Ring-fencing submission to the IRD

4 June 2018

The New Zealand Property Investors’ Federation have provided input into the suggested introduction of ring-fencing rental property losses. You can see the full submission here.

Government have stated that their aim in ring-fencing rental losses is to level the playing field between property speculators/investors and home buyers. They believe there is unfairness in the system because investors (particularly highly-geared investors) have part of the cost of servicing their mortgages subsidised by the reduced tax on their other income sources, helping them to outbid owner-occupiers for properties. Rules that ring-fence residential property losses, so they cannot be used to reduce tax on other income, are intended to help reduce this perceived advantage and perceived unfairness.

However there is a fundamental error in the assumption that tax deductibility for rental property allows property investors to outbid owner-occupiers. When purchasing a property, owner occupiers get the benefit of accommodation, while rental property owners get the benefit of rental income. Owner occupiers have no income from the property from which to deduct costs while rental providers have rental income from which they deduct expenses from and either pay or are refunded tax depending on whether they make a profit or loss.

In addition, the proposed tax change will not affect all rental property providers. Many rental property providers make taxable profits, so only those that currently make loses will be affected. This may reduce the immediate impact of the proposal as a relative minority of investors' will be forced to sell their rentals.

The main effect will be on the future supply of rental property which will be required to meet growing demand. There are already financial difficulties in buying and providing a rental property. These difficulties are most pronounced in the early years of ownership. Being able to use these early losses to reduce an owners other income helps to smooth out these early year cashflow difficulties. This helps investors' to increase the supply of rental property at a time when we need more rental properties due to large gains in our population.

Ring-fencing will encourage higher rental prices in order to make providing rental property feasible. If rental prices do not increase, many people will no longer be in a position to provide rental property and supply will fall behind tenant demand. Ultimately this will lead to higher rental prices, so either way, higher rental prices are inevitable.

Ring-fencing will have a larger effect in areas where rental yields are low, such as Auckland, Tauranga, Wellington and Queenstown, which are areas that already have housing cost and rental affordability issues.

Ring-fencing does not provide any additional tax revenue to the country, it merely defers tax losses from being accessed into future tax years.

Ring-fencing will have a dramatic effect on large and costly repairs, such as reroofing or painting the property. These large and one off costs can put a cashflow positive rental property into a loss making situation during one financial year without the ability to use the loss in the same year. This would encourage ad hoc and piecemeal repairs and maintenance.

The NZPIF believes an alternative option would be preferable, in order to maintain rental property supply, minimise rental price increases and provide a disincentive to highly geared rental property. To achieve this, the NZPIF has recommended a cap on claiming rental losses rather than an complete ban.

An NZPIF study shows that it currently costs around $10,800 in the first year to buy and provide the average New Zealand home as a rental. We believe that this should be the cap on claiming rental losses, as this would still allow the average property to be provided as a rental home.

The NZPIF recommends that:

1. Ring-fencing in its proposed form is not introduced as it will not achieve the Governments stated aim of levelling the playing field between investors and home buyers.

2. Government produces and makes public an impact statement on the likely effects of ring-fencing on rental prices and supply.

3. If ring-fencing is introduced, it should be at a level of losses over $10,800 so that rental supply and rentals prices are not too adversely affected.

4. If ring-fencing is introduced, losses should be offset against residential rental income from future years or on any of the owners taxable income if a property is sold.

5. If ring-fencing is introduced it should not include interest allocation rules.

6. If ring-fencing is introduced it should apply on a portfolio basis.

7. If ring-fencing is introduced it should be phased in gradually over a period of at least five years.