tax Act. The dates of the budget over the same recent period were as follows:

<u>1980</u>	4th July
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<u>1981</u>	1st July
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<u>1982</u>	6th August
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<u>1983</u>	29th July
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In 1984 the rate was first notified by the Land Tax (Annual) Bill which was introduced in the middle of September. Obviously many property transactions are entered into and settled between 1st April and the time when the rate is known.

25. What can a purchaser do to protect his position if he settles in these circumstances? Assume he buys a commercial property of moderate land value (say \$50,000.00 land value) from a vendor in April. He knows nothing of the vendor's assets or liabilities. In fact the vendor has a number of other properties (perhaps in another part of New Zealand). The aggregate of the vendor's land value at 31st March was \$300,000.00. Settlement, as is common, takes place within one month of the signing of the agreement. After settlement the purchaser takes title. It is not until the end of the financial year or even in the following financial year that demand is made upon him or a land tax charge is registered for an assessment which:
- (a) Relates to the tax due by his vendor. The purchaser himself may have no other commercial or industrial land and no liability to land tax.
 - (b) Is made pursuant to an Act announced and passed into law some months after he became the registered proprietor.

If he finds that the vendor is insolvent he will be unable to recoup from the vendor all of the money he is obliged to pay to the Commissioner.

26. Such a situation may not be unfair if it is a practical matter for the purchaser's solicitor to protect his client against the risk. However, it will be clear from the preceding paragraph that this is not possible in some circumstances. Furthermore, it cannot be assumed that the vendor will necessarily reveal the true position in answer to the purchaser's pre-settlement enquiries. He may deny ownership of other land. If the transaction is settled prior to the passing of the Annual Taxing Act it would seem that the vendor cannot be asked to file a land tax return. If he does file one it may not be correct. The purchaser cannot approach the Department for information because the Department is unable to reveal any information without the vendor's consent. The information on the Department's file may not be correct.
27. As no charge then exists (either registered or unregistered) against the land it would seem that the purchaser is not entitled to require a deduction from settlement moneys. All the purchaser can require is a warranty. (He already has this under the standard form of agreement approved by the Real Estate Institute and the New Zealand Law Society - see clause 6.1(4)). Even if the agreement permitted the purchaser to make a deduction how can this be accurately assessed given the possibility of:

- (a) Concealment of information by the vendor and/or
- (b) A change in tax rates?

28. In discussions with a member of the Committee a representative of the Inland Revenue Department has suggested that land sale agreements should contain provision for the purchaser to be entitled to receive a certificate from the Inland Revenue Department before settling. It would be easy enough to amend the standard form to include such a provision but, as demonstrated above, in the early part of the financial year the Department would not be able to provide a worthwhile certificate in relation to the tax to be assessed in that year. Moreover, if such a practice - of requesting certificates - became common the Department would incur significant expense in servicing them promptly. Since most property transactions are settled within two months from the date of the agreement it would be essential that the Department be able to provide a prompt response. Quite possibly the cost of servicing the enquiries would be at least as much as the land tax now recovered from purchasers.

(iii) The Mortgagee

29. The position of a mortgagee also has its difficulties if the borrower becomes insolvent and the mortgagee wishes to conduct a mortgagee sale. The mortgagee may be required to warrant to a purchaser that the purchaser will not be troubled by claims for land tax. However, the mortgagee may be unable to discover from the Department how much (if any) land tax is outstanding in respect of the property - either because an assessment has not been made for the current period or because the Department regards that information as confidential and will not reveal it to the mortgagee without the consent of the mortgagor.

COMPARISON WITH GENERAL RATES

30. There are a very limited number of other statutory exceptions to the principle that the title of a registered proprietor of land under the Land Transfer Act 1952 is indefeasible. Only one of these other exceptions is even superficially comparable with a land tax charge - a charge for general rates under the Rating Act 1967, ss.62, 73, 76. A liability for rates exists in respect of all privately owned land. There are standard and well understood procedures for checking on the position and ensuring that a vendor meets his responsibilities to the local authority. It is quite easy to ascertain the amount of the rates owing by a vendor since no obligation of secrecy is imposed on a local authority. Thus arrears of rates can be discovered upon enquiry by letter or telephone. The current year's rates can be similarly established. The one problem which sometimes arises is that the current year's rates have not been struck at the time when the property sale is to be settled. However, the experience of solicitors has been that local authority rates clerks are able to predict fairly accurately the maximum level to which rates in respect of a particular property are likely to rise when the council strikes the rates for the current year. Thus it is quite simple to arrange with a

vendor for an apportionment based upon an estimate, which is usually accurate to within a few dollars. This problem arises only when a sale is settled early in the rating year and, of course, in that circumstance most of the increased rates will be payable by the purchaser in any event.

31. It should be emphasized that rates under the Rating Act are assessed solely on the basis of the relative value of the land as compared with the value of other land in the local authority area. The personal circumstances of the vendor/ratepayer are irrelevant. There is no sliding scale dependent upon the total value of the land which the ratepayer owns. There is therefore no room for concealment by the vendor/ratepayer of the true position.
32. The Committee's study of the relevant provisions of the Land Tax Act 1976 have led it to the conclusion that land tax is in reality a personal tax which happens to be levied in a manner which depends upon the level of property ownership of the taxpayer. It is not a true property tax like general rates, arising each year in respect of the land regardless of its ownership (with exceptions for land which is not privately owned). In the consideration of any reform it is crucial to keep this distinction in mind, for the problem discussed in this report arises because the present law seeks to pass on the personal liability of one taxpayer to his successor in title and other persons having dealings with him. The Committee questions whether it is fair that a person should be made liable for the tax properly payable by another merely because he is a successor in title, mortgagee or tenant of the real taxpayer.

Recommended Reform

33. The Committee recommends that the provisions of Section 49 and 50 of the Land Tax Act 1976 be amended so that:
 - (a) A purchaser who registers his transfer before a land tax charge is presented for registration will have no liability for the land tax of his predecessor(s) in title;
 - (b) Where land has passed out of the hands of a taxpayer, the Department will have no right to collect land tax personally from any successor in title, and until the Department's charge is registered, its rights would be those of an unregistered chargeholder;
 - (c) The guaranteed search notes provisions (Land Transfer Act 1952, s.172A as inserted by Land Transfer Amendment Act 1982) would apply to protect a purchaser or mortgagee relying on the Land Transfer Register.
 - (d) A mortgage registered before a land tax charge is presented for registration will have priority over the land tax charge;

- (e) The Department's right to claim land tax from a tenant of the taxpayer should be limited to requiring the tenant to pay a sum to the Department in lieu of rental or other payment which would otherwise be due to be paid by the tenant to the taxpayer;
 - (f) A mortgagee exercising his power of sale will not be liable to account to the Department for land tax except for such amount as is stated in a land tax charge registered prior to the date of the mortgagee sale, provided that the Department has been given not less than one month's prior notice of the intention of the mortgagee to conduct a sale. The presence of the charge on the title should not prevent transfer of the title by a prior ranking mortgagee.
34. The Committee has considered whether in practice a less extensive reform will suffice but it was concluded that the position will be ameliorated only very slightly by the available alternatives which are:
- (i) Considerably curtailing the present period during which a charge can be registered; and
 - (ii) Limiting the charge to a proportionate part of the tax applicable to the taxpayer's total land holdings.
35. The first of these alternatives is unsatisfactory because, even if a charge were registered as soon as default in payment occurred (7th October), that will still leave the purchaser at risk if he settled between 31st March and 7th October. Such a reform also pre-supposes that the Department would be in a position to process land tax returns and carry out its other necessary procedures immediately following 7th October. The Committee anticipates that the Department would find difficulty in so doing. No criticism of the Department is intended by this comment.
36. The limitation of the charge to a proportionate part of the tax applicable to the taxpayer's total land holdings would not, in the view of the Committee, truly solve the problem with which this report is concerned. However, it would go some distance towards a solution if the apportionment was required to be done by the Commissioner on the basis that the only tax charged against the interest of a purchaser would be such land tax as would have been payable in respect of that parcel of land were it the only land owned by the vendor/taxpayer on the date to which the assessment related. Unless the reform extends this far it seems to the Committee that most of the difficulties for a purchaser still remain because the tax continues to be linked to the personal circumstances of the vendor. For example, the land could be of relatively low value and be taxable merely because the vendor had considerable other land holdings. It is true that a limited reform might reduce the amount of tax for which a purchaser was rendered liable but significant residual liability would remain. The Committee

appreciates that if the alternative suggestion made in this paragraph is enacted there may, whilst the present exemption level remains at \$175,000.00, be very few instances of a purchaser being rendered liable for tax. This reflection causes the Committee to conclude that it would be better to have the more thorough going reform proposed above in paragraph 33.

37. The Committee wishes to conclude by stating that in its view the present provisions of s.49 and s.50 of the Land Tax Act 1976 appear to represent a serious injustice. It may be said that very few people are affected but that in itself suggests that there will be little significance to the Revenue if the reforms proposed in this report are adopted. The matter is obviously of great significance to those few purchasers mortgagees and tenants who are affected by the present law.

For the Committee



Chairman

Committee

Professor R. J. Sutton (Chairman)
Mr P. Blanchard
Mr R.G.F. Barker
Professor F. M. Brookfield
Mr B. J. Blacktop
Mr W. B. Greig
Mr A. J Forbes
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