

Residential rental losses Now restricted

As forewarned in our previous tax publications, the government has now passed the law which will restrict the use of losses from residential property.

These rules take effect from 1 April 2019,
so apply from the current tax year.



STORY

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What are the new rules?

The rules apply to 'residential land', using the same definition of 'residential land' already existing for the five-year bright-line test (basically, land zoned residential or used for residential purposes).

The rules apply by default on a 'portfolio basis', allowing investors to offset losses from one residential property against income from other properties the investor also holds. However, the investor can elect to apply the rules on a property-by-property basis (this could be useful if the investor holds some property which may be taxable on disposal).

Losses from residential rental properties will be 'ring-fenced', carried forward to future income years, and will only be able to be offset against:

- Residential rental income from future years; and
- Taxable income (after deducting the cost of the property) on the sale of any residential land. The rules around this are complex and, in most cases, sales would not be taxable.
- If any losses remain, they are available to carry forward against residential property income from future purchases or under the bright-line test.

If the property is held by a company, the usual losses carry forward rules (being 49% shareholder continuity) must also be met to allow unused residential rental losses to be carried forward.

There are anti-avoidance rules that apply if someone has an interest expense for money they borrow to provide funds to a 'residential land-rich entity', being an entity where more than 50% of the

assets by value are residential land. Broadly, these loss ring-fencing rules apply to the interest deduction available to the owner of that land rich entity.

What is not caught?

The following situations are not caught by the new rules:

- Residential land which is a person's main home, or for property subject to the mixed-use asset rules (which have their own loss quarantining rules).
- Residential land held by a land developer for the purposes of developing or subdividing the land, or other land that is held on revenue account, and the person has notified Inland Revenue of this when they file the tax return for the year they acquire the land or, if they already hold the land, when they file their 2020 income tax return.
- Property that is accommodation provided to employees or other workers in all cases and, if the employee is associated with the employer, the accommodation is due to the nature or remoteness of the business.
- Property owned by 'widely-held' companies, as large companies often hold residential land incidentally to their business.

These rules underwent substantial revision as they passed through the law-making process, and there are some added complexities that apply now to interposed entities and residential portfolios that are made up of both taxable and non-taxable residential properties.

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