Tax Working Group
Te Awheawhe Tāke

Tax Working Group Public Submissions Information Release

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In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

SUBMISSION TO THE TAX WORKING GROUP – Joanna Saywell

1. **INTRODUCTION**

My name is Joanna Saywell, I was an asset manager for our local authority and I am a civil engineer. I have been a residential landlord for seven years. We have five rental properties and have owned our current home for nearly four years having moved from Wellington to take up employment in Feilding.

We bought our five rental properties as long term investments so that we could have a passive income from rents in our retirement.

All our rental properties have required at least [1] spent on them to bring them up to a standard where we have felt comfortable with renting them out. In most cases this expenditure was needed to rectify years of delayed maintenance and improve insulation and electrical safety. All these works are considered Capital Improvements and so cannot be offset against rental income.

Despite spending up to [1] on two of our houses when we bought them, their Government Valuations remained relatively static for six years.

2. **INCOME TAX**

I believe that the tax working group should have paid more attention to income tax inequalities.

Since benefits such as pensions and unemployment allowances are paid from taxes they should be assessed and included in the overall income assessment for individuals. This would be fairer for those that are temporarily unemployed or are able to get part-time work.

Currently the benefit system punishes people who work part time or receive an overseas pension by reducing their benefits by the amount of their additional income. This creates a disincentive to work or claim overseas pensions. There should be a low income threshold below which there is no tax liability e.g. at just above the old age pension. Then both benefits and other income over and above this threshold could be taxed at 11% until the minimum wage is reached.

All the existing income tax thresholds need to be raised to ensure that the only people on the highest income tax bracket are the top 10% of earners, as it was when the current tax brackets were set.

3. **TAX ON RENTAL PROPERTY – RING FENCING OF LOSSES**

Most property investors have one or two rental properties. Typically these were bought with an 80% loan with the rent set to cover the mortgage interest and standing charges (currently averaging about $8,000 per property). With current limits on lending, investors need a 40% deposit in order to purchase a rental property. This yields a return, before tax, of 2.3% on money invested or 11% of the rental income. It only takes a few weeks without

rent for a loss to be incurred. Many small investors subsidise their rental properties for the first few years until they have paid off more of the mortgage.

If the investment sum were placed in a term deposit it may yield as much as 3.5% before tax but the value of the investment sum would reduce in real terms due to inflation.

Small investors can cope with minor losses on their rentals if they are able to offset these losses against their other income tax liabilities. Ring fencing losses benefits the rental companies and investors with large portfolios at the expense of the smaller (majority) of investors.

Typically, rent goes to pay mortgage interest (54%), insurance, depreciation of chattels, maintenance (20% excluding GST), tax including GST and rates (18%) and landlord/property manager (8% after tax). Clearly taxes are a considerably higher proportion of the rent than the income for the investor.

I believe that ring-fencing of losses would be unfair, particularly to small investors. It will lead to a reduction in available rental property and an increase in rents overall.

4. CAPITAL GAINS TAX

I don't see any suggestion of a CGT on shares (although these are reported to increase in value more quickly than property), nor the sale and purchase of franchises where these are dependent on goodwill.

Current tax guidance states that capital gains tax is due on the sale of any properties bought with the intention of re-sale for a profit (property speculation) regardless of how long the properties have been owned. Capital Gains Tax is not applied if the intention at purchase was to keep the property for rent.

The example given by the tax office is a case of a home owner who tried to sell her house before going overseas to work. She failed to sell so instead rented out her house while she was overseas. She eventually returned to New Zealand twenty years later and sold her house without living in it again. She was charged tax at current income tax rates on the total capital gains on the increased value of the house from when she first put it on the market to when she sold. The IRD reason that her intention, when she first rented out the property, was to retain the property until she could sell it at a profit.

Recent governments have struggled to understand how the Inland Revenue Department can determine the intention of an investor at purchase and so have introduced the "Bright-Line Test" which is designed to catch property speculators who buy properties, renovate and sell for profit. I believe that a person receiving their main income from buying a property, renovating that property and then selling the property at a profit should be taxed on their income. Buying and selling within two years is a reasonable indication of intention at purchase.

However, investors who want to have a few rental properties may find that they have difficulty getting tenants for a particular investment property so may need to sell in order to purchase a similar property in a more popular rental area. If they have only had a property for less than two years, chances are that they have lost money so the Bright-Line test would mean that they could claim sale losses against tax. Without the Bright-Line test, if their intention had been to rent the property indefinitely, they would have been unable to claim for their losses.

As a property investor I support the Bright-Line Test as a means of demonstrating intention when applied over a two year period.

The recent extension to the Bright Line Test to five years may catch investors who experience fluctuations in rental demand but should enable them to claim any losses against tax when formerly these could not be claimed. I can understand that extending the time to five years is a good way of claiming tax from speculators that habitually renovate and sell one or two properties every two or so years. I am not sure whether there are exemptions for people who need to move to retain their employment (for example people in the armed forces) but I think this needs to be allowed for.

When I lived in the UK there was a Capital Gains Tax on property used for income. Own homes were exempt but if a portion of the home was used for business and building costs (e.g. mortgage) were claimed then CGT could be levied on that portion of the sale (less the CGT allowance for inflation).

I believe that CGT should be limited to properties sold within two years of purchase.

However, if CGT is introduced for all property other than owner occupied homes then there should be an adjustment for inflation (CGT allowance) that is either linked to the construction index or the annual rate of inflation. There should be no CGT on property that forms part of an estate as it then becomes an inheritance tax.

5. INFLATION

The main problem with a CGT is that there needs to be an allowance for inflation, otherwise the tax becomes a tax on inflation which is clearly ridiculous. Despite comments in the discussion document, I cannot think of any items that are taxed on their inflation component. There are several commodities that need time to age, such as vintage wine and cheeses but the value of the item is in its flavour not its cost to produce plus inflation.

Cars, yachts and antiques can fluctuate in value depending on rarity and demand but generally lose value over time.

Shares in large companies can vary considerably but, we are told, generally increase in value over time at a higher rate than property. Large sums are needed to make financial management cost effective and this is outside the reach of most small scale property investors.

6. DEPRECIATION

Utility providers, such as local authorities have a large assortment of valuable assets, paid for by customers or ratepayers, these are regularly re-valued, taking into account the original cost of installation, the remaining useful life and the current cost of replacement. Recently, most local authorities make allowances for replacement of assets by setting money aside in their annual budgets. They call this "funding depreciation" and is an expense every year. This fund is then used for replacement of assets. Note that this is a maintenance expense not a capital expense.

Interestingly utility asset values never appear to increase over time, other than by installing new assets.

As noted in the discussion document, there is now no allowance for depreciation of rental properties despite their design life being very similar to utility assets. Existing houses are rarely sold at or above their replacement cost. So any capital gains are mainly land related.

Hence a CGT just on rental property is actually a Land Tax.

7. CONCLUSION

I believe that income taxes need to be fairer for those requiring temporary benefits or living on pensions. I believe that the higher tax threshold needs to be increased with more intermediate steps, including a minimum where no tax is paid.

I also support efforts to increase tax revenue from overseas corporates (such as banks) that are taking their New Zealand profits off shore.

The government seems determined to reduce the number of small investors. The current CGT rules already target property speculators so there should be no reason to ensure investors are required to pay CGT on rental properties, particularly where this looks like a Land Tax.

If CGT is applied across the board then there should be CGT allowances index linked to inflation.

Any increase in taxes in one area should provide tax savings to the majority of taxpayers by a reduction in income tax or rates.

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Submitting your submission

You can email your submission to submissions@taxworkinggroup.govt.nz