PROPERTY INVESTORS AT A LOSS

RING FENCING PROPOSED BY IRD

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It's now official. The government is actively moving against property speculators and investors.

THE LATEST IS A WHITE Paper from the Policy Team at IRD which is seeking to 'ring fence' losses from rental properties to ensure that we can no longer use those rental losses to reduce our "other" taxable income (wages, salaries, business income), and in turn, reduce our tax payable.

The rental losses won't be forfeited; however, they will simply carry forward, so they can be offset against future rental profits. Arguably, this is just a timing issue, but for some property investors, cash flow is going to be significantly impacted.

IRD has been saying for years that where an investor suffers some sort of real economic cost, i.e. it hit their back pocket then, to that extent, as long as an amount was ordinarily tax-deductible, they should be entitled to deduct that for tax purposes. The thing about rental property losses these days is that with the removal of the depreciation deduction anyone incurring a loss on their rental property has probably had to pay for that loss themselves by either borrowing more or using their own funds. In other words, the rental loss is a cash loss, and so the investor has suffered a real economic cost. If the government pushes through their proposed changes, there will be no relief until your rental property makes a profit.

Most investment decisions are not driven off the back of tax savings. However, these proposals will mean that property investors will need to fund losses themselves until the properties start turning a profit. IRD's position is that under a 'portfolio' basis investors will be able to offset losses from one rental property against rental income from other properties and thereby calculate the overall profit or loss across all of their portfolio. So at least investors are not going to have to wait until a particular rental property makes a profit before they can offset any losses - that's something positive at least.

Don't think you can set up clever structures using trusts, companies, or partnerships to circumvent these rules. Trusts don't work anyway because trust losses cannot be distributed to beneficiaries, so they are quarantined until the trust has taxable income. If you borrow money to invest in a company or a partnership that is 'land rich' (over 50% of their assets are residential properties) your capital investment will be deemed to be "interest", and so if there has been no return on the investment, the interest will essentially result in a loss for your company or partnership, which under the proposals will be ring fenced! Clever.

Needless to say, the proposal doesn't apply to a main home, properties owned as part of a land related business (they are taxable on sale anyway) or any properties which are subject to those mixed use asset rules, like the bach which is used privately and rented out occasionally.

It's probably fair enough that middle New Zealand has been guilty of focusing too heavily on property rather than investing in productive businesses, but the removal of the depreciation deduction for building structures a few years back largely remedied the problem as it removed those from the market who genuinely couldn't afford to self-fund their rental portfolios. These proposals go too far in our opinion.

If these proposals do eventually find their way to the statute books, the expectation is that they will apply from the beginning of the 2020 tax year. So, for most of us with a 31 March balance date, this means from 1 April 2019. However, IRD has also suggested that these rules be phased in over two or three years. Submissions to the White Paper closed on 11 May but do keep an eye out for some draft legislation as we believe this is a done deal.

For those interested in understanding more about the IRD position, the White Paper (which is an easy read) can be found at taxpolicy.ird.govt.nz/publications/2018-ip-ring-fencing-losses/overview or contact your usual Staples Rodway tax advisor.