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Ring-fencing of rental losses

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Disclaimer

This presentation is of a general nature only and based on **proposed legislation** at this stage.

Please obtain specific advice on your personal situation as minor changes in facts may result in significantly different outcomes.

This presentation does not purport to cover **all** aspects of law and accounting relevant to the topics covered.

Overview

- Background
- An example of the proposed rules
- Summary of the suggested changes
- Types of property the rules will apply to
- Applying a portfolio approach
- Using ring-fenced losses
- Ability to structure around rules
- Timing

Background

- In NZ tax is applied on a person's net income
- Typically no ring-fencing of income/losses from particular investments (some exceptions e.g. bright-line and mixed use assets)
- Rental property investments can provide ongoing tax losses with an eventual capital gain (which at the moment is tax-free)
- There is an argument that rental housing is under-taxed
- Ring-fencing rules aimed at "levelling the playing field" between investors and home buyers

An example of the proposed rules

Kendrick is an electrician earning $70k per annum (gross). He has saved hard for a deposit to purchase a rental property. Expenses relating to the rental property (e.g. rates, insurance, interest and repairs) leads to a net rental loss of $12,803.

Income	Current	Proposed
Wages	70,000	70,000
Net rental loss	(12,803)	~~(12,803)~~
Total taxable income	**57,197**	**70,000**
Tax payable	10,179	14,020
Less PAYE deducted	(14,992)	(14,992)
End of year tax refund	**(4,813)**	**(972)**

Summary of the suggested changes

- Speculators/investors with residential properties won't be able to offset tax losses from those properties against their other income (e.g. salary/wages)
- Rules won't apply to a person's main home, mixed-use assets or land already held on a taxable basis
- Portfolio basis
- Ring-fenced losses can only be used against future property income
- Special rules to deal with related structures
- Proposed to apply from 1 April 2019 for March balance dates

Types of property the rules will apply to

- “Residential land”
- Same definition as bright-line test
- Applies to land in NZ **and** overseas (i.e. Gold Coast apartment caught)
- Includes bare land
- Exclusions:
  - Own home
  - Mixed use assets
  - Revenue account land
  - Farm land
  - Land predominantly used for business premises

Applying a portfolio approach

- Able to offset losses from one rental property against rental profits from another rental property
- Good news for those with multiple properties
- Compliance requirements and costs

Using ring-fenced losses

- Ring-fenced rental losses could be offset against:
  - Residential income from future years from any property
  - Taxable income on sale of any residential land
- Tax on sale can only be reduced to nil – any remaining losses would remain ring-fenced

Ability to structure around rules

- Proposals are aimed at stopping structuring “opportunities”
- General anti-avoidance rules also need to be considered
- Special rules to ensure:
  - Trust, Company, Partnership and LTC cannot be used to get around the rules
  - Interest deduction is not permitted when buying shares in an entity that owns residential property

Timing

- Start of 2019/20 income year (1 April 2019 for most)
- Phased approach?
- No bill as yet … due ages ago?
- Wider impact of Tax Working Group report?
- Obsolete if Capital Gains Tax?

Questions?

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