

Submission of the  
**New Zealand Property Investors' Federation Inc**

to the

**Finance and Expenditure Committee Select Committee**

examining the

**Taxation (Bright-line Test for Residential Land) Bill**

September 2015

Andrew King  
Executive Officer  
New Zealand Property Investors' Federation Inc  
PO Box 20039, Bishopdale  
Christchurch

Email: [Andrew@NZPIF.org.nz](mailto:Andrew@NZPIF.org.nz)  
Mobile: 021 216 1299

## **SUMMARY**

The New Zealand Property Investors' Federation welcomes the opportunity to provide input into the Taxation (Bright-line Test for Residential Land) Bill.

The proposed legislation is well-intentioned, primarily seeking to clarify when property profits are taxable and improving systems to identify and locate those who should be paying the tax they owe.

We note and agree that the Bill targets on and offshore property Traders (Speculators) as well as habitual homeowner resellers. The Bill is not intended to capture owners of private residence held for the long term or long term rental property providing accommodation to tenants.

Although property traders are the target of the Bill, all investors, including rental property providers are covered. The NZPIF consider the two year test to be at the outside limit before it starts to become a capital gains tax for rental property rather than the intended clarification of existing property taxation. A capital gains tax on rental property would ultimately be borne by the consumer, in this case tenants. Consideration should be given to reducing the two year test to one year or eighteen months.

We agree with the proposed exceptions to the test, but believe they should be extended to a financial hardship clause, as used in other legislation such as Kiwisaver. In the first few years of ownership, providing rental property to tenants often involves significant start-up capital and regular top-up payments. A hardship clause would allow an owner to sell the rental property within the two year period provided they could demonstrate evidence that they are suffering significant financial hardship. We note that an investor in any other type of investment or business would not be subject to a capital gains test in the same circumstances.

The Federation believes that the acquisition and disposal dates should be when the title is registered or updated. This is consistent and provides a certain date. The potential for avoidance can be captured under the existing intention rules.

We agree that the capital and holding costs involved in any property transaction captured by the Bright Line Test should be deductible as with current land sale rules.

In principle, the NZPIF believes it is fair and reasonable that losses made within the two year period should be available to offset other taxable income. This offset of losses is currently available to property traders or traders in any other assets.

In order to reduce complexity and costs, the NZPIF believes that specific anti avoidance rules should be used to eliminate trading of shares in land rich companies or trusts to avoid tax commitments under the Bright Line Test.

## **RECOMMENDATIONS**

- That the proposed two year Bright Line Test be reduced so that it does not become a defacto capital gains tax on rental property, adversely affecting the rental industry and tenants.
- That the acquisition and disposal dates for the Bright Line Test should be when the title is registered or updated.
- That a significant hardship clause is added to the existing exceptions, so that rental property owners facing hardship not of their own making do not incur a tax that would not occur to share or other types of investors in a similar position.
- That within certain parameters, losses made within the two year period should be available to offset other taxable income.
- That specific anti avoidance rules should be used to eliminate trading of shares in land rich companies or trusts to avoid tax commitments under the Bright Line Test.

## **DISCUSSION**

### **1. Term of the Bright Line Test**

The key purpose of the Bill is to clarify when profits from the sale of property are taxable.

Many media commentators and the general public are unaware of the difference between a property Trader and a Property Investor. A Property Trader buys and sells property to make an income, where a Property Investor buys property to provide tenants with a home.

Currently property Traders (Speculators) are considered to be in the business of trading properties and therefore the profit they make from buying and selling property is considered taxable income. This is also the case for other investments (shares, antiques, paintings, metals) and businesses.

Profits from selling a private home are also considered taxable if the seller is considered to be in the business of buying and selling their homes.

Profits from selling a family home or rental property are not taxable. Providing your own home or a home for others is mostly a long term commitment. This is also the case for other investments and businesses, so is consistent.

The current law defines whether you are to be taxed on asset sales by your intention when you bought the asset. If your intention was to buy it and sell it for a profit, then any profit you make is considered income and taxed. If you buy an asset with an

intention that it be a family home, rental property or long term investment, then any profit made when the asset is sold is not taxable.

The system encourages long term holding of assets, which is considered a good thing, but tax has the potential to be avoided if traders claim to be investors by saying that their intention was to buy the property as a rental.

The IRD has the power to designate these "investors" as Traders if their activity shows them to be. The IRD has a property investigation division that was established specifically to investigate such property transactions. This property division has been highly successful in finding Traders and ensuring they pay their fair share of tax. The NZPIF has supported this action since the IRD Property Division was first established.

The reason for the NZPIF support is that we are an industry group for rental property owners. It is not in the interest of our members that Property Traders pass themselves off as Rental Property Owners in order to avoid paying tax.

Property Traders attempting to avoid paying tax and some media commentators have created the perception that rental property owners are not paying their fair share of tax and a Capital Gains Tax should be applied against them.

The NZPIF hoped that the Bright Line Test would clarify for the general public the difference between a property Trader and Investor. The Test would give the general public confidence that those who were trading property would no longer be able to avoid paying the tax that they owed. At the same time, the Test would mostly prevent extra tax being applied to rental property providers. This is beneficial as any extra costs in providing rental property would ultimately be borne by tenants.

The two year Bright Line Test is arguably as long as it could be before it changes from ensuring Traders pay their fair share of tax towards becoming a Capital Gains Tax on rental property.

The Bill should send a message to the General Public that rental property is not intended to be captured by the Test by reducing the Test to one year or eighteen months. This would prevent some rental property owners from unintentionally being caught by the new test, but would still capture the Traders that the Test is actually intended for.

The majority of Property Traders earn a living from their activities, so are incentivised to turn over the property quickly and move onto their next trade. This means that a one year or eighteen month term would be more than adequate to capture them. The current intention rule will also remain in place to capture traders who try and corrupt the system.

## **2. Exceptions**

There are currently two circumstances where the Bright Line Test is exempted from applying. A matrimonial property settlement and an inheritance.

As the Bright Line Test applies only to property investments, there is a discrimination of property investors' against investors' in other investments.

The NZPIF believes that this is unfair and that all investments should have a Bright Line Test to distinguish between Traders and Investors'. How many share traders or business Traders are not paying their fair share of tax?

In absence of comparable treatment between investors', we believe that the level of exceptions should be expanded to include financial hardship.

Providing a rental property for tenants to live in usually requires a large capital investment plus ongoing top ups in the early years of ownership. If a rental property owner incurs financial hardship beyond their control within two years of owning the rental property, there is a high likelihood that they will no longer be able to afford to keep it.

By selling within the two year period, under the Bright Line Test they would be required to pay income tax on any increase in the property's value. This would be unjust given that an investor in shares, a business or any other form of investment, would not have to pay such a tax if they found themselves in the same position.

For this reason, we believe that a financial hardship clause should be included into the Bill, similar to that included in the Kiwisaver regulations. Such a clause could be:

### **Significant financial hardship**

If you can provide evidence that you're suffering significant financial hardship, you are exempted from the bright-line test.

Significant financial hardship includes:

- being unable to meet the costs of providing the rental property
- being unable to meet mortgage repayments on the rental property, resulting in your mortgage provider enforcing the mortgage on your property
- being unable to pay the cost of medical treatment for you or a dependent family member:
- becoming ill, have an injury, or require palliative care suffering from a serious illness

## **3. Losses**

Current land sale rules allow property traders to claim losses from selling property to be offset against their other taxable income.

As the intention of the Bill is to merely confirm the existing laws, it is fair and reasonable that losses should remain being allowed to offset other taxable income.

Under the new law, some rental property owners will have to pay income tax on the sale of a property that they would not have had to pay before the bright-line test. There are several reasons for this. They may find an additional property that has better investment potential, but they cannot finance both. They may have changing personal circumstances that mean they need to sell the property.

If Government is going to instil an extra tax if property gains value, then it needs to counter this if there is a loss in value.

Rental property owners will not be incentivised to sell on a whim, as even with a tax deduction, by selling the property they are realising the loss and will still have to cover the majority of that loss.

As an example, if a property loses \$30,000 of value within two years of buying it, if it is sold then the tax offset benefit is \$9,900 at a marginal tax rate of 33%. By selling the property, the owner has still realised a true loss of \$20,100.

Compared to property traders, ring-fencing losses would be unjust for rental property owners as they are not in the business of buying and selling property. They may never be in a position to offset a ring-fenced loss because they are unlikely to ever have a property gain that is subject to tax because of the bright-line tax.

We do agree that the system could be manipulated by selling property to an associated person, in order to offset tax losses against other income while continuing to retain control of the property. Because of this, we agree that a person should not be able to access a tax loss under the bright-line test for a transfer of property to an associated person.

#### **4. Land rich companies or trusts**

It is possible that property's could be bought under a company or trust ownership structure for the purpose of circumventing the intentions of the bright-line test. It is understandable that rules should be looked at to restrict this.

If rules are to be introduced then these should be the simplest required to eliminate using shares and trusts to avoid tax commitments under the Bright Line Test.

A point to consider are the changes to social housing provisions. As Government is seeking new and innovative ways to provide social housing, this may involve multi owners in a company or trust structure. Rules intended to stop people avoiding tax commitments under the bright-line test may make it complicated for structures looking to provide large scale social housing under a multi ownership structure.

Consideration could be given to the purpose and rules of the company or tax structure. If it is to provide tenants with long term rental accommodation, no matter who the shareholders are, then it could be exempt from anti-avoidance rules.

## **New Zealand Property Investors' Federation**

This submission has been prepared by the New Zealand Property Investors' Federation Inc (the Federation) in response to the select committee invitation to provide feedback on the Residential Tenancies Amendment Bill.

Established in 1983, the Federation has twenty affiliated local associations situated throughout New Zealand. It is the national body representing the interests of over 7,000 property investors on all matters affecting rental-housing.

The Federation welcomes this opportunity to participate and comment on the draft legislation.

## **Industry Background**

To assist readers understand the extent of the economic and social importance of the private rental industry in New Zealand and the implications of residential tenancies legislation the following background points are offered.

What is the extent of the private rental industry?

- There are approximately 300,000 landlords in New Zealand. There are no corporate or institutional residential landlords.
- There are over 464,000 residential rental properties<sup>1</sup>, housing over 600,000 tenants, and worth around \$150 billion<sup>2</sup>.
- Private landlords are the largest providers of rental accommodation in New Zealand. 81% of tenants rent from a private landlord or trust<sup>3</sup>.
- Median weekly rent for all accommodation is \$380<sup>4</sup>. The amount spent on rent each week is \$64 million and annually this is \$3.3 billion.
- Most property investors (57%) have been engaged in the business for 10 or more years<sup>5</sup>, which dispels the myth that people are investing in property to make a "quick buck". Instead, property investors are using their rental income business as a mechanism for saving for retirement and are professional and committed long-term service/accommodation providers.

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<sup>1</sup> "Landlord group's code sets high standards" 5/9/08 NZ Herald

<sup>2</sup> NZ Herald 10/1/07

<sup>3</sup> Jo Goodhew MP, RTA Bill, First reading, Hansard 26/5/09

<sup>4</sup> Tenancy Bond Centre statistics

<sup>5</sup> ANZ NZPIF Annual Survey 2006

10 September 2015

The Committee Secretariat,  
Finance and Expenditure Committee,  
Parliament Buildings,  
Wellington

By email: jo.elworthy@parliament.govt.nz

Dear Jo

**NZPIF SUBMISSION ON THE  
TAXATION (LAND INFORMATION AND OFFSHORE PERSONS INFORMATION) BILL**

Please find attached the written response of the New Zealand Property Investors' Federation Inc to the **Taxation (Land Information and Offshore Persons Information) Bill**.

The Federation is happy to provide the Committee with any further information it may require and wishes to be heard in person before the Social Services Committee in support of this submission.

Yours sincerely

Andrew King  
Executive Officer