MAKING A SUBMISSION ON THE PROPOSAL TO RING-FENCE RENTAL TAX LOSSES

1. Introduction and disclaimer

We have prepared this guide to assist our members and other investors in writing their submission on the proposal to ring-fence rental tax losses ("the proposal").

In putting this guide together, we seek to provide you with a balanced overview of the issue at hand and its potential consequences. This is not a position statement of the Auckland Property Investors' Association nor does it proffer a cut-and-paste style submission template. To make an effective submission, you must put forward your position in your own words.

It is our opinion that the proposal has such wide-reaching consequences as to compel all property investors to put forward their own submission. We sincerely hope that you will find this guide helpful and that you will take the time to participate in the process.

2. Background

In December 2018, the Revenue Minister, Stuart Nash, introduced to Parliament the Taxation (Annual Rates for 2019–20, GST Offshore Supplier Registration, and Remedial Matters) Bill ("the Bill"). Amongst its various proposals, the Bill seeks to ring-fence tax losses sustained by residential rental properties. Mr Nash has, on several occasions, made the policy argument that to ring-fence rental tax losses would 'level the playing field between property investors and home buyers.'

3. The Bill and its legislative milestones

The Bill is titled the Taxation (Annual Rates for 2019–20, GST Offshore Supplier Registration, and Remedial Matters) Bill and the provisions to ring-fence rental tax losses are set out in s49.

It was introduced and received its first reading in December 2018 and now sits with the Select Committee. Submission is open until 28th February 2019. The submissions (written and oral) are considered with the possibility that changes may be made to the legislative language before the Bill leaves committee.

Once the Bill leaves committee, it (including possible amendments) will be 'read' a second and a third time before receiving a royal assent to become law.

The window we are in right now (before 28th of February 2019) is critically important for property investors. It is widely acknowledged in the property industry that ring-fencing will be unfavourably received. If you are in any way concerned or have strong views for/against, now is your chance to speak up.

4. Ring-fencing in a nutshell

In its current form, the Bill seeks to prevent anyone who owns residential rental properties from offsetting an otherwise legitimate tax loss arising from their residential property portfolio against other taxable income. If you own a profitable chip shop and a loss-making rental portfolio, this Bill prevents you from offsetting the loss of one against the profits of the other. But that is not all. The proposed ring-fencing legislation does not deny you the tax relief from the loss, it simply delays it by preserving that loss and carrying it forward to future tax years when your rental portfolio makes a profit (or when a taxable income is derived from the sale of the property).

Other key features to note include

- The bill will only apply to residential land as defined by the definition in the Brightline legislation.
- The rules will not apply to a taxpayers main home
- The rules will not apply to holiday homes subject to the mixed-use asset rules where they are partially rented and partially used for private use.
- Ring-fencing will be on a **portfolio basis** with an elective option to apply the rules on a property by property basis.
- Ring-fenced losses will be able to be used to offset future income from residential land or taxable gains from the sale of residential land.
- There will be anti-avoidance rules preventing deductions for interest on money borrowed to buy shares in property companies where the company's assets are 50% or more property.
- The bill will take full effect from **1 April 2019 for the 2019 – 2020 year.**
- Losses from overseas residential properties will also be ring-fenced.
- Ring fencing will not apply to revenue account property where the proceeds of sale are definitely taxable
- The rules will not apply to employee accommodation where the remoteness of location of the business forces it to provide accommodation to employees

(Source: Wither Tsang Chartered Accountants)

Further readings

- IRD regulatory impact statement
- David Hargreaves: Caution warranted

5. Both sides of the argument

For	Against
The Government contends that ring-fencing will 'level the playing field between property investors and homebuyers' by taking away the unfair tax advantage investors have over homebuyers.	Residential rental investment is not tax advantaged. To own a residential rental portfolio is to operate a business which should be, and is, taxed as such. Comprehensive arguments set out here. First home buyers are not disadvantaged by investors' activities. According to CoreLogic's latest Quarterly Property Market and Economic Update Report (Q4, 2018), first home buyers' activities were on par with the previous market peaks of 2006-07 (see diagram 1 in the appendix). It is a baseless claim to suggest that investors have a direct impact on the ability of first home buyers to buy a property.
Ring-fencing would discourage speculative activities by "reducing the tax benefits enjoyed by property investors who buy property in anticipation of capital gain." Those who choose to, in the words of economist Shamubeel Eaqub 'park money' in properties should not have the tax cover to do so.	Those who buy properties solely for capital gain are speculators, not investors. If the intention of the Bill is to discourage speculative activities then it should define the subjects of the tax as such. The current Income Tax regime, especially post-Brightline-test, sufficiently captures property speculation. Rather than passing more laws and creating further complexities, the Government should place further resources into pursuing all the tax recoverable under current laws.
The effects of ring-fencing will only be felt at the margins. That is to say, only the investors who are making a net loss across the entire portfolio will be affected.	If the effects are only felt at the margins then why introduce the law at all? In this respect, the argument that the Bill would level the playing field must fail. The proposal in its present form disproportionately affect small and new investors while doing nothing to disincentivise larger and profitable investors (who will have an unfettered access to continue purchasing properties).
Ring-fencing of rental losses is expected to increase tax revenue by approximately $190 million per annum.	No it doesn't. The proposal doesn't write off losses, it simply delays the ability to claim a loss by pushing back a tax credit from the Government.

	The Government admits to not having 'clear knowledge' of the effects of this proposal. The IRD regulatory impact statement uses language that is disturbing to say the least: "Ring-fencing of rental losses *could* help improve first home buyers' ability to compete with investors, improving housing affordability for home buyers, and potentially increasing the share of New Zealanders who own their own homes." "Uncertainty around the impact on the housing market. The Government is closely monitoring the performance of the housing market. However, given the number of other policy and regulatory changes to the housing market, *it may not be possible to isolate the impact of this proposal on the housing market.* " "Evidence supporting housing market impact analysis is *limited*, and suggests *significant uncertainty* as to the net impacts of the policy, especially on the rental market. Fiscal impact estimates have been modelled using Inland Revenue data on negatively- geared rental properties. *Significant simplifying assumptions have been made, on which the fiscal estimates are conditional*." We entrust our elected officials to act in the best interest of the country. It is not in our best interest for the Government to rush through a policy proposal that has not been adequately scored and that which comes with what can only be described as a flimsy impact statement. As a fiduciary of all New Zealanders, the Government has an ethical obligation to pass sensible legislations with an outcome that can be realistically anticipated at the outset. In this case, the Government has set out what it *hopes* the Bill will achieve rather than what it *knows* to be the case. Simply put, New Zealanders deserve better than that. If the Government intends on ring-fencing rental tax losses all along, wouldn't it be wise to take the time to do proper studies and engage with industry stakeholders further? What's the rush?

	If ring-fenced investors choose to sell their properties as a result of this proposal, that would diminish the market's rental stock and drive up rent prices. If these investors continue to hold their properties then they would be incentivised to increase rent at least to a cost neutral point. By its own admission, the Government acknowledges that rent would rise. 'Early last year Inland Revenue and MBIE advised the Government that ring-fencing losses would result in the sale of an unknown number of properties to owner occupiers, reducing availability of rentals and increasing rents by around 10%.' (source: Mike Butler, spokesperson for Stop the War on Tenancies) Either outcome would disadvantage renters especially those who are marginalised and at risk.
	Ring-fencing would disincentivise investors to carry out repair and maintenance at a higher standard (than that is required by the law), or at all. Property investors serve an important social function of providing housing and accommodation for renters. It is not in the interest of renters (who the Government has set out to protect) if their landlords cannot afford the financial burden of adequate repair and maintenance. If the Government is to persist with the proposal, then at the very least, and in the interest of both the landlord and tenant, to carve out the loss that is brought upon and flowed from repairs and maintenance to the building.
	Simply put, investors are not motivated by losses. To invest is to acquire an income-generating asset. Property investors (as opposed to speculators) invest in properties with the intention that these properties would one day create an income stream. For an investor to claim a $1 tax credit, he would have to make a $3 loss. Tax deduction is never the primary reason for investment. It is an ancillary relief intended for a definable period of time after which the investor has all the intention of creating a profit. To legislate on the incorrect assumption that investors are driven by tax losses is a sure-fire way to ensure that the law fails on delivering its intended outcome.

	In essence, negatively geared investors (i.e. those investors who will be ring-fenced) are, right now, subsidising the living cost of their tenants. By topping up the portfolio each week with additional cash, the investor is ensuring that the property the tenant lives in has a real market value that is greater than what the tenant is paying in rent. In a way, tenants of negatively geared investors are benefiting from the loss of their landlords. It is very conceivable that ring-fencing these landlords could have a direct and negative impact on their tenants (such as loss of their homes, access to the communities they are used to, increase in rent to a level they cannot sustain).

6. Making your submission

Details to note

Deadline: 28th February 2019

Submission link: Click here

Formats: A written text file (.docx, .pdf etc) uploaded onto the submission portal or by filling out the two text fields under 'I/We wish to make the following comments' and 'I/We wish to make the following recommendations' (we recommend the latter).

Suggested submission structure

Under *I/We wish to make the following comments*

- Your name
- A statement that your submission relates to the proposal to ring-fence rental tax losses
- Your background as an investor and landlord (how long have you been investing in properties, how many properties do you own, how many tenants do you currently house)
- Your position and personal impact statement (would you be captured by the proposal to ring-fence, what would you do to alleviate the additional tax burden placed on you)
- Bigger picture implication (how would your tenants be affected by your responsive actions and what does all of this mean to the rental market as a whole)
- Comment on fairness and whether you believe the proposal would bring about a 'levelling of playing field between investors and homebuyers'.

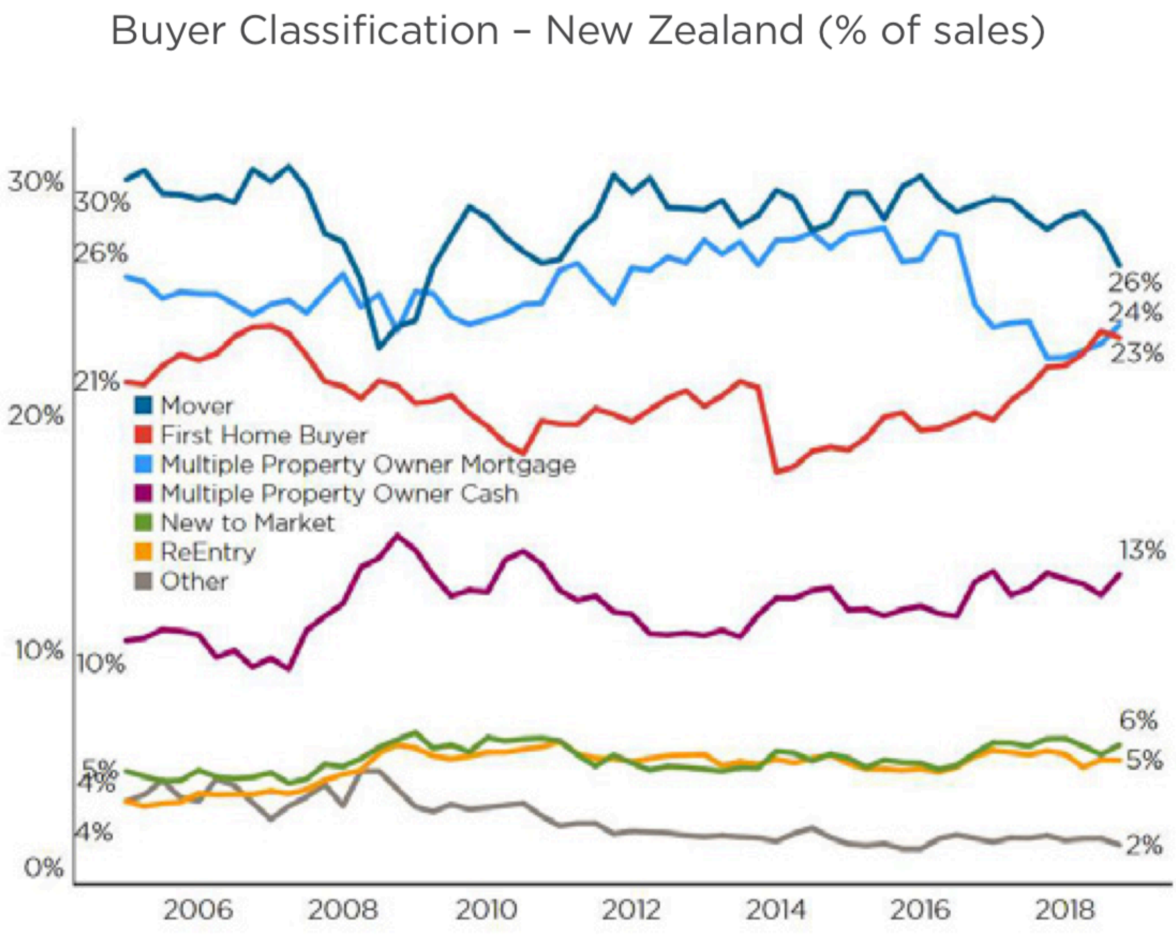
Under *I/We wish to make the following recommendations*

- Do you think the Government should persist with the idea of ring-fencing rental tax losses?

- If so, how can the Bill be improved upon so that it delivers what it promises (i.e. levelling out the playing field between investors and home buyers)
- Can you see any unintended consequences that would have a negative impact on investors, tenants and market stability? If so, can you suggest any changes that would minimise these potential outcomes?
- Do you agree with the short timeframe the Government has given this new piece of legislation especially in light the IRD's regulatory impact statement? Is it prudent for a law to be passed before there is clear visibility of its effects and consequences?

7. Appendix

Diagram 1



Source: Corelogic Quarterly Property Market and Economic Update Report (Q4, 2018)