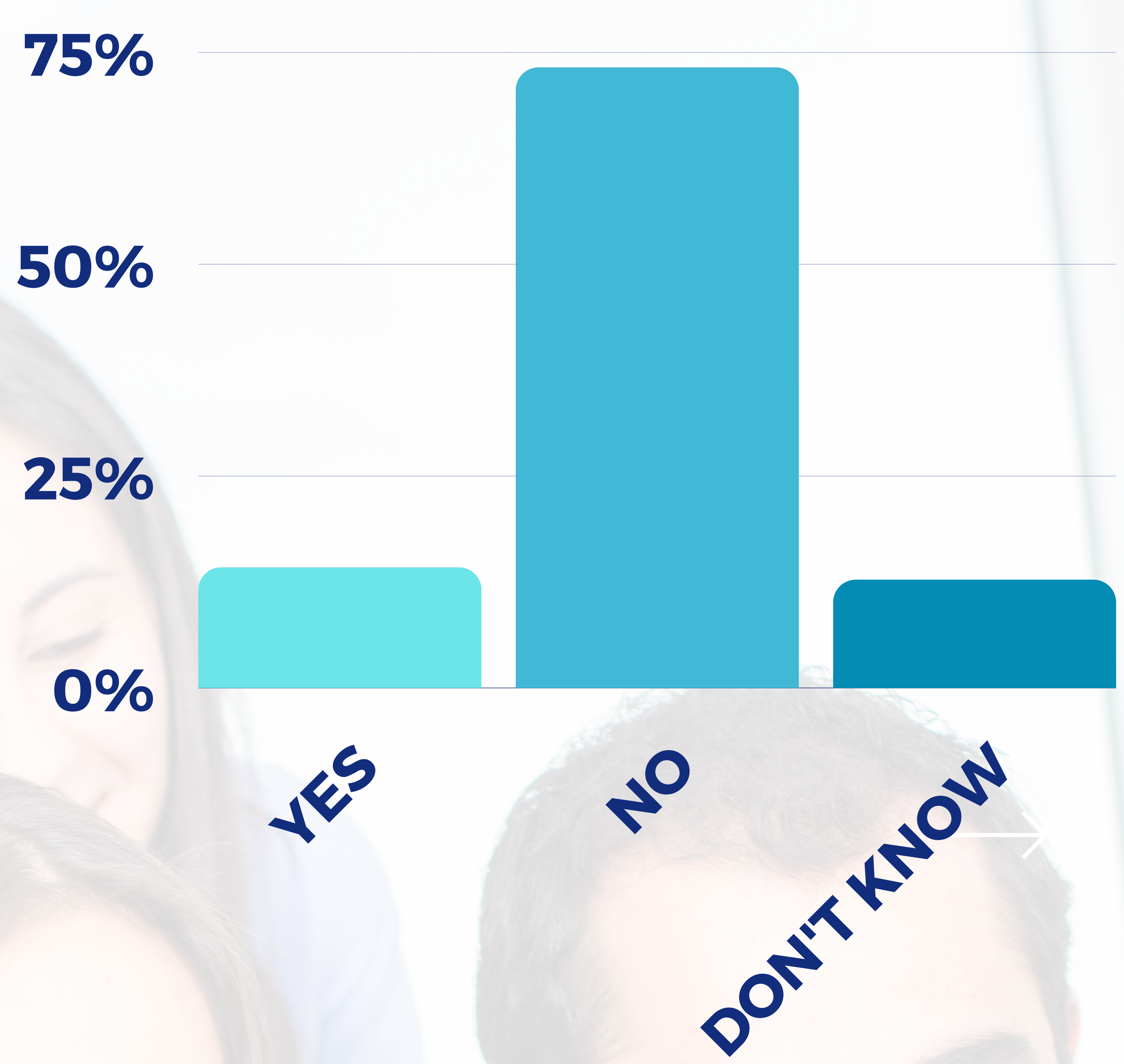
Is removing interest deductibility a tax loophole?

Almost 75% said "No."

Whilst the majority believe that the Government is wrong in calling the removal of interest deductibility against rent a ‘tax loophole’. Nearly three-quarters of all respondents do not consider this to be a tax loophole.

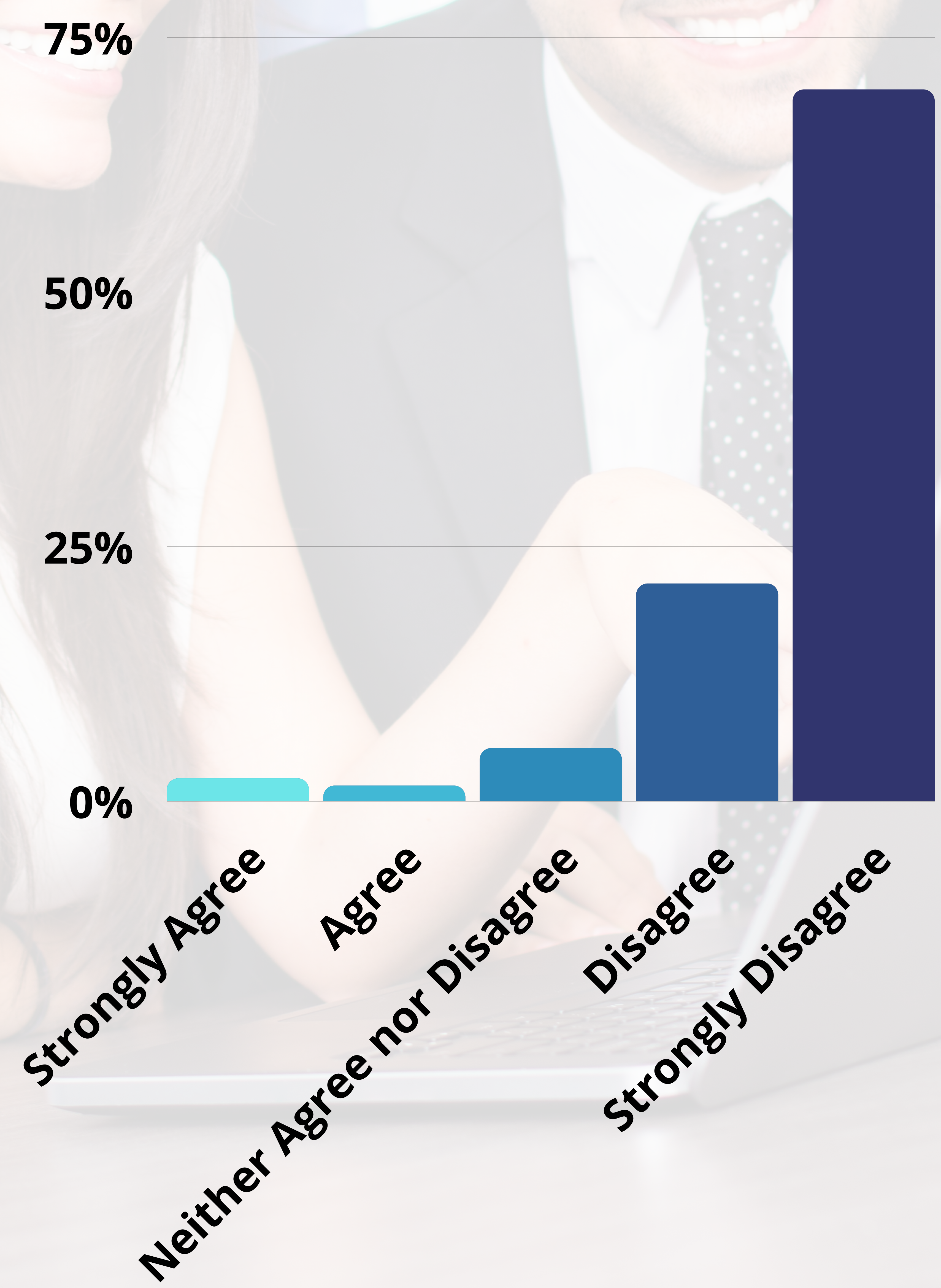


Will removing interest deductibility improve the situation for tenants

Most have stongly disagreed

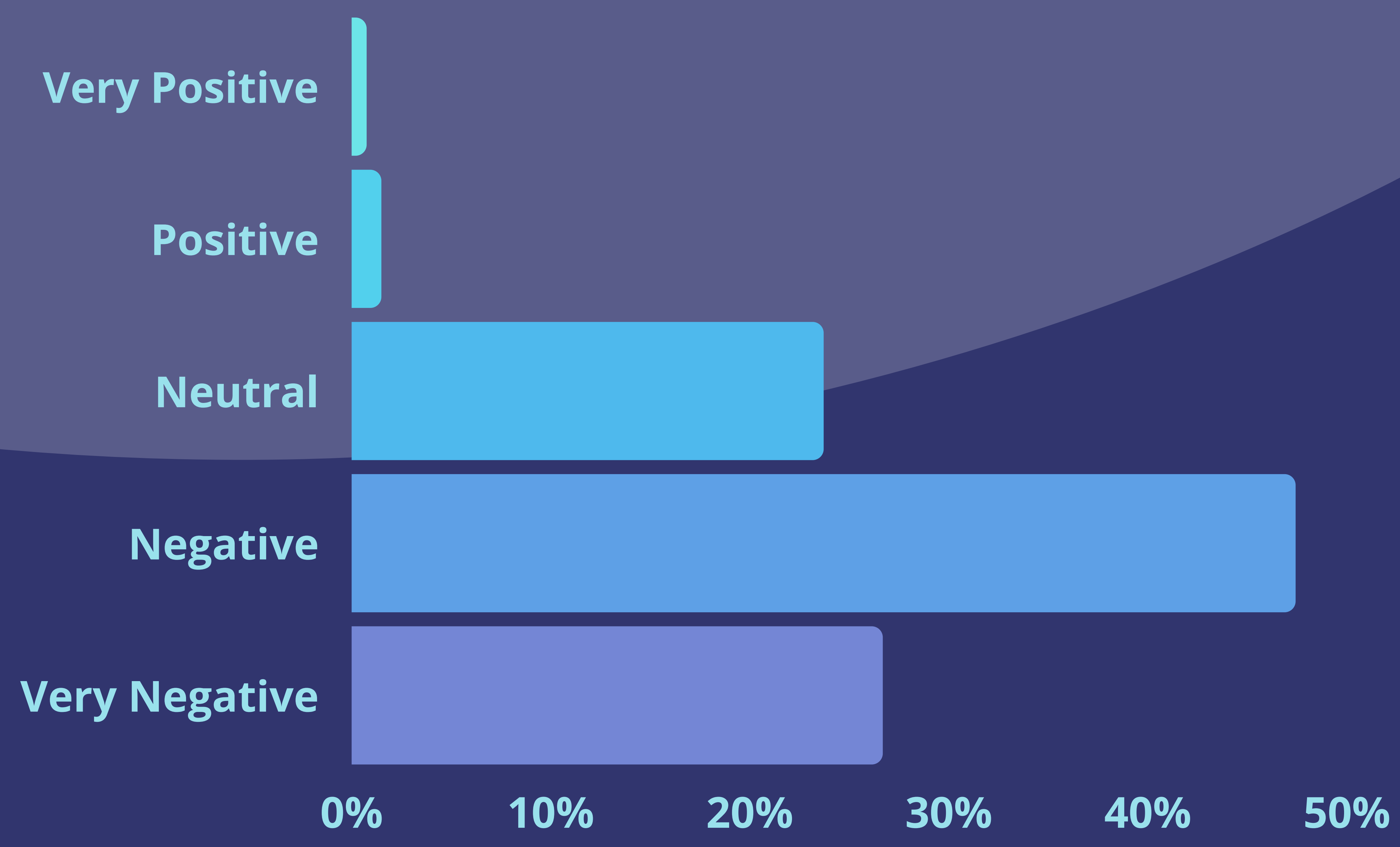
The extra costs that landlords will be liable for when the removal of the interest deductibility kicks in will see many landlords who stay the course with their investments put rents up more aggressively. In which it will impact tenants in a negative way.

Over 70% of respondents strongly disagree and 21% disagree that the introduction of the recent housing policy will improve the situation for tenants. Only 4% of respondents believe that this policy will improve tenants situation.



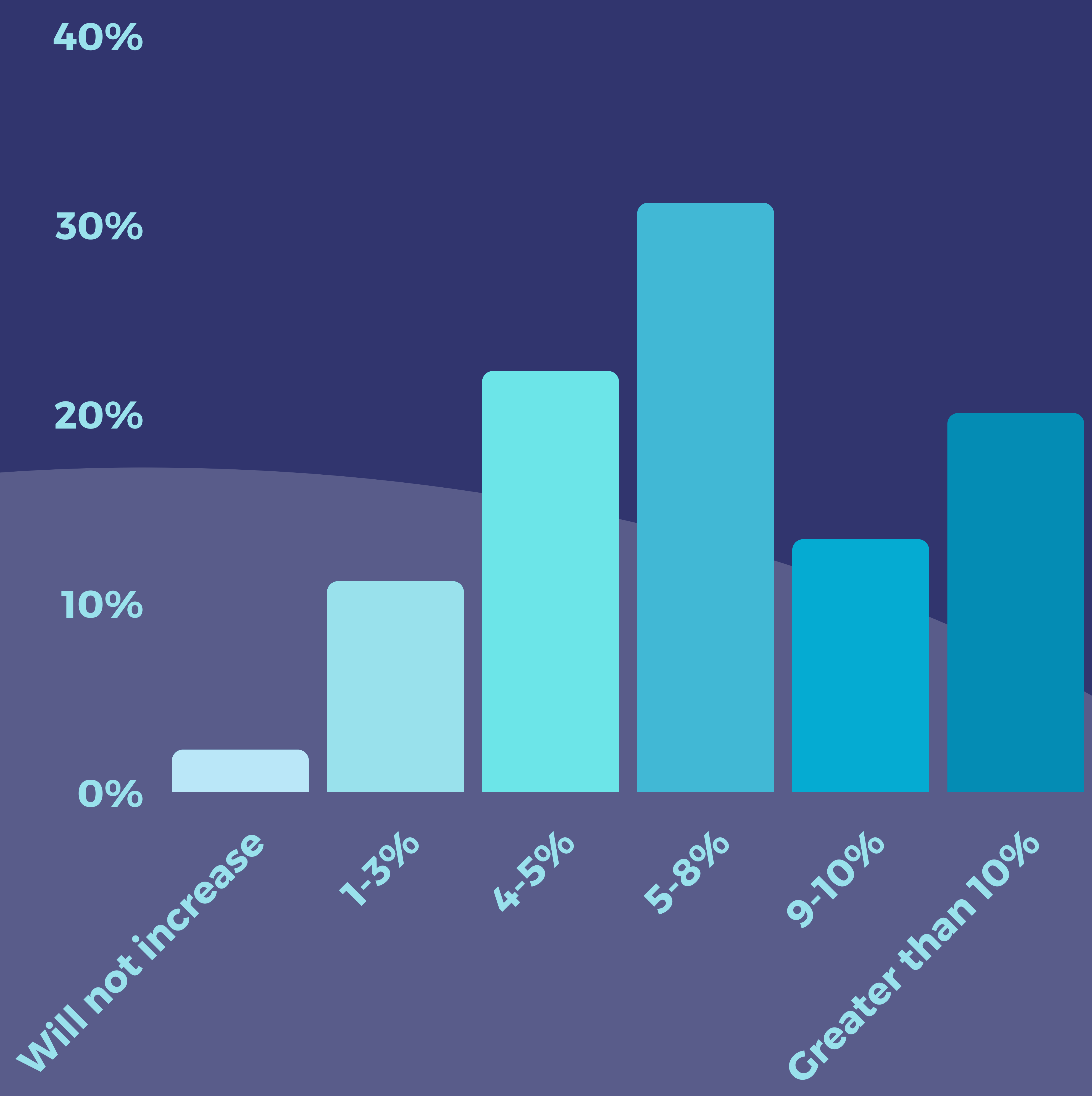
What will the likely impact be on your situation following the Government announcement?

According to the survey, over 90% believe that the situation will have a negative impact on them.



Will rents increase over the next 12 months and if so how much by?

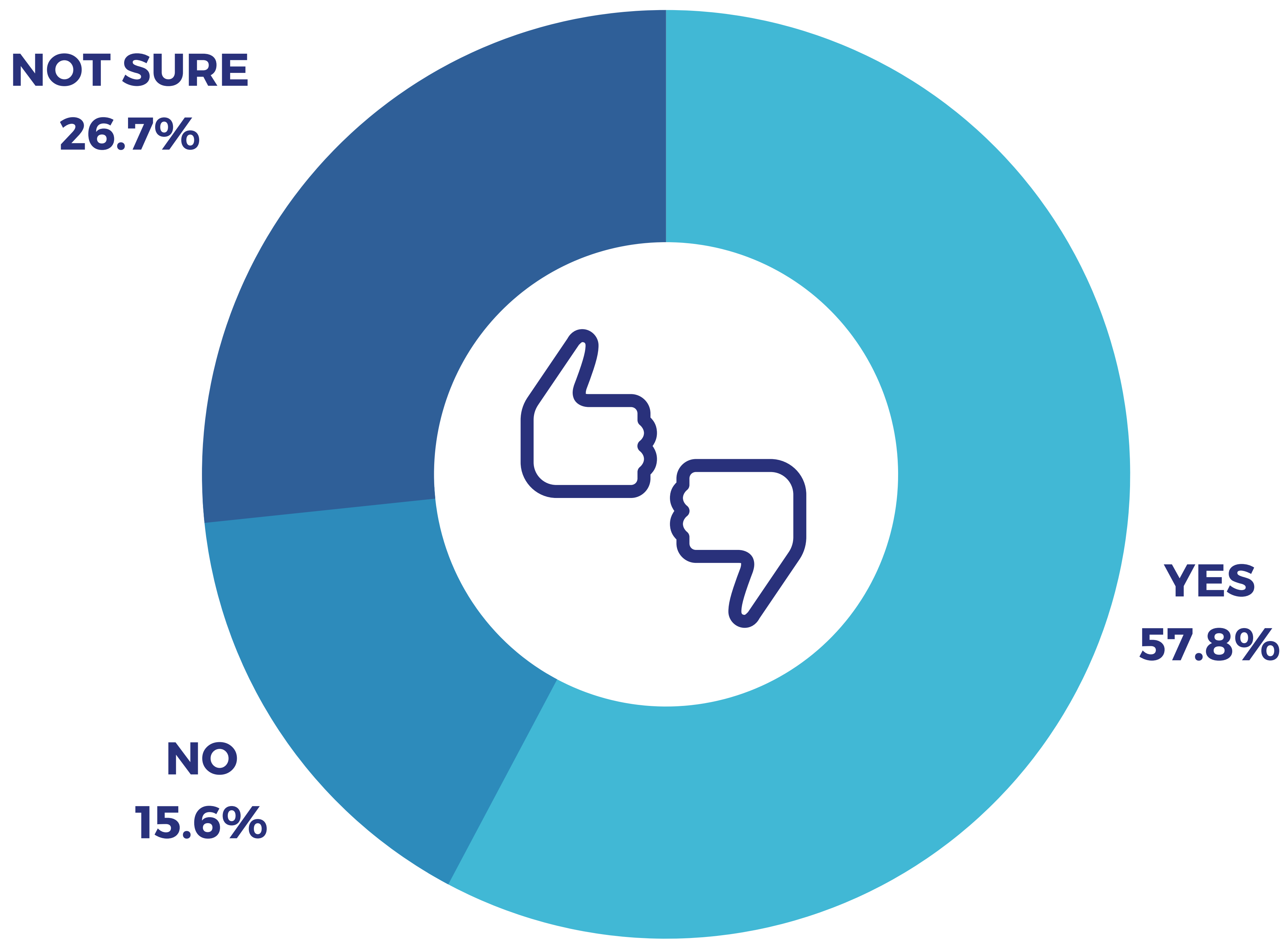
Over 64% of those surveyed believe that rents will increase by more than 5% in the next 12 months with over 20% believing that rents could increase in excess of 10%.



Real-iQ

Real-iQ

Do you believe the Government will introduce rent controls?



57.78% of all our responses stated: YES.

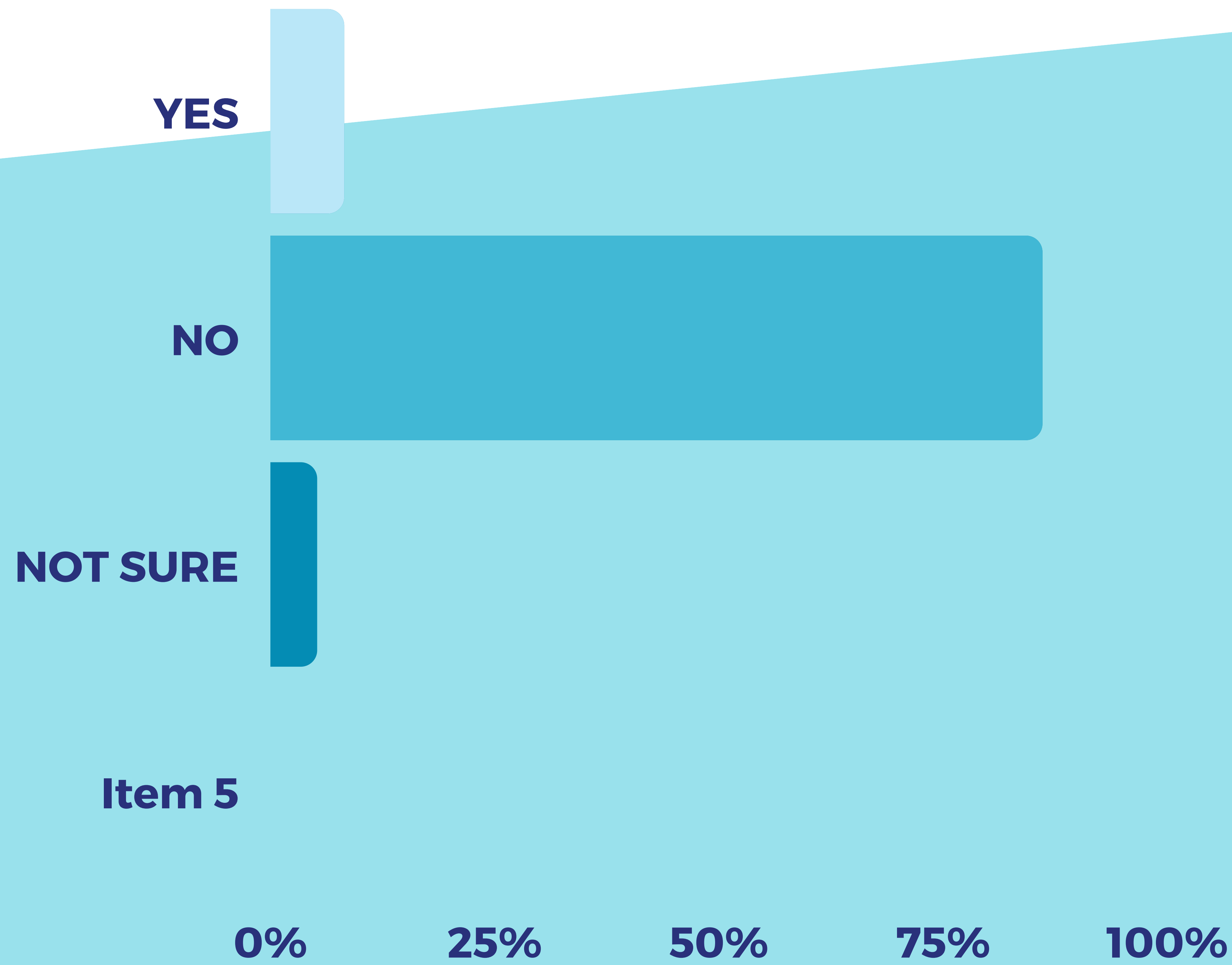
The majority of the respondents believed that the Government would introduce rent controls.

16% didn't think that they would be introduced whilst 27% were not sure whether they would be introduced or not.

Should the Government introduce rent controls?

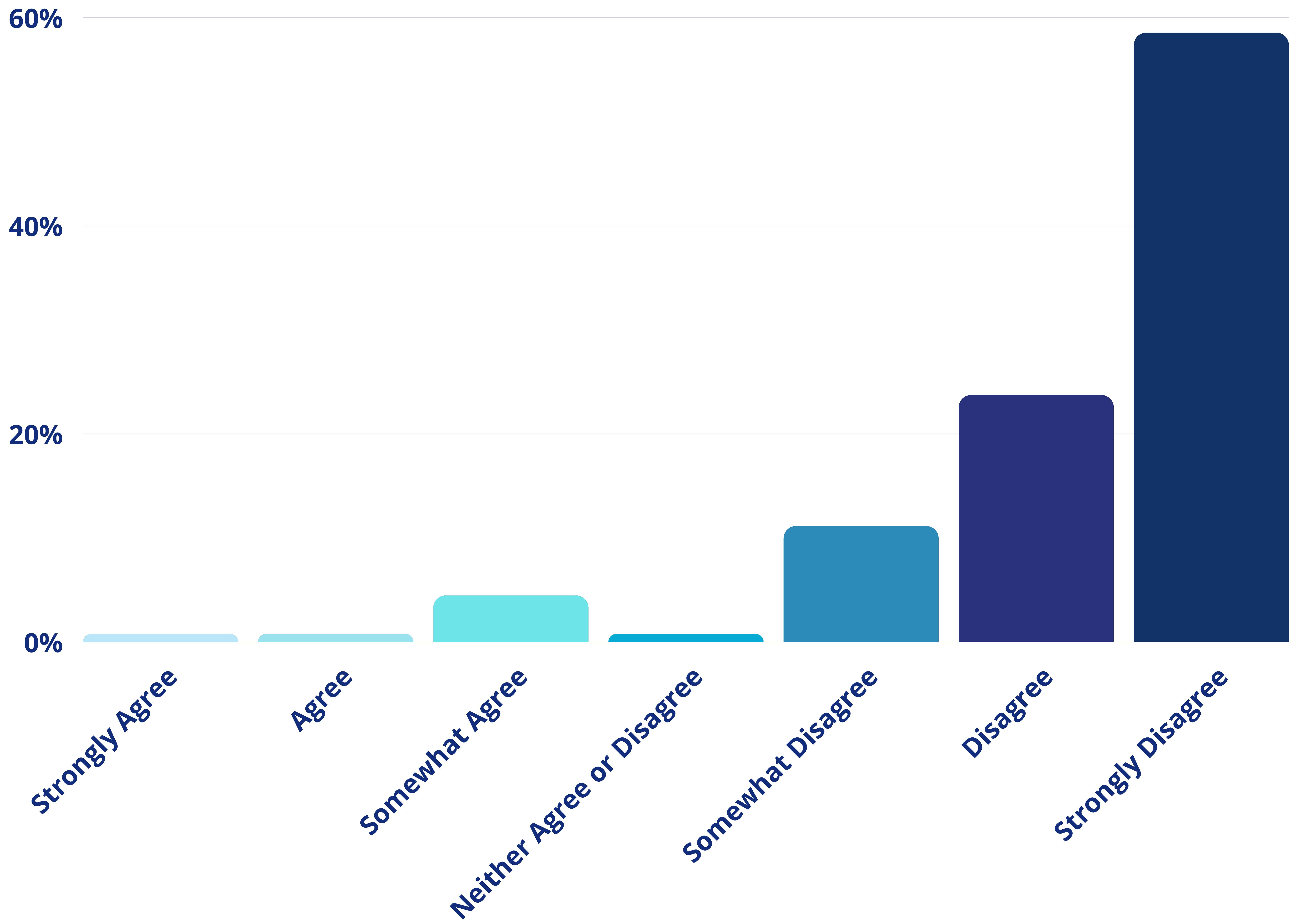
86.03% of all our responses stated: NO.

We asked in the survey whether participants believed that the Government should introduce rent controls meaning that rents could only be increased in line with inflation or if you made substantial improvements to the property. 86% believe that rent controls should not be introduced.



The Government understands what is required in regards to the housing crisis

We've collected your responses on what you think about the Governments Housing Policy.

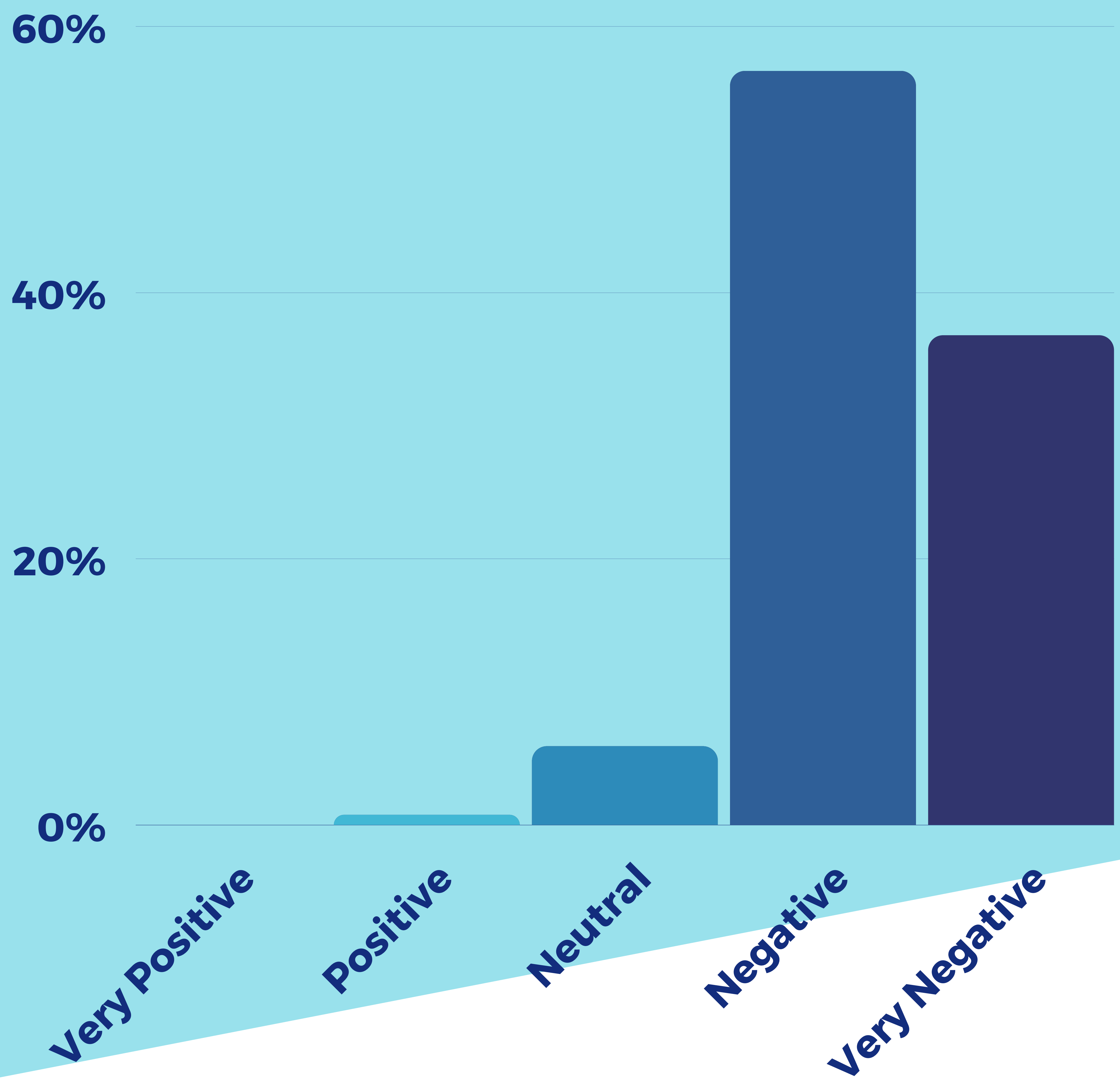


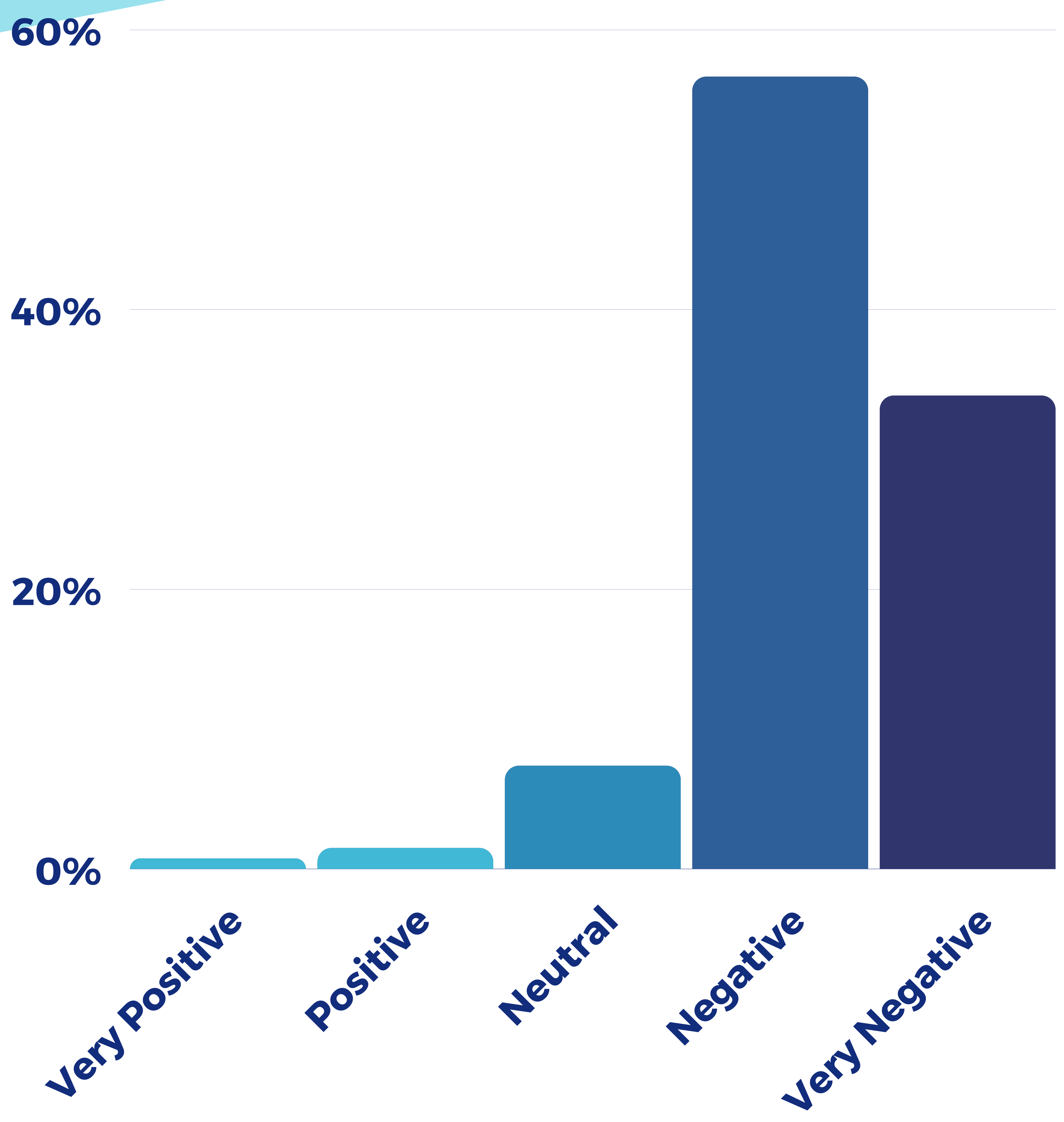
The responses are unanimous. Over 57% of respondents strongly disagreed with this statement and in total 92.7% disapproved of the Government's handling of the crisis.

What will be the likely impact of the recent housing policy announcement be on landlords?

Most agree the impacts will be negative.

Over 90% of those surveyed believe that the situation will be negative for landlords.

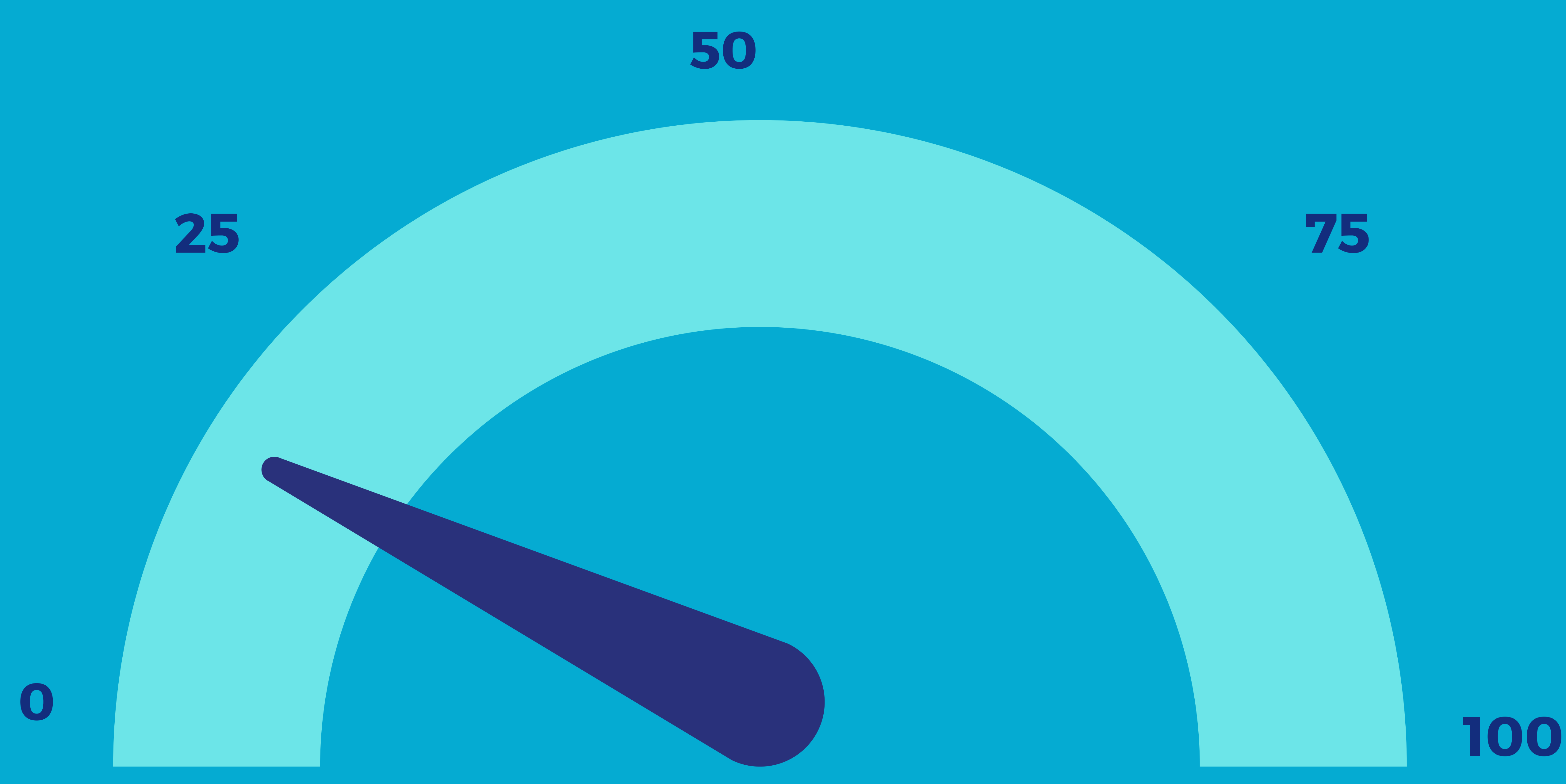




What will be the likely impact of the recent housing policy announcement be on tenants?

The consensus of opinion is that these changes will do nothing to improve the plight of tenants and will actually make their situation worse.

On a scale of 0 (awful) to 100 (excellent), How good a job is our Government doing in regards to housing?



An alarmingly low score

When we asked what score out of 100% they would give the Government in regards to housing, the average score was 17% and just under 90% of respondents believed that the announcement would negatively affect tenants as well as landlords with a reduction of supply and an over-inflated increase in rents.

Real-iQ

Real-iQ

Are there any comments you would like to make about the Government housing policy?

Too many academics and not enough people involved that are actually working in the industry

Band-Aid over Band-Aid. The more they interfere the worse it is getting for tenants and the "mum and dad" investors trying not to rely on a pension at the end of it all.

Policy aimed at controlling investors and helping first home buyers will most likely have some negative consequences for those unable to purchase property and need rentals. Current policy particularly around tax will likely encourage sales of rental stock and discourage investors in long term residential rentals.

They are making a bad situation worse by the minute.

Stop funding emergency housing and build house

Already 10% of my portfolio has gone on the market or sold since 1 January due to the number of changes and escalating cost. This is just removing homes from the rental market and increasing rent due to supply and demand.

Can we just call it a tax policy? It hasn't done anything to address lack of housing, cost of building, homelessness, the difficulty for first home buyers to purchase, so how is it a housing policy???

I'd like them to think out where all the tradies are going to come from with new builds. Contractors are already under the pump & overworked so we desperately need apprenticeships as well as qualified tradies being reliable.

Healthy homes requirements are too high at a time when there is a high housing shortage. From 1 July 2021, there will be a further problem when properties that would normally come onto the rental market as the "accidental investor" when owners absent due to job or study transfers for a year won't meet requirements, so they will leave them empty, not prepared to spend extra on a new bigger heat pump and extractor fans and reports as well as all the other risks perceived. Their homes may be perfectly average but not up to high enough standard. Better than people living in motels.

They're a bunch of wallies that consistently show us they have no real-life experience in owning rental properties or running a business.

Serious changes need to be made.

I feel their policies may be more applicable for City areas. In the small provincial town where I am, it is 100% taking homes out of the rental pool making it harder for tenants.

The housing crisis has got a lot worse, and for the government to create this so call housing policy will only cause further issues. Owners will look to sell, increase rents or change how they have their rentals set up which may include Air BnB, holiday houses etc. They have just removed the options for investors to purchase more rentals to help the tenants out and provide them with accommodation. I believe their focus should be put on providing more social housing, whether it is rebuilds or purchasing of rental properties.

Brightline is a Capital Gains tax, no other words should be used. It is only effective on speculators not investors, I have no concerns about it at all.

Unfortunately, I believe the tenants will cope with the extra costs involved, fingers crossed these changes help create more homeownership however I don't believe that will be the case.

I think the government understands the issue however the solutions they have are not matching. Therefore it comes down to execution rather than defining the problem

Rents will only increase and fewer properties will become available therefore making the housing shortage worse.

One comment as to why there are fewer rentals is – We are losing units to developers who are replacing them with homes for first homes buyers where are those tenants supposed to go? This is only one, there are too many people who work and are in state housing why they now are on a living wage? Time to give them notice oh you can't do that it's not kind

It feels like their policies have been rushed through without talking to the coal face to see what we see. We now have emergency housing tenants that are very unlikely to succeed in securing a rental property. These can be potentially good tenants but who will risk putting them into their rentals

There will be more of a shortage of rental accommodation as landlords will sell their rentals, the majority of tenants still won't want to or can afford to buy and NZ taxpayers will fund the emergency accommodation. The government have too much control over what landlords do as it is but with the new laws it's becoming quite a socialist country.

The media only cover one side of the story, Property Managers who are trained in their fields are never approached about the housing and rental situation. Under this Government, the situation for emergency housing has increased because of their new legislation. It will not be improved any time soon under this Government.

Idealistic socialism! Counterproductive and counter-intuitive to a market shortfall Tired of the "landlord bashing"

Real-iQ

A lot of landlords are now considering selling the properties making it harder for tenants to find new homes

At least extending the bright-line test will mean owners will have to hold on to their properties for longer, but if there was a capital gains tax on investment properties only this would be fairest.

It seems that the governement think that making it harder to invest in housing (providing rental stock) is going to make it better for renters ... every legislation change lead to rents going up and less affordability for the regular family just trying to make ends meet. I work for a property management company and I rent and I deal with property investors all the time. Most of them are having to put the rent up to cover the cost of Healthy Homes upgrades and now this tax stuff, finds them almost crippled with extra costs. It seems to me that the repercussions for all of these decisions are not fully thought through.

Short sighted. Rents will go up to compensate for no tax incentive on mortgage interest. And first home buyers are renters first.

Short-sighted – there will be no winners – more owners will sell and there will be fewer houses to rent. First home buyers are now competing with Housing NZ in our area.

Stop making Landlords a scapegoat for the housing shortage. We should be your best friends, not constantly being hammered by the Labour part media and propaganda machine.

Criminal.

More transportable housing that people can afford they will be better and warmer than the older houses we have now

When campaigning they said they would make rents cheaper and improve the housing situation, by it has worsened.

They have no idea what they are doing how to run an economy or the country. I hope the stupid people that voted for them last time see sense and don't cite them in next time

They obviously don't understand what the impact will be in 12-18 months, this will impact landlords negatively but will be just as bad for tenants and still won't help home buyers either, the housing crisis just got worse wait and see.

Hold a snap election ASAP then we can get a real Government

They need to build more houses & their policy doesn't address the underlining supply issue

They have not done their homework. They are listening to tenants rather than landlords who provide the housing that is so much in need at the moment. The RTA Amendments were meant to be a balance for both owners and tenants. NOT so, it now leans towards the rights of tenants. This Government is relying on the private sector to provide housing but not rewarding them in doing so, only if they build new homes.

This is a supply & demand issue and removing interest cost deducibility is not going to address the true issues.

Absolutely out of touch with the reality of the market and the effects that these retarded changes will have

Labour is in it to get as many votes as possible to stay in power. The more people in social housing, emergency accommodation or on WINZ the better it is for them. They are a communist government in disguise. They don't care what is really good for the country so long as it's good for Labour. They don't have a clue how to solve the housing crisis because if they did they wouldn't be punishing landlords who provide the majority of housing. We have a wood shortage because we export our best wood – go figure! How are they going to build more houses! Next, we will be importing wood that is more expensive than our own.

It is an uninformed policy with significant side effects they haven't considered. They need to stop mucking around with the legal side and focus on how we can get more houses built.

Unfortunately, I believe the tenants will cope with the extra costs involved, fingers crossed these changes help create more homeownership however I don't believe that will be the case.

I think the government understands the issue however the solutions they have are not matching. Therefore it comes down to execution rather than defining the problem

Rents will only increase and fewer properties will become available therefore making the housing shortage worse.

One comment as to why there are fewer rentals is – We are losing units to developers who are replacing them with homes for first homes buyers where are those tenants supposed to go?   This is only one, there are too many people who work and are in state housing why they now are on a living wage? Time to give them notice oh you can't do that it's not kind

I feel like they are slapping in these grandis policies on a national scale (very quickly too) and not actually playing out each eventuality that can occur. It seems aren't rooted in reality. Why hamstring landlords and why not just pump out social housing and housing in general. Give the people on the ground every ability to fill the supply hole on a private and public level. Purpose-built emergency housing, social housing and lessen barriers to building privately. Bring supply up and naturally, the market will correct, more people will be able to purchase cheap homes due to the greater supply. Build small 1 and 2 bedroom houses/units so beneficiaries can live in them instead of motels. If they don't want to live in them, work up and get out. At the moment governments and consecutive governments have made it more and more difficult to work out of poverty. No one can save with the rents they have to pay at the moment.

The process adapted to install this reeks of Muldoon

They have no idea what a mess they are creating

Real-iQ

THEY ARE TRYING TO DO THEIR BIT

They're a bunch of wallies that consistently show us they have no real-life experience in owning rental properties or running a business.

It is not well developed or consulted

It's great that the government want to make housing better for tenants and at most, this does need to happen but the way they have gone about it is wrong. If you introduce anything that makes landlords better their property and have to spend money, the flow-on effect will reach the tenant in the way of dearer rents. Unfortunately, they are penalising owners which means they will leave the industry. Houses are getting too expensive for landlords to buy to make money off and if you introduce rent controls, there will be no money to be made for a landlord/investor. Even first home buyers can't afford the housing so who is actually going to buy all the stock once landlords leave the market?? Maybe the government will buy it in the form of state housing. Crazy as I don't think the government have much clue as to the legislation they have written, it's so confusing and makes no sense a lot of the time!

Like a monkey with a shotgun, pretty cute, but very dangerous.

They truly have no idea how much an owner of a rental property is helping the government house people because the government does not know how to. If the government keep stabbing investment owners they will have a bigger problem as people exit the industry and again they will have no idea how to house more people

They have no idea of the effect they have on the industry. It was highlighted when the PM stated in a press interview last year that she would be disappointed if Landlords increased rents because of the legislation changes. Go figure!! Property investment is a business and this government has no inclination to assist businesses. Sadly the tenants will miss out.

I agree with the initiatives that will aid tenants, like more money to build new homes, but making things harder for landlords isn't actually going to help, because the ones that they are actually targeting – the ones with multiple properties – are going to be the one who feels the impact the lease. They can sell one property and the other 19 will balance out. It's the 'mom and pop' investors, who only own one or two extra houses – and who are usually the better, caring landlords, that are going to be hardest hit, and most likely to sell – good for first home buyers, but bad for the (probably long term) tenant who has to leave and enter a competitive market, and bad for the landlord who is counting on that investment for retirement.

The Govt needed to consult with the industry insiders before making reforms such as this

The Government is in a very difficult position with no easy solutions but this housing policy appears to set up to help middle-class millennials (children of politicians) to get on the property ladder. It has very little thought to the well-being of long term tenants who are likely to suffer from these changes.

Landlords will continue to sell up as it's just getting too hard to be a landlord.

Typical playing with end results NOT addressing the base causes of the problem

Unfortunately, I believe the tenants will cope with the extra costs involved, fingers crossed these changes help create more homeownership however I don't believe that will be the case.

Yes a more consultative process

Like a monkey with a shotgun, pretty cute, but very dangerous.

The government need to take a step back and think long and hard about the changes that they make, and not just the impact that it has on the tenants (in their mind for the better), but what the impact is on the landlords as this is for the worse.

Sadly once again the Government seem to fail to understand the rules and changes they put in place like this the more it makes it very difficult for the very people they are supposedly wanting to help. There are so many factors that contribute to the housing crisis. Immigration. The Osaki case and Insurance have a big impact as does the removal of the 90-day notice. We can no longer take a chance on someone that may have had a slight hiccup along the way. Tenants need to be held accountable for their actions and making owners claim insurance is ridiculous. I have always likened renting a house to renting a car, we don't hire a car & make alterations, not pay for it and drop it back off and say oh well too bad get your insurance to pay for it. Why should the rental property be any different? To announce such a drastic change in the interest deductibility within our tax system was sudden and the government gave no indication that something like this was about to happen this causes uncertainty across a number of industries and people become cautious of the current government's intentions. Particularly when they were advised against it. What about blocks of flats, a first home-owner is not going to buy them why penalise people trying to provide somewhere for people to live. If they want us to build houses then they need to sort out local governing bodies councils take too long, make the process difficult etc I believe they have targeted the wrong group of people landlords are not all bad. Regulate the industry!!! Push more private landlords to property management, to qualified people.

They truly have no idea how much an owner of a rental property is helping the government house people because the government does not know how to. If the government keep stabbing investment owners they will have a bigger problem as people exit the industry and again they will have no idea how to house more people

Knee jerk and populist policy

Real-iQ

Landlords are already starting to sell their investment properties, this may be good news for first home buyers, but it will create a shortage of investment properties for tenants who either do not want to own a home (their money is in their business for example) or for tenants who prefer to tenant (it does have it's advantages, maintenance is done at no expense to the tenant, rates and insurance are paid for etc.) As a result, rents will rise, simple supply and demand Economics 101. They would have been better seriously increasing new builds and then encourage new build housing purchasing for everyone, no matter who you are. Tenants still need to live somewhere, this will eventually end up disadvantaging some. Poor judgement and lack of foresight!

Short term they may have a limited effect on curbing the number of investors buying property, but long term it will have very little effect. Those investors with large portfolios will just sell off a couple of properties to make it all work – they will be the least affected. Investors that own 1 or 2 properties may possibly hang in there and be in it for the long haul, as was their thinking when they first bought into an investment property. The problem is supply and demand, there are simply not enough houses to go around. The Govt can put all these other things in place to try to solve the problem of housing shortage, but it really just defers the problem. We need more housing.

From: s 9(2)(a) [redacted]
To: Policy Webmaster
Subject: Design of the interest limitation rule and additional bright-line rules
Date: Monday, 12 July 2021 1:10:01 PM
Attachments: Buildcorp.pdf

Please refer to the attached.

s 9(2)(a) [redacted]

[redacted]

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Submission on Proposed Interest Limitation Rules

12 July 2021

Summary of the Group

Financial Impact the Proposed Changes

Recommendations

Summary of the Group

s9(2)(b)(ii) [redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

Financial Impact of the Proposed Changes

s 9(2)(b)(ii) [redacted]

[redacted]

[redacted]

[redacted]

[redacted]

Recommendations

The objectives in the discussion paper should not be achieved at the expense of residential rental businesses that are of a scale and size where they support full-time employment. Not only will the full-time employment of family be compromised, but the continued employment of a small workforce would come to an end.

Our recommendations are that consideration is given to excluding from the proposed changes, those businesses that are of a scale sufficient to support full-time employment of at least 6 people. The reason we have nominated 6 employees is this is the lower limit used by IRD in defining a SME and at this level and represents a business and a serious commitment to investment over a sustained period.

From:	s 9(2)(a)
To:	Policy Webmaster
Cc:	s 9(2)(a)
Subject:	Urban Plus Limited - Submission to Inland Revenue
Date:	Monday, 12 July 2021 1:27:31 PM
Attachments:	UPL - Submission to IRD on interest limitation discussion document 09.07....pdf

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Dear Deputy Commissioner,

Please see Urban Plus Limited submission letter **attached** regarding the Government discussion document on interest deductibility for residential property.

Regards

s9(2)(a)

Level 1, Russell Keown House, Cnr Laings Road & Queens Drive, Hutt City, Private Bag 31912, Lower Hutt

s9(2)(a)

URBAN PLUS

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Deputy Commissioner
Policy and Regulatory Stewardship
Inland Revenue
PO Box 2198
Wellington 6140

By email: policy.webmaster@ird.govt.nz

12 July 2021

Dear Deputy Commissioner

Thank you for the opportunity to comment on the Government discussion document: *Design of the interest limitation rule and additional bright-line rules*.

Urban Plus Limited (**UPL**) is a council-controlled organisation (**CCO**) owned by the Hutt City Council ("**the Council**"). As an extension of the Council's social policy programme, UPL provides, among other services, social housing.

The overall objectives of the reform are aligned with UPL's purpose and activities. In particular, to "ensure that every New Zealander has a safe, warm, dry, and affordable home to call their own – whether they are renters or owners". Our submission seeks to illustrate the impact of the proposals on UPL, to ensure that the new rules will not detract from UPL's ability to advance the Council's social housing objectives.

Background

Activities

UPL manages and invests into the Council's portfolio of social housing, since it took ownership of the portfolio in 2007. Its activities include:

- Property development throughout the Hutt Valley region, including basic greenfield subdivisions to full residential home construction and sale to the market; and
- Provision of rental housing targeted towards the low-income elderly of the Hutt Valley region.

Tax status

As a CCO, UPL is operated as a for-profit enterprise and subject to income tax. Due to its legal status and ownership structure, UPL is not tax exempt as a registered charity or as a community housing entity under section CW 42B of the Income Tax Act 2007 ("**the Act**").

Impact of the discussion document proposals

Development activities

In principle, development activities are proposed to be exempt from the interest limitation rules. This is currently proposed to apply in relation to:

- land being developed by persons in the business of developing or dealing land or erecting buildings (i.e. land which would be captured under section CB 7 of the Act); and
- activities which contribute to the creation of a new build.

We expect that interest expenses in relation to UPL's development activities should still be deductible under the proposed rules, on the basis that the land should be taxable on disposal under section CB 7 of the Act.

Social housing

There is a recognition that the proposed interest limitation rules should not capture properties that are used to provide public and social housing (including emergency and transitional). We agree with this view as it would be contrary to the Government's general housing objectives of increasing housing supply and in particular to those that are most in need.

The discussion document assumes that social housing providers are likely to be exempt from income tax as either a registered charity or a community housing entity (as defined under section CW 42B of the Act). However, this is not necessarily the case. As noted above, UPL is a taxpaying CCO, and is precluded from being a community housing entity under section CW 42B of the Act.

We consider there should be an exclusion for properties that are being used to provide social housing – i.e. interest deductions should be available to the investors. Our preference is that the exclusion should apply on a property-by-property basis as opposed to an entity-type exclusion. We further note that an exclusion could arguably make providing social housing more attractive than renting the property as general residential rental. This could help alleviate the current issues faced by the Government due to the lack of social housing available.

The proposals as currently drafted may reduce social housing providers' ability to maintain its current level of services. UPL currently charges a below-market rent and this would either have to be increased or a number of properties would have to be sold. The overall effect would be to reduce the amount of social housing available for those in need.

Further, from a tax policy perspective the current proposals would impose undue compliance costs for entities such as UPL which conduct a mix of activities (some of which are exempt from the current proposals and some of which will be subject to interest limitation). For example, if there was no exclusion for UPL's social housing activities, UPL would be required to trace its loans to whether the funds are used for its property development activities and its social housing (residential renting) activities (including both its existing stock of social housing properties and any newly acquired properties). Given the context of the Government's wider housing objectives, we submit that this increase in compliance costs is not justified.

Bright-line

As part of the Government's consideration of the tax treatment of social housing providers, we submit that consideration should be given to exclusion from the bright-line rules. Although properties are acquired for the purpose of providing social housing (i.e. no purpose or intention of disposal), there are some instances where sales occur within the bright-line period as part of ongoing portfolio management (for example, sales to a community housing provider).

If the Government agrees to introduce a definition for property used to provide social housing, we submit that consideration should be given to excluding such properties from both the interest limitation rules and the bright-line rules. Subjecting such properties to tax under bright-line decreases the amount of capital that social housing providers have, reducing the overall level of social housing services available to be offered.

If the Government does not agree that an exclusion should be provided, we submit that consideration should be given to a shorter bright-line period, such as the 5 year bright-line test which applies in respect of new builds.

Conclusion

We trust our submission has been helpful for your consideration of the impact of the proposed interest limitation rules on the provision of social housing. We would be happy to discuss our submission in further detail with tax policy officials if that would be helpful.

Ngā mihi,

s9(2)(a) [redacted]

From: s 9(2)(a)
To: Policy Webmaster
Subject: Design of the interest limitation rule and additional bright-line rules
Date: Monday, 12 July 2021 1:31:49 PM

To Jacinda Arden and the Labour Party,

I am a property investor with four rental properties. All of my tenants are great tenants and have been living in those houses for at least 1 to 2 years. In one case, the tenant has made it clear that she intends to stay for life; s9(2)(a) She is a great tenant with huge respect for the property.

s9(2)(a)

I disagree with the proposed changes to rental property interest deduction and the brightline rule. I believe that they will inevitably disproportionately hurt tenants s9(2)(a) and will only serve to increase their cost of living.

I will outline why this is and the points of changes I disagree with here.

1) The proposed interest limitation rules do nothing to help with the supply of housing, and does nothing to achieve one of the governments key housing objectives, which is to ensure “affordable home to call their own”. I believe rents will increase over time as more existing rentals are sold to personal house owners. Not only this but landlords will end up having to raise rents in order to cover costs.

2) If a long term hold rental property is sold, and is caught by the brightline rules or other taxing provisions, then interest should be fully deductible in the year of sale. The long term hold investor is already paying a large amount of tax if the sale is taxable, and if interest was not an allowable deduction, tax would then be at an unreasonable level and would severely penalize the property owner. If interest was not deductible for a taxable sale, it could see an owner paying more tax then the gain they made.

3) Interest deductions should be allowed from when the tenant moves out from the old property. This should be the first stage in an older rental property becoming a new build. Or the interest should be allowable from when the older property is demolished.

4) I agree that there needs to be rollover relief now that Brightline has been extended to 5 and then 10 years. This should cover all related party transactions, and the following should receive rollover relief
- Becoming an LTC should also be excluded from a brightline sale, as becoming an LTC can simplify ownership for a Company and reduce unnecessary compliance costs.
- Sole trader or partnership to LTC, Trust, Company or LP
- LTC share changes, between related parties, including to Trusts and between individuals
Roll over relief should also be back dated to 29/3/18 as there are a lot of rental property owners who unintentional have been caught by these very complicated rules. In my view this is also contributing to supply issues as investors who would actually sell are forced to hold on to their properties.

5) 143 page of discussion document, shows that these rules are already too complicated and will be an unfair burden on taxpayers to comply with the rules. The new rules need to be simple and easy for all to follow.

In Summary:

- I disagree with the propose interest limitation rules.
- Capital account property holders who are caught with the taxable sale should be able to deduct interest for the whole period of ownership in the year of sale.
- Date of commencement for new build should be the earliest date possible in the process of developing, and I suggest from date the existing tenant moves out.
- Rollover relief should be included and should be broadened to include LTC elections and all related party transfers, including share transfers. This should also be back dated to 29/3/18.

Kind Regards,
s 9(2)(a)

From: s 9(2)(a)
To: Policy Webmaster
Subject: Interest deductibility feedback
Date: Monday, 12 July 2021 1:34:17 PM

Hi

Removing Interest deductibility will create profit on rental income because interest rate cannot be deducted . This will create unnecessary liability for people who are playing child support .

Regards
s 9(2)(a)

PUB-0374

From:	s 9(2)(a)
To:	Policy Webmaster
Subject:	Interest deductibility feedback
Date:	Monday, 12 July 2021 1:41:46 PM

If interest deductibility is not allowed this will cause profit in rental income which will increase in further liability for people who are paying child support .

I believe people who are severely affected be allowed to sell their properties without been affected by brightline test .

Interest deductibility will only affect mum and dad investors ,

Regards
s 9(2)(a)

From: s 9(2)(a)
To: Policy Webmaster
Subject: [SUSPECT SPAM]Design of the interest limitation rule and additional bright-line rules
Date: Monday, 12 July 2021 1:44:52 PM
Attachments: s 9(2)(b)(ii)

Good afternoon,

Please find attached our submission on the proposed interest limitation and bright line rule changes.

Kind regards
s9(2)(a)

[redacted]

NewGroundCapital
Capital Ideas For New Zealand

NewGroundCapital

Submission on the proposed interest limitation and bright line rules

12 July 2021

s 9(2)(a)

[redacted]

A. INTRODUCTION

New Ground Capital is a specialised build to rent ('BTR') investment manager formed in 2014 and having initiated the construction of over 500 residential dwellings to date.

New Ground's core strategy is to attract institutional capital into developing and operating BTR housing for the long term. We believe that this Government wishes to see this occur, but for BTR to achieve its full potential contribution to the NZ housing market, we need a stable and supportive regulatory landscape in order to activate this capital from local and offshore institutions alike.

B. SUMMISSION

Macro Considerations

1. We support the Government's objectives in improving housing affordability and increasing housing supply while maintaining the efficient allocation of investment capital, a coherent tax system, and avoiding complexity in the tax system.

2. The proposed changes seem to largely ignore the interests of the significant percentage of the population that either chooses to rent, or has no other choice but to rent. Approximately one third of New Zealanders rent with this percentage increasing over time, partly as a result of housing affordability, but it also has to be recognised that many of these people choose to rent and may be using their capital in more productive business pursuits which should be encouraged.

3. We believe that we need a paradigm shift away from a preoccupation with home ownership at any cost, to a focus on security of tenure and quality of housing. Our view is that Build to Rent housing is part of the solution that can:
    a. Increase housing supply in general
    b. Provide better quality housing options
    c. Provide people with security of tenure and professional management

4. While two years ago we were ahead of Australia in terms of number of BTR units completed, we have seen the Australian market gain considerable traction with up to 20,000 BTR units now in the pipeline. This is as a direct result of Australian federal and state Governments enabling investment into BTR housing which has given the sector in Australia a strong tailwind while in NZ we have been facing continued hurdles and an ever changing regulatory environment.

5. The policy and legislation changes made by this Government to date have done nothing to encourage large scale investment in BTR housing. In fact, changes made to the Overseas Investment Act have discouraged offshore capital flowing into New Zealand to increase housing supply and the proposed changes to the Income Tax Act

only serve to further hinder institutional capital (both NZ and offshore) from flowing into generating new, high quality rental houses with security of tenure.

New Build Exemption

6. We believe the new build exemption will generally cover BTR developments and allow the initial BTR developer or early purchaser to claim interest deductibility.

7. We believe that the private investor market with smaller developments should also be able to access interest deductibility and the proposed form of exemption caters for this. The private investor market is currently significantly larger than the BTR market and therefore currently more of a material factor.

8. As such, we don't necessarily believe that any further definition of BTR is required under the form of the proposed rules, as this is effectively covered by the new build exemption. We do not agree with attempts by the NZ Property Council (and presumably others) to have a specific treatment for larger scale BTR operators, as this merely an attempt to tilt the playing field away from the large number of private investors in favour of a small number of larger (potential) BTR investors.

Limitations on New Build Timeframes and Transactions

9. We have a fundamental issue with any time limitation being imposed on new builds and the concept of early and subsequent investors.

10. Limiting the timeframe or number of transactions for which new builds can claim interest deductibility will severely limit the liquidity in the institutional BTR market and in doing so will result in fewer BTR dwellings being supplied.

11. Imposing time limitations on BTR developments will most likely result in large numbers of tenancies being terminated at the end of the interest deductibility period, and only serves to undermine security of tenure for renting households.

12. Alternatively, in order to get around time or transaction limitations, the type of BTR assets supplied may become less self-contained, smaller and more hotel like. We see this kind of rental product as being suitable only for shorter term stays but may, as a result of the proposed rules, become a more common long stay option. This would result in lower quality housing outcomes for those seeking long term rental.

13. **We propose that New Builds should be able to claim interest deductibility in perpetuity where they have been rental dwellings continuously from the time of CCC.** This will encourage new rental housing supply, promote a vibrant and liquid

BTR market and give renting households the security of tenure that has been lacking in the New Zealand market.

March 2021 Date

14. We have a fundamental issue with purpose-built rentals built before 27 March 2021 being unable to achieve the same interest deductibility as those built after then 27 March 2021.

15. s 9(2)(b)(ii) [redacted]

16. Again we expect that an unintentional outcome could be that we see mass terminations of leases where the tenants were otherwise expecting to have the benefit of long term security of tenure.

17. It seems quite perverse that the proposed changes are seemingly trying to encourage investors to build new houses and make them available on long term leases when the changes could actually 1) punish those that started on this path early and 2) result in reduced security of tenure. It also seems quite unfair that when such properties were developed that owners could claim interest deductibility and if these properties were built today the owners could claim interest deductibility but because of a retrospective rule change based on a new build being defined by a 'hard' date that these properties may be ineligible for interest deductibility.

18. **We would propose that the definition of new build be extended to include properties that have been owned by the developer since inception (i.e. at the time CCC issued) and the CCC has issued in the 10 years prior to 27 March 2021**. This timeframe generally aligns with other tax rules for developers holding buildings on capital account and GST treatment on retained residential dwellings. This reduces complexity in the tax system promotes confidence in the tax system to reduce the impact of retrospective changes in tax rules.

Miscellaneous

19. We support the bright line test remaining at 5 years for new builds but can also see merit in having a 10 year bright line that was truly a 'bright line' in that sales within the 10 years are deemed to be on income account and those after 10 deemed to be on capital account. This would create a much clearer unambiguous test and reduce complexity in the tax system.

20. Serviced apartments should be exempt from the rules. Failure to do so could decimate the serviced apartment market and have serious knock on effects for tourism and the economy. We see little risk of any material conversion of existing apartments to serviced apartments.

21. We support the apportionment approach on mixed use developments.

22. Interest deduction on sales should always be allowed where property is held on income account. If the property is held on income account from inception, then interest should be able to be claimed from inception and likewise if the property was held on capital account but then deemed to be assessable (most likely as it is sold within a bright line period) then the interest should be claimable at the time of sale. All interest costs should be claimable up to a maximum of the taxable gain.

C. SUMMARY

The two main issues we have with the proposed rules are:

23. ***The definition of a new build should be broadened to include properties owned by the original developer*.**
    We are of the strong view that new builds that have been owned by the developer at the time CCC issued and CCC has issued in the 10 years (as a minimum) prior to 27 March 2021 should qualify as new builds and be able to claim interest deductibility.

24. ***New builds should be able to claim interest deductibility in perpetuity.***
    Limiting the timeframe that new builds can claim interest deductibility will only reduce the supply of large scale BTR rental housing and the market liquidity of such assets and reduce the security of tenure for renting households. We propose that new builds should be able to claim interest deductibility in perpetuity.

25. If you require any further information or have any questions please contact s 9(2)(a) [redacted]

From: s 9(2)(a)
To: Policy Webmaster
Subject: Design of the Interest Limitation Rules and Additional Bright-Line Rules
Date: Monday, 12 July 2021 1:58:19 PM
Attachments: image001.png
210712 Interest Limitation Rules and Additional Bright-Line Test Rules Final Submission.pdf

Dear IRD,

Please find attached a copy of Federated Farmers' submission on the above consultation document.

Kind regards,

s9(2)(a)

s9(2)(a)
Federated Farmers of New Zealand

s9(2)(a)
W: www.fedfarm.org.nz
A: 8/35 Sir William Pickering Drive, Burnside, PO Box 20448 Bishopdale, CHRISTCHURCH 8543

Submission on the Design of the Interest Limitation Rule and Additional Bright-Line Rules

Federated Farmers of New Zealand

12 July 2021

0800 327 646

FED FARM .ORG.NZ

SUBMISSION ON THE DESIGN OF THE INTEREST LIMITATION RULE AND ADDITIONAL BRIGHT-LINE RULES

TO: Inland Revenue Department

DATE: 12 July 2021

ADDRESS FOR SERVICE

Name	Position	Phone	Email Address
s9(2)(a)	[redacted]	[redacted]	[redacted]

OTHER CONTACTS

s9(2)(a) [redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]

Federated Farmers of New Zealand
PO Box 715
WELLINGTON 6140

ABOUT FEDERATED FARMERS

Federated Farmers of New Zealand is a membership organisation, which is mandated by its members to advocate on their behalf and ensure representation of their views. Federated Farmers does not collect a compulsory levy under the commodities levy act and is funded from voluntary membership.

Federated Farmers represents rural and farming businesses throughout New Zealand. We have a long and proud history of representing the needs and interests of New Zealand's farmers.

Federated Farmers aims to empower farmers to excel in farming. Our key strategic outcomes include provision for an economic and social environment within which:

- Our members may operate their business in a fair and flexible commercial environment;
- Our members' families and their staff have access to services essential to the needs of a vibrant rural community; and
- Our members adopt responsible management and sustainable food production practices.

SUBMISSION ON THE DESIGN OF THE INTEREST LIMITATION RULE AND ADDITIONAL BRIGHT-LINE RULES

1.1 Federated Farmers of New Zealand welcomes the opportunity submit to Inland Revenue on the Design of the Interest Limitation Rule and Additional Bright-Line Rules.

1.2 Federated Farmers acknowledges the Government's March 2021 announcement to limit the deductibility of interest on residential investment property in response to long-standing concerns about housing affordability.

1.3 The Federation's interest in this issue is not to debate the policy decision but to ensure that design of the rules to limit deductibility are appropriately targeted and do not have unintended consequences, especially for the agricultural sector.

1.4 As such we support the approach taken with 'carveouts' for farmland and employee accommodation. Farmers, in common with other employers in remote areas, have to house their employees. This is often on-farm but may be off-farm. Providing this accommodation is a core part of their business model.

1.5 With regard to the on-farm accommodation, we support the discussion document's discussion (paragraphs 2.23-2.25 on page 18), where dwellings on farmland which are used to provide accommodation should not be subject to the limitation rule. These dwellings are not 'residential investment properties', rather they are integral parts of the farming business, usually financed under the farm's mortgage. It is therefore totally appropriate for mortgage interest payments to remain deductible.

1.6 We agree with the definition of 'farmland' for the purpose of these rules (table in paragraph 2.18 on page 17):

Farmland means land that –
Is being worked in the farming or agricultural business of the land's owner:
Because of its area and nature, is capable of being worked as a farming or agricultural business.

1.7 Federated Farmers also supports the discussion document's proposed approach to off-farm employee accommodation (paragraphs 2.70 to 2.74 on pages 26-27). While most farm employee accommodation is on-farm, there will be cases where such accommodation is located off-farm, for example on a neighbouring or nearby block or in a nearby town or village.

1.8 As noted above, the provision of employee accommodation is a core part of farmers' business model. We therefore support the Government's proposed carveout for all employee accommodation, including the off-farm accommodation. We accept the need for satisfactory integrity measures to minimise abuse provided they keep complexity and compliance costs to a reasonable minimum.

1.9 To conclude, Federated Farmers supports the discussion paper's proposed carveouts for dwellings on farmland and for off-farm employee accommodation and we agree with the definition of farmland.

ENDS

From: s 9(2)(a)
To: Policy Webmaster
Subject: Design of the interest limitation rule and additional bright-line rules
Date: Monday, 12 July 2021 2:06:13 PM
Attachments: image001.png
image002.png
image003.png
image004.png
image005.png
image006.png
The Registered Master Builders Association submission on interest limitation rule v4.pdf

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Kia ora

Please find our submission on interest limitation rule attached.

Ngā mihi

s9(2)(a)
[redacted]

Registered Master Builders Association
Level 14, 2 Hunter Street
PO Box 1796, Wellington
masterbuilder.org.nz

Building a Better New Zealand

Registered Master Builders Association of New Zealand Incorporated

Design of the Interest Limitation rule and Additional Bright-Line Rules submission

July 2021

Summary of Submission

RMBA supports ensuring every New Zealander has a safe, warm, dry and affordable home to call their own. We are also supportive of improving New Zealand's housing availability and addressing New Zealand's housing supply shortage, including increasing New Zealand's new build stock.

Therefore, we broadly support initiatives to increase the construction of new builds via the introduction of the interest limitation rule and bright line test. However, it is important that the implementation design is practical and workable and does not depress other parts of the housing supply system.

Feedback on specific design proposals

There are a number of "chapters" for discussion, however the RMBA proposal is focused on specific chapters covering matters most relevant to our member organisation.

Chapter	**Feedback**
Chapter 2 – Residential investment property subject to interest limitation	• RMBA is supportive of the current exclusions proposed. • An apportionment calculation is preferable to an all or nothing approach to dual-purpose (residential and commercial) buildings on the same title.
Chapter 3 – Entities affected by interest limitation	• The calculation to determine a "residential investment property-rich' proposes to compare the company's residential investment property with its total assets. Companies that have over 50% residential property will be covered by the rules. There may be some challenges in this calculation, particularly in finding a simple method of determining residential property from other business assets. We recommend working directly with companies impacted to land on a more practical approach.
Chapter 6 – Property development and related activities	• RMBA is supportive of a wide definition for exempting property developers from the rules, for example - "engaging in development activity that has created a new dwelling or made an existing dwelling habitable or extended its life". • RMBA is of the view that the overriding principle of "adding to New Zealand's housing stock" should be the presumption for interpretation for this exemption. • We support the following work being exempted: ○ Extends the life of a building for the purpose of continued use by an investor ○ Making improvements to land which contribute to housing supply, which also includes erecting a building or otherwise ○ one-off developments by people not in the business of developing property

    - property development on land not captured by section CB 7 (for example, because the land was not acquired for the purpose of a development business but was nevertheless developed

    - Building a house
    - Converting a single house into multiple-flats
    - Converting a commercial or industrial property to a residential property
    - Relocating a house

- RMBA supports including remediation work in the property development exemption.
- We are also supportive of including a wide definition of remediation work for the purposes of the exemption. This best fits with the principle of "adding to New Zealand's housing stock". It is our view any remedial work that makes an existing dwelling habitable, liveable, and/or extends its life is adding to New Zealand's housing stock, and therefore should be included in the exemption. In this way renovating a kitchen or bathroom may very well make the dwelling "habitable" or "liveable", particularly if the existing one is not functional. Not only does this increase New Zealand's housing stock by making a house that was not liveable – liveable, but it also improves the health, quality, and efficiency of existing stock, which aligns with other Government initiatives in the sector.
- In regards to establishing a methodology for assessing the remedial work to determine if it meets the exemption options could be:
    - Minimum improvement to 50% of the floor and walls sqm of the dwelling, including insultation and glazing improvements; and
    - A 50% improvement to the building code
    - The overall age calculation of the house has improved

  We recommend working with the sector on developing a practical workable threshold and assessment.
- We support the following activities being captured under the exemption:
    - Taxpayers who carry out remediation work professionally as part of development activity (buying, renovating, and selling properties)
    - Making structural improvements such as earthquake strengthening, weather tightening
    - Renovating parts of a dwelling such as kitchen or bathroom that make the dwelling "habitable" or "liveable", particularly if the existing one is not functioning

	○ Heritage buildings
Chapter 7 - Definition of new build	• RMBA is supportive of the definition of a new build - "where residential housing has clearly increased" - which is when "a self-contained dwelling (with its own kitchen and bathroom) has been added to residential land and the dwelling has received a code compliance certificate ("CCC")." • We recommend keeping the definitions as simple as possible rather than creating an onerous and costly compliance or assessment process. The intention of this policy is to increase affordable new housing stock, and we are of the view this should not be hampered by overly technical and complicated rules and regulations. • We support including in the definition houses that are not built on-site nor are a new building. • RMBA is supportive of the following being included in the definition of new builds: ○ A dwelling added to vacant land ○ An additional dwelling added to a property, whether stand-alone or attached ○ A dwelling (or multiple dwellings) replacing an existing dwelling ○ A dwelling created by renovating an existing one to create 2 more. ○ A dwelling converted from commercial premises. For example. • RMBA is of the view that making an inhabitable building habitable is adding to existing stock, particularly as the work will be lifting the build to meet current building standards and requirements. We are of the view this work should be included in the remediation exemption (discussed above) rather than coming under the definition of a new build
Chapter 8 – New Build Exemption	• We are supportive of applying favourable incentives such as access to interest deductibility and a shortened 5-year bright line test to new builds, and also to dwellings captured under the property developer (and remediation) exemption. • We are supportive that new builds will receive their exemption if the CCC was received on or after 27 March 2021 as follows: 1. New Builds under the Developer Exemption - from the date the CCC is issued (noting the developer exemption may apply earlier while the dwelling is being "developed")

	2. Adding a new build to a property - from the date the CCC is issued (noting the developer exemption may apply earlier while the dwelling is being "developed") 3. Acquires a new building no later than 12 mths after it receives CCC. This includes completed new builds and those acquired off the plans. • We recommend that early owners are only able to access the exemption for a fixed period of 10 years. We recommend that the exemption period expires with upon sale to a subsequent owner (ie the subsequent owner is not able to access the exemption) unless the subsequent owner purchases the property within three years from the date it was acquired by the early owner.

Other comments and recommendations

Although supportive of increasing availability of homes for New Zealanders, we note the following potential risks in increasing demand for new builds.

- Shortage of land availability - We support a planned approach to development, which helps guarantee the consistent and timely availability of development feasible land. This approach allows for housing and its integration with the provision of physical and social infrastructure alongside other necessary services. To achieve this, the Government and councils should consider the use of dynamic planning system levers coupled with the use of appropriate financial tools to incentivise the development of land identified for housing, and disincentivise land banking. Without the Government and councils utilising these levers and tools, constrained land supply will continue to add unnecessary additional costs for builders, developers, and homeowners.
- The supporting infrastructure will not keep up with the pace of the new builds, one example is the Mill Road cancellation.
- Builders will go where the demand is and this may negatively impact the renovation industry (although we note the recommendations in this submission regarding a wider interpretation of remediation work will go some way to address this).
- Prices of new builds will likely increase, which may then push first home buyers into older homes that are unhealthy and less energy inefficient and need renovations, at a time when the renovation industry may move to new builds.

We note the complexity of this matter, as evidenced by the 142 page discussion document, and would welcome another round of consultation on specific rules once developed.

s 9(2)(a)

[redacted]

From: s 9(2)(a)
To: Policy Webmaster
Cc: s 9(2)(a)
Subject: Interest deductibility consultation
Date: Monday, 12 July 2021 2:24:48 PM

Submission on Government Policy Changes for Taxing Rental Properties

1. The changes will not achieve the aim of suppressing house prices. That aim will not be met until supply is increased.
2. The Government needs to focus on the supply side of the market rather than tinkering with the demand. The Governments supply actions have failed namely Kiwibuild and this is a kneejerk reaction to tax investors unfairly.
3. The Government must address the supply of housing through numerous measures and that will take more time to take effect. in the meantime rising interest rates about to hit the economy to control inflation will stop the house price inflation very quickly.
4. The interest deductibility changes are contrary to the fundamental concept of deducting business and investment expenses.
5. The changes are unreasonable for owners of one or two investment properties – "Mums and Dads" who have made investment decisions for their retirement plan only to have the goalposts shifted.
6. There should be no change for owners of one or two investment properties.
7. There should be no change for those who have purchased property prior to 27 March 2021.
8. Of the changes proposed, upping the Bright Line Test to 10 years will target more effectively those that the Government is seeking to dissuade from this investment class.

Yours Sincerely

s 9(2)(a)

[redacted]

From:	s 9(2)(a)
To:	Policy Webmaster
Subject:	Submission: Design of the interest limitation rule
Date:	Monday, 12 July 2021 2:25:45 PM

I am writing to make a submission on the proposed tax changes for interest deductibility for property owners.

EXEMPTION REQUESTED FOR MULTI-TENANCY PROPERTIES

I submit that an exemption is granted for multi-tenancy properties which comprise of 3 or more dwellings on a single title.

I submit that this exemption would fit the principles in para 2.11 and para 2.12 of the Government discussion document. Para 2.11 states in determining whether a property in this category should be within scope of the interest limitation rule, the Government's key consideration is whether the property is of a type that would normally be available for owner-occupiers. If a property is not of a type that is generally available for owner-occupation or easily convertible to owner-occupation, there is a greater argument for exclusion. Multi-tenancy properties are not normally available to or compete with owner-occupiers.

A multi-tenancy property is commonly referred to as a block of flats. For the purposes of an exemption, I suggest they be defined as 3 or more dwellings on a single title. It is not intended that multi-tenancy properties include apartments, duplexes (semi-detached) or home and income properties which are typically on separate titles and available for owner occupiers.

Multi tenancy properties are specialised to investors. They are unlikely and difficult to be used as private owner-occupied residences. Their physical structure and configuration are unique in that they are configured with separate dwellings/flats usually within the same single structure, and on the same title. Multi-tenancy properties should be defined as comprising 3 or more dwellings, in order to make a key distinction with home and income properties, where an owner occupier lives in one dwelling and may rent another typically smaller dwelling.

There are significant barriers to convert multi-tenancy properties for owner occupier use. Without separate unit titling and establishing a body corporate the dwellings would not be available as owner occupier units. They typically cannot be converted as of right, being subject to survey, valuation, council consents and a solicitor to separately unit title each dwelling subject to satisfactorily navigating a number of conditions and infrastructure work which usually makes unit titling uneconomic. Depending on the property, council may prescribe additional conditions to bring the property up to an appropriate standard.

Exempting multi tenancy properties gives investors an asset class to invest in, which is on a level playing field with other types of investment for which interest costs are deductible. An exemption will further help take investors away from competing with owner occupiers, furthering the Government's objectives.

Typically they are a lot more expensive and larger properties. They typically have higher yields, so investors buy them for long term (taxable) cashflow (not short term capital gain), accordingly the interest should be deductible.

This important investment category also typically provides vital accommodation for many tenants in the same block, and landlords should not be unnecessarily penalised for doing so.

Exemptions are considered for student accommodation (halls of residence) and serviced apartments due to their specialised nature. Multi tenancy properties are equally different and merit exclusion in accordance with the Government objectives.

Please contact me if you would like to discuss further.

Regards,

s 9(2)(a) [redacted]

[redacted]

[redacted]

[redacted]

[redacted]

.

From:	s 9(2)(a)
To:	Policy Webmaster
Subject:	Design of the interest limitation rule and additional bright-line rules
Date:	Monday, 12 July 2021 2:26:31 PM
Attachments:	s 9(2)(a)

Hi

I attach a submission relating to the Government discussion document, 'Design of the interest limitation rule and additional bright-line rules'.

Kind regards

s 9(2)(a)

12 July 2021

Design of the interest limitation rule and additional bright-line rules
C/- David Carrigan
Deputy Commissioner, Policy and Regulatory Stewardship
Inland Revenue
PO Box 2198
WELLINGTON

Dear David

Design of the Interest Limitation Rule and Additional Bright-line Rules: A Government Discussion Document

I am writing to make a submission on the Government discussion document "Design of the interest limitation rule and additional bright-line rules" ("the discussion document").

My submission is focused on Chapter 10: Rollover Relief and specifically regarding the application of rollover relief to family trusts for the purpose of the bright-line rules.

Paragraph 10.57 proposes 3 conditions that would need to be met for rollover relief to apply to the settlement of residential land on trusts, being:

1. Every settlor is also a beneficiary;
2. At least one settlor of the land is a principal settlor of the trust; and
3. Every beneficiary is associated with a principal settlor.

With regards to the first factor, it is possible in the case of family trusts that a parent may settle residential land owned by that parent directly into a family trust (Trust A) for the benefit of their child whilst not intending to be named as a beneficiary themselves.

Whilst it may be common in practice for the settlor to also specify themselves as a beneficiary in Trust A, it does not necessarily dictate that every settlor will do so, particularly if the trust is being set up as an inheritance vehicle for the child. In situations where the parents of the child are separated and each are separately contributing property into Trust A (e.g. one parent contributing residential land, another contributing money or money's worth), it may be the desire that both parents are excluded as beneficiaries of Trust A to ensure equality between the settlors into Trust A and minimise disputes between the parties involved. With the recent amendments to disclosure rules for trusts with regards to their beneficiaries, including additional beneficiaries solely for the purpose of achieving a specific tax outcome would increase compliance costs and deliver no net benefit. The third factor (association of beneficiary to settlor) should be sufficient to ensure the rollover relief only applies in the case of family trusts.

With regards to the second factor, a principal settlor is currently defined in section CB 16A(7) of the Income Tax Act 2007 (the ITA) as “a settlor whose settlements for the trust are the greatest or greatest equal, by market value”. In the example above where two separated parents are separately contributing property into a trust for the benefit of their child, the current definition of ‘principal settlor’ will restrict the contributions of each parent to be equal by market value to the value of residential land being settled into the trust in order to ensure rollover relief applies to the residential land. The alternative would be to have separate trusts set up by each parent which would increase compliance costs with no net benefit being generated.

Paragraph 10.65 discussed rollover relief in the context of land disposals from one trust into a different trust and indicates relief could be provided where the beneficiaries of the two trusts are identical. From an inheritance planning perspective, the requirement for identical beneficiaries between the two trusts is not practical.

For example, a family trust currently in existence may contain the main home of the settlors (the parents) as well as residential properties acquired for the purpose of the parents’ children to reside in on a rent-free basis. As each child marries and has their own children, it may be the desire of the parents to separate the main family trust into several inheritance trusts, one set up for each child and their descendants. Each inheritance trust may be settled with the family home relating to each individual child and the beneficiaries of the inheritance trusts may not necessarily be identical (e.g. because the parents are not beneficiaries of the inheritance trusts, because siblings are excluded or because the children’s’ partners have been added as beneficiaries in the inheritance trusts).

The design of a rule for trust to trust settlements should allow for situations as described above, which are not expected to be uncommon as a means of inheritance planning within families. The rule may draw upon existing terminology used with the ITA, such as the natural love and affection rules for the forgiveness of debt between associated persons.

I appreciate the opportunity to submit on this discussion document.

Yours sincerely

s 9(2)(a)

[redacted]

From: s 9(2)(a) [redacted]
To: Policy Webmaster
Cc: Green Party of Aotearoa New Zealand; The Green Party of Aotearoa New Zealand; Julie Anne Genter & Dr Elizabeth Kerekere | Green MPs
Subject: "Design of the interest limitation rule and additional bright-line rules"
Date: Monday, 12 July 2021 2:32:11 PM

Submission on "Design of the interest limitation rule and additional bright-line rules "

Submission from: s 9(2)(a) [redacted]

My Background: I have been a landlord for 20 years. I own 10 small rental properties. I have two adult children struggling to buy a home. I have two family members locked out of the wider rental market because of their disabilities.

1/ I recommend Interest deductibility be allowed on all borrowings used to renovate old rental properties. It is pointless and unworkable to differentiate between different types of renovation.

- Every single renovation or repair extends property life, improves habitable functionality, and improves quality of life for the tenant.
- This will support govt key objective of promoting safe, warm, dry homes and improving old housing stock. To remove deductibility on renovation costs contradicts Govt Objective.
- If interest deductibility is permitted only when making an uninhabitable house habitable complexity and hypocrisy enters situation. What is definition of 'uninhabitable'. Encouragement should be given to prevent the decline of habitability.
- Exempting 100% of renovation / maintenance costs is simple, easy to apply, easy to trace, and avoids confusion, misinterpretation, and complexity.
- If this is not permitted expect the following unintended consequences:
  - Money will flow away from maintaining and improving old rentals.
  - Less funds spent increasing energy efficiency of old rentals
  - Landlords discouraged from exceeding healthy home standards (a basic minimum standard)
  - Landlords discouraged from making improvements to benefit disabled tenants
  - Tenants in older homes will have higher energy costs and lower standard of living.
  - Quality between old and new rentals will widen.
  - Increased carbon footprint as homes that could be renovated are instead demolished for rebuilding.
  - Negative impact on governments drive to improve the quality of old housing stock.
- I planned to spend $300,000 upgrading a block of 1980 units to a standard exceeding the low healthy home requirements (relevel, wall insulation, double glazing, whole home ventilation, improve passive heating, improve security). This project was one of many projects I have on the go – I stopped all projects until legislation clarified.

2/ I recommend new build definition includes properties built up to two years prior to 27th March21

- This improves tenants long term tenure & reduces risk of eviction (homes not sold).

It is the fair thing to do as these buyers took action to boost housing stock numbers before the Govt acted.

- These builds have high debt burden (interest is often =$15,000/yr) & reduced cash flow means owners are likely to sell after 5 yr bright line is reached. This impacts the Tenant with little negative effect on Landlord.

3/ I recommend exemptions on interest deductibility for new builds should last in perpetuity (or at least 20 yrs). These exemptions should be passed to all future owners. If this does not occur expect the following unintended consequences:

- Massive reduction in small affordable build to rent properties. They will have limited resale value. Too small for owner occupiers to occupy long term. Investor funds will flow elsewhere.
- reduced capital invested into new builds. Investors are incentivized to pay down existing debt quickly reducing their ability to service further borrowings to buy more new builds.

Anyone is welcome to +contact me to discuss the points raised.

s 9(2)(a)

From: s 9(2)(a) [redacted]
To: Policy Webmaster
Cc: s 9(2)(a) [redacted]
Subject: [WARNING MESSAGE ENCRYPTED]Design of the interest limitation rule and additional bright-line rules
Date: Monday, 12 July 2021 2:32:56 PM
Attachments: image001.png
image002.png
image003.png
image004.png
image005.png
image006.png
Submission residential property updated.pdf

Hi

Please find attached a submission on the Government discussion document "Design of the interest limitation rule and additional bright-line rules" on behalf of our clients s 9(2)(b)(ii) [redacted]

Regards
s9(2)(a) [redacted]

Deloitte
24 Anzac Parade, PO Box 17, Hamilton 3240, New Zealand
s9(2)(a) [redacted]

Deloitte.

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12 July 2021

Design of the interest limitation rule and additional bright-line rules
C/- David Carrigan
Deputy Commissioner, Policy and Regulatory Stewardship
Inland Revenue
PO Box 2198
WELLINGTON

Dear David

DESIGN OF THE INTEREST LIMITED RULE AND ADDITIONAL BRIGHT-LINE RULES: A GOVERNMENT DISCUSSION DOCUMENT

s 9(2)(b)(ii) [redacted] we welcome the opportunity to submit on the Government discussion document "Design of the interest limitation rule and additional bright-line rules" ("the discussion document").

Background

s 9(2)(b)(ii) [redacted]

[redacted]

[redacted]

[redacted]

[redacted]

s 9(2)(b)(ii) [redacted]

s9(2)(b)(ii) [redacted]

[redacted]

[redacted]

[redacted]

s 9(2)(b)(ii) [redacted] wish to submit on the following points in the discussion document:

- The entities subject to the proposed interest limitation
- The type of residential property subject to the proposed interest limitation
- Application of rollover relief to Maori entities
- Residential ring fencing

Chapter 3 – Entities affected by interest limitation

Widely held company exclusion

- Non-close companies, e.g. widely held / listed companies, will be excluded from the rules provided they are not "residential investment property rich".

- s 9(2)(b)(ii) [redacted] and its subsidiaries will not qualify as widely-held companies, as ownership is through a single trust s 9(2)(b)(ii) [redacted] s 9(2)(b)(ii) [redacted] submits that this is inequitable treatment for Maori Authorities, as s 9(2)(b)(ii) [redacted] is similar to a widely held company with its broad underlying base of beneficial owners.

- The following reasons given for widely held companies to be exempted from the interest limitation rules equally apply to s 9(2)(b)(i [redacted] as the group is primarily a commercial property owner:

    - To reduce compliance costs where the main business does not involve residential investment property.
    - Small amounts of residential property relative to total assets are unlikely to contribute to high house prices.

- s 9(2)(b)(ii) submits that Maori Authorities as provided for in section HF 2 and HF 11 of the Income Tax Act 2007 ("the Act") along with any subsidiaries (whether or not they themselves are Maori Authorities) should also be excluded from the interest limitation rules in the same way as widely held companies. The eligibility requirements in section HF 2 restrict Maori Authorities to being trustees or certain companies charged with administering assets communally owned by Maori. This provides that these entities generally have multiple owners usually defined by connection to a particular iwi or hapu. The s 9(2)(b)(ii) beneficial owners would exceed the 25 shareholders required for a widely held company as defined in section YA 1 of the Act, even treating all those associated within two degrees of blood relationship as one person.

Are there other organisations that should not be subject to the interest limitation proposal?

- The discussion document also notes that Kainga Ora Homes and Communities and its subsidiaries will be excluded from the interest limitation rules as this group provides social housing and is not exempt from tax by being a charity or community housing provider.

- It is a well-known fact that Maori home ownership rates are low, and that Maori are a group who experience poorer housing outcomes and higher rates of crowding and homelessness. Both s 9(2)(b)(ii) are supporting whanau s9(2)(b)(ii) by providing residential housing. Earlier this year, following the interest limitation announcements in March, Kainga Ora approached s 9(2)(b)(ii) to look at options for the provision of land or direct participation in new transitional housing s9(2)(b)(ii) is already working with Kainga Ora to explore if its land may be suitable for public and social housing development.

- The interest limitation proposals limit the ability to be involved in such housing initiatives due to the negative impact on cashflow. s 9(2)(b)(ii) estimates the cost to be approximately $40,000 per annum (the tax effect of interest deductions that will be lost) based on current funding arrangements. If the Crown wants Iwi to be directly involved in working on the delivery of solutions to the housing crisis, then the lack of future interest deductions for residential property compared to other property investments will prove a disincentive.

- s 9(2)(b)(ii) submit that greater participation in residential housing solutions could be achieved by exempting Maori Authorities and subsidiaries from the interest limitation proposals, regardless of the level of residential property investment. This is because Maori Authorities by their very nature will have a focus on providing whanau with affordable housing.

Chapter 2 - Residential property subject to interest limitation

- s 9(2)(b)(ii) administer Maori freehold land and general title land. The general title land is important for group funding arrangements as banks will not typically lend against Maori freehold land due to restrictions on sale.

- Both s 9(2)(b)(ii) support whanau by providing residential rental housing. This residential property is situated on both Maori freehold land and general title land.

- s9(2)(b)(ii) is experiencing a housing shortage that is impacting s9(2)(b)(ii) iwi, a group at risk for poorer housing outcomes. To be able to support whanau with affordable housing s 9(2)(b)(ii) need to have funding and cashflow. Removing interest deductions for residential land negatively impacts on cashflow.

- Housing will be provided in the form of residential rentals by s 9(2)(b)(ii) and its subsidiaries. s 9(2)(b)(ii) is looking at public and social housing at its s9(2)(b)(ii) development, including retirement village and Papakainga housing models. Both have engaged with Kainga Ora in discussion on the provision of housing solutions.

- While the new build exemptions from the interest limitation rules may remove limitations for debt funded new properties this still comes with additional compliance obligations to trace borrowing to respective properties and will not apply to existing properties.

- s 9(2)(b)(ii) submit that both Maori land and other general title land that is residential property held by Maori Authorities or subsidiaries should be excluded from the interest limitation rules. As noted, Maori Authorities by their very nature have a focus on helping whanau in the housing crisis.

Chapter 10 – Rollover relief

- s 9(2)(b)(ii) [redacted] support the rollover relief principle and agree that where property has changed legal ownership but not economic/beneficial ownership that this should not trigger a taxing event.

- Rollover relief should allow for Maori Authorities that are either trustees or companies to transfer land for a number of reasons including from a post settlement governance entity, or within group entities to align land ownership with the entity using the land.

- s 9(2)(b)(ii) [redacted] submit that the proposed trust rollover relief is too narrow for Maori Authorities and their subsidiaries. Instead, the eligibility criteria in section HF 2 of the Income Tax Act 2007 or a relevant subset of this section could be used to provide rollover relief to Maori Authorities and subsidiaries. The requirements for an entity to be eligible to be a Maori Authority under section HF 2 already reflect instances where land is controlled by Maori owners, their whanau, hapu, and descendants, e.g. where an entity is subject to the Te Ture Whenua Maori Act 1993 or is established on behalf of claimants.

Residential loss ring-fencing

- The residential loss ring-fencing rules in subpart EL do not apply to companies other than close companies due to the exclusion in section EL 11 of the Act. s 9(2)(b)(ii) [redacted] subsidiaries are owned by a single shareholder, s 9(2)(b)(ii) [redacted] therefore are treated as closely held companies for the purposes of the ring-fencing rules. As a result, amounts of residential rental property expenditure have been ring-fenced since the 2020 income year.

- While not directly the subject of the current Discussion Document, s 9(2)(b)(ii) [redacted] submit that it is inequitable to Maori Authorities and subsidiaries that they are subject to these rules. Maori Authorities and subsidiary companies should also be excluded from subpart EL on the same basis as widely-held companies.

If you have any questions or would like to seek consultation from s 9(2)(b)(ii) [redacted] directly on any matter please do not hesitate to get in contact.

Yours sincerely

s 9(2)(a) [redacted]

From:	s 9(2)(a) [redacted]
To:	Policy Webmaster
Subject:	SUBMISSION INTEREST DEDUCTIBILITY AND BRIGHTLINE TEST- OPIA
Date:	Monday, 12 July 2021 2:39:42 PM
Attachments:	s 9(2)(a) [redacted]

Hi

Please find attached the submission on interest deductibility and the bright-line test from the Otago Property Investors Association.

Thank you

--
s9(2)(a) [redacted]
otago.nzpif.org.nz

OTAGO PROPERTY INVESTORS ASSOCIATION

SUBMISSION INTEREST DEDUCTIBILITY AND BRIGHTLINE TEST

Para 1.2.1

- Ensure that every New Zealander has a safe, warm, dry and affordable home to call their own-whether they are renters or owners.

How does this legislation do this? It penalizes rental property owners who supply the rental accommodation by increasing the tax costs and extends the period that properties must be held without having to pay a defacto "capital gain" tax on the increased value (often due to inflation)

Para1.2.3

- If, in any business, the costs of running the business go up, then ultimately these increased costs will be passed on.

Para 1.14.5

- In the student rental market in Dunedin, we have "studio rooms" where dwellings (often purpose built with ensuited bedrooms) are rented room by room with a communal kitchen and lounge. These would not be suitable for a family owner/occupier due to the number of rooms and layout.

Para 2.4

Modified and purpose built rental units should be exempt from the interest limitation as these units would not be suitable for first home buyers. For example, a property that has two or more household units on it as the first home buyer can only live in one so has to rent out the other(s) out.

Also, where you have a 5 (or more) bedroom student dwelling as there are too many bedrooms and the layout will not be suitable for the average first home buyer.

Example 2

- In the second example (David's building), the ratios used are 45% for the fish and chip shop and 55% for the flat above. Is this based on rental income, valuation or rented area- not specified. This should be based on area that is leased by the commercial tenancy as this is the way commercial are calculated.

Para 2.75

- Where you have a modified or purpose built student flat with five or more bedrooms, these should be exempt from the interest limitation as they are unsuitable for the average owner/occupier accommodation due to the number of bedrooms and often the layout of the dwelling which is designed for group living.

Para 2.78

- Under the tenancy rules quoted in this section, boarding houses and studio rooms will be exempt as they have 'house rules' regarding tenant's responsibilities for the smooth running of the flat.

Para 3.13

- What happens when an entity has a mortgage secured over a number of properties and the owner demolishes a single dwelling to build multiunits on it. How is the mortgage apportioned between interest limitation and the interest exemption for the new build.
- What happens where there is an existing mortgage on a property where another dwelling is built on the back financed by 'topping up' the existing mortgage.

Para 5.30

- Most property investors hold their investment on a capital account basis as they are at the rental income and looking at selling the asset. Under these proposed rules, it would look like they are being taxed twice- once when they pay tax on the interest being paid and if they sell under the brightline rules, tax on the capital gain. For the people outside the brightline rules, the capital gain (inflation) would generally far greater than the interest paid as a non claimable expense.
-

Para 5.38

- With most investors having one or two investment properties, ringfencing any losses would mean that these losses would be lost once the revenue producing property was sold, unless there is other taxable income in the same entity. The proposal mentioned in Para 5.40 of adding interest losses to the cost price would be a fair treatment without having to allow exemptions to the ring fencing and anti arbitrage provisions.

Para 6.22

- Interest on remediation costs should be treated the same as new builds as it prolongs the life of the building and often modernizing it to bring it up to today's standards for the comfort of the tenants i.e new kitchens and bathrooms.
- Where you have heritage buildings or residential units that cannot be demolished due to zoning or other requirements, then remediation interest cost should be treated as new builds as it will prolong the life of the building which are often in well located aeras or are character contributing building.

Para 6.29

- MBIE has directed that building control authority can only issue a CCC (code compliance certificate) two years after a building consent is issued (unless a extension is granted). After this period a code of acceptance is issued.

Para 7.10

- Normally when you renovate an uninhabitable building, a building consent is required to modernize the layout, shift the kitchen or bathroom, take out or install walls etc. This could be a defining point to allow interest costs classed as a new build.

Para 8.20

- The developer or the owner of the development should be exempt from the five year brightline test. If they are subject to the test, they would tend to hold on to it for five years to escape the tax payable on the increased value of the property. If they were exempt, they could sell anytime after the CCC issued thereby freeing up capital to build some more.

Para 8.20.3

- Under the building code, buildings are designed to have a life of fifty years plus. If the exemption was to be twenty-five years then this is half the life of the building. This exemption could be tied to the building having rental income thereby excluding owner/occupiers from claiming the exemption. Under present tax laws an owner/occupier cannot claim interest on their mortgages as a claimable expense.

- If they wanted to deduct interest before the CCC was issued, then records of the building consent and drawdown payments for the new build could be requested.

Para 9.3

- What happens if the land was acquired before the bright test came in and a new build was built on it recently.

Also what happens in the situation when the owner replaces an existing rundown rental unit with one or more new units-does the existing mortgage have the interest claimable as once the old rental is demolished then it has no value i.e. all the value is in the land that is part of the development

SUBMISSION ON BEHALF OF THE OTAGO PROPERTY INVESTORS' ASSOCIATION INC.

s 9(2)(a)

[redacted]

From: s 9(2)(a)
To: Policy Webmaster
Subject: Design of the interest limitation rule and additional bright-line rules
Date: Monday, 12 July 2021 2:49:39 PM

Dear Sir or Madam,

The following submission relates to the proposed changes to the interest limitation rules outlined by the government earlier this year.

Please withhold my name and email address from any OIA requests received.

1. Definition of residential property investor
The proposed changes are simplistic in their definition of what constitutes a residential property investor.

The consultation document indicates that anyone considered to be a residential property investor is a person (or company) who owns a property which is not their main home.

This is a simplistic definition and fails to take into account a number of scenarios, because of which a large number of ordinary New Zealanders will be significantly disadvantaged. For example,

A) A person who owns their own property and begins a relationship with another person who owns their own property.

B) A person who owns their own property but temporarily must relocate to a different part of NZ (or a different country) and rents their property out. For example, a police officer who attends police college or is posted overseas in East Timor / PNG.

C) A person who owns their own property and chooses to do an OE (not relevant in this climate, but will be relevant in the future).

These three categories of persons are all property owners who bought their main home, however at a later date have had to vacate the property and rent it to tenants.

These types of people are not, it can be argued, "typical" residential property investors however they are being significantly negatively impacted by the proposed phasing out of interest deductions.

Indeed, according to MBIE statistics released in February this year 77.9 percent of residential landlords own just one rental property each. - Meaning that 77.9% of the people who will be affected by these changes are either persons in the categories mentioned above, or individuals/companies with only one other property. Not the large scale residential property investors the changes should really be targeting.

In relation to A), persons who own their own property and begin a relationship with another person who owns their own property. There a large number of New Zealanders, particularly in their 30s and 40s, who are affected by this.

Speaking from personal experience, I am affected by this, along with two other individuals within my immediate vicinity at work and another friend.

Having worked long and hard for many years to buy my own property, and worked significantly at paying down my mortgage as much as I can, it is particularly disheartening to find that the government clearly expects people in this position to sell their own properties when they move in with a partner.

I own one property. I am not a “residential property investor” - the property was bought and lived in as my main home, however after owning it for a number of years I have moved in with my partner.

Selling the property would leave myself, and others in the same situation, with nothing, no assets and nowhere to live should our relationships fail. And given the housing market, it would be unachievable to re-enter the Auckland housing market for myself at a later date.

With the proposed changes, I personally stand to be s9(2)(a) [redacted]. This is money (in addition to the tax bill I already have to sa[redacted]o personally save through the year to be able to afford my tax bill, or I will need to sell my home.

Proposal: A stricter definition of “residential property investor” should be adopted, which should allow individuals to own one property with interest deductions allowed (as it is for owners of a main home that rent out part of the building)

2. New builds - interest deductibility and 5yr bright line test

If the government is to proceed with the removal of interest deductions and introduction of a 10yr bright line test for existing properties, this should apply to ALL investment properties.

Different rules for new builds will only benefit large scale property investors who have significant capital and can take advantage of the loop hole.

Everyday New Zealanders, who only have one home and/or one investment property will be those who are most negatively affected by this disparity.

These proposed changes therefore will only benefit the very wealthy.

As a final remark, myself and my colleagues referred to in this submission are all public sector workers. Therefore not only will we be worse off because of the tax deductibility changes, but we will be even worse off because of the three year public sector pay freeze.

Thank you for your time,

s 9(2)(a) [redacted]

From:	s 9(2)(a)
To:	Policy Webmaster
Subject:	Design of the interest limitation rule and additional bright- line rules
Date:	Monday, 12 July 2021 2:49:43 PM

I disagree with the proposed interest limitation rules.

This will not help with the supply of housing, and does nothing to achieve one of the governments key housing objectives, which is to ensure "affordable home to call their own". I believe rents will increase with more existing rentals remaining in the rental market and increase demand for housing as long term holds are kept even longer, which is the main aim of investors. No shedding of investors current stock has occurred on the residential housing market since 29/3/21, nor will it happen in the future. Speculators are not being effected with these changes as they are already captured under the already existing tax revenue policies. The issue is demand and the govt needs to loosen the burden and costs to develop and build rather than tax mum and dad investors because they have worked hard.

PLEASE JUST KEEP IT SIMPLE – 143 page of discussion document, shows that these rules are already too complicated and will be an unfair burden on taxpayers to comply with the rules. The new rules need to be simple and easy for us all to follow.

ROLLOVER RELIEF I agree that there needs to be rollover relief now that Brightline has been extended to 5 and then 10 years. This should cover all related party transactions, and the following should receive rollover relief
- Becoming an LTC should also be excluded from a brightline sale, as becoming an LTC can simplify ownership for a Company and reduce unnecessary compliance costs.
- Sole trader or partnership to LTC, Trust, Company or LP
- LTC share changes, between related parties, including to Trusts and between individuals

Roll over relief should also be back dated to 29/3/18 as there are a lot of rental property owners who unintentionally have been caught by these very complicated rules.

- I disagree with the proposed interest limitation rules
- Capital account property holders who are caught with the taxable sale should be able to deduct interest for the whole period of ownership in the year of sale
- Date of commencement for new build on an existing property to be developed should be the earliest date possible in the process of developing, and I suggest from date the existing tenant moves out of the existing property.
- Rollover relief should be included and should be broadened to include LTC elections and all related party transfers, including share transfers. This should also be back dated to 29/3/18

CAPITAL ACCOUNT PROPERTY HOLDERS – If a long term hold rental property is sold, and is caught by the bright line rules or other taxing provisions, then interest should be fully deductible in the year of sale. The long term hold investor is already paying a large amount of tax if the sale is taxable, and if interest was not an allowable deduction, tax would then be at an unreasonable level and would severely penalize the property owner. **If interest was not deductible for a taxable sale, it could see an owner paying more tax then the gain they made.**

DATE OF COMMENCEMENT FOR NEW BUILDS – Interest deductions should be allowed from when the tenant moves out from the old property. This should be the first stage in an older rental property becoming a new build. Or the interest should be allowable from when the older property is demolished.

Thanks and Regards,

s 9(2)(a)

From:	s 9(2)(a) [redacted]
To:	Policy Webmaster
Subject:	Design of the interest limitation rule and additional bright -line rules
Date:	Monday, 12 July 2021 3:02:27 PM
Attachments:	image001.png SUBMISSION3 (003).pdf SUBMISSION3SUMMARY.pdf
Importance:	High

Enjoy!

s9(2)(a) [redacted]

Mint Advisors
Mint Advisors Trust
Specialist in Property and Trusts

12th July 2021

Design of the interest limitation and additional bright-line tests
c/- Deputy Commissioner, Policy and Regulatory Stewardship
Inland Revenue Department
PO Box 2198
WELLINGTON 6140

Dear Mr Carrigan,

Design of the interest limitation and additional bright-line tests

Submission on the Design of the interest limitation rule and additional bright-line rules.

s9(2)(a) [redacted]

[redacted]

When considering the Government objectives regarding safe, warm dry and affordable home – renters or owners.

This proposed legislation does not achieve this.

This will REDUCE THE RENTAL STOCK AND BE A DISINCENTIVE FOR MUMS AND DAD INVESTORS.

NOR WILL IT DAMPEN ANY DEMAND.

IT WILL ACHIEVE AN OVER-REGULATED RENTAL HOUSING MARKET THAT FAVOUR'S THE STATE.

So this law should not apply to mum and dad investors with taxable rental income (which includes an interest deduction) of up to $ 25,000.

YOUR OBJECTIVE:

Not to discourage new stock is not complex.

Unfortunately, you will end up with an extremely complex piece of legislation that will take years to understand and end up in legal arguments and tie up a large resource within the IRD when they should be focusing on audit work and non-compliant tax payers.

This submission is a comment on the submission paper not an open expression of an individual's right to express their concern at this intended legislation.

So, I will answer the questions your have raised in the 143-page document

Re Business exclusions

YES, All things deemed business.

The Income Tax definition for a business is suitable.

Simple% allocation for mixed use dwellings.

EMPLOYEE ACCOMODATION

Should be excluded from this legislation.

STUDENT ACCOMODATION

Exclude if it is complying under the Education and training Act.

SHORT TERM ACCOMODATION

Excluded as per discussion paper.

SERVICED APARTMENTS

Should be carved out, but a service must be provided.

Papakainga Housing

Should not be excluded

Company Structures- New Builds Valuations of Assets

Valuations of assets within companies should be consistent. If the residential property is to be valued at market price so should the Business assets . Valuation for property could be by rateable value.

OTHER ENTITIES

What is the status of an overseas buyer?

Will the exemption apply?

In my opinion there should be no exemption for overseas buyers.

Feedback on tracing

Where significant sums are involved, say $ 50,000 up tracing should be used.

Refinancing Existing Loans

Refinancing with overseas loans should enable the borrower to deduct the interest

Another alternative would be to continue to allow all the loans that were pre-27 purely for simplicity.

REVOLVING CREDIT FACILITY

Using the examples 14and 15 , the application appears simple. So yes, use it.

But then all accountants must keep a record of the highwater mark level of all clients with a floating facility.

Agree in principle, but on a loan-by-loan floating facility basis.

Chapter 5:

What to do with the interest that you cannot claim on the sale of the property?

The rental sale should never result in a loss and the legislation intents only to limit the interest that

Could be claimed under normal accounting principles.

So, I would agree that any non-deductible interest should be claimable on sale of the rental property.

Chapter 6

Development and related activities

When the property is held in revenue account it should be craved out of this legislation.

If the property held in capital account is used to add to the rental stock, then the funds used to create

The rental stock should be carved out of this legislation.

NEW BUILDS

Overall, the proposed definition for new builds is satisfactory.

There should be no exception with papakainga or Heritage buildings.

New Build exemption

To cover all the issues that are raised I suggest that ALL new titles that are issues as new builds should have

An entry on the title for the period the new build exemption applies.

5 YEAR BRIGHT LINE TEST.

By being on the title professional can clearly determine if the Brightline test is applicable.

Naturally with a new dwelling on the old title with an existing property another indicator would need to be added to the tile.

ROLLOVER RELIEF -UPON DEATH

Matrimonial settlement or inheritance would be able to claim the interest for the remaining years as per the title.

TRUSTS AND TRANSFERING ASSETS FROM THE SETTLOR TO THE TRUST

THIS ADOPTION STATUS NEEDS TO BE CLARIFIED.

IT SHOULD BE INCLUDED.

TRUSTS AND MAORI AUTHORITIES

The trust rules are not applicable to Maori authorities as the iwi are too diverse.

Special rules should apply to include them.

Any transfer under the Treat settlement would be excluded from this legislation.

CHAPTER 11 INTERPOSED ENTITIES

The simple examples shown in this section are easy to follow. The complex ones are not.

These types of entities are not common in my Accounting Practice.

Use their balance date for Tax purposes be used as the date the apportionment calculation is undertaken.

LOSS RING FENCING RULES

As the focus is to encourage new builds then the interest MUST be deductible in the year it is incurred.

INTEREST LIMITATION ON MIXED USE PROPERTY

The whole area of mixed used assets is a bit of a mine field.

So my suggestion is simplicity.

Administration

The concept of overtime removing the interest deduction for existing rentals

And allowing interest deduction on new builds is not a simple task. As the document is 143 pages!!

The sources that could be accessed to verify a new build and subsequent buyers could be: -

The bank , the builder , the lawyer and then put on the title .

The issue with CCC's is that in the countryside there are large numbers of building with no CCC's.

So, relying on CCC's is this case is not practical.

OTHER ISSUES NOT CONSIDERED IN THE SUBMISSION

As a professional I have been asked many times what I should do and what are the consequences of this new law.

The trouble is it is currently not law.

SO, ANY LEGISLATION SHOULD INCLUDE A CLEAR STATEMENT AROUND ADVISE GIVEN BY ADVISORS UP TO THE

TIME THAT THE LAW IS PASSED BY GOVERNMENT.

That the taxpayer, if the advice is incorrect is given one year to amend their position and any changes will not

Be subject to any part of the legislation this submission is about. No penalties will be charged by the IRD to the client.

As I said at the beginning of this submission this law is a stick not a reward system.

Instead of creating a raft of additional conditions you should be using a reward system to encourage new home buyers to buy.

Capitalise the Working for Families, give this to first home buyers on a lump sum.

Provide an incentive of say up to $ 7,000 to be given to first home buyers and not repaid if they keep the house as a home for more than 6 years.

BUT IF YOU DO NOT TAKE UP THIS IDEA THANK YOU FOR PROMOTING A COMPLEX NEW LAW THAT WILL ADD MANY CHARGEABLE HOURS

OF INCOME FOR ME FOR YEARS TO COME. THAT WILL TAX THE IRD RESOURCES WHO ARE TRYING TO REDUCING THEIR EMPLOYEE NUMBERS. THAT WILL CREATE A RAFT OF SPECIALIST LAWYERS AND ACCOUNTANTS.

<u>Submission on the Design of the interest limitation rule and additional bright-line rules</u>

s 9(2)(a) [redacted]

12th July 2021

Design of the interest limitation and additional bright-line tests
c/- Deputy Commissioner, Policy and Regulatory Stewardship
Inland Revenue Department
PO Box 2198
WELLINGTON 6140

Dear Mr Carrigan,

Design of the interest limitation and additional bright-line tests

When considering the Government objectives regarding safe, warm dry and affordable home – renters or owners.

This proposed legislation does not achieve this.

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YOUR OBJECTIVE:

Not to discourage new stock: not be complex.

Unfortunately you will end up with an extremely complex piece of legislation that will take years to understand and end up in legal arguments and tie up a large resource within the IRD when they should be focusing on audit work and non-compliant tax payers.

This submission is a comment on the submission paper not an open expression of an individual's right to express their concern at this intended legislation.

So I will answer the questions your have raised in the 143 page document.

To understand this submission you will need to understand the Design of the interest limitation rule and additional bright-line rules document.

RE BUSINESS EXCLUSIONS

If the targeted segment of the market place is non-business first time home buyers than there MUST be an exclusion for

All things deemed business.

The apportion element can and could be complex.

We suggest that there should be an apportionment formula allowed for home accommodation for a dual purchase property.

BOTH PROPERTIES UNDER ONE TITLE

.i.e. downstairs business upstairs accommodation. Formulae, say the total area is 140sq meters.

Business 65 M2 Accommodation 75M2. Purchased in 2021 July for 450,000. Sold 2025 for 650,000.

Difference in value $ 200,000. Accommodation portion 75/140 * 200,000 = $ 107,143.00 taxable income to the owner.

If two properties under separate titles, then any sale of the business premises is an exempted sale.

While the accommodation would fall within the scope of this intended legislation.

The Income Tax definition for a business is suitable.

EMPLOYEE ACCOMODATION

Bringing it back to the fundamental focus of this legislation being the first home buyers' market I believe that the Employee accommodation should be excluded from this legislation.

STUDENT ACCOMODATION

Naturally, there would be an incentive to be excluded from the legislation but again this area does not affect the target market. Any conversion post the legislation should be reviewed to ensure the landlord is complying under the Education and training Act.

SHORT TERM ACCOMODATION

If the accommodation is used a majority of the time for short term rentals, i.e. the majority is available bed nights then it should be except from the legislation.

If the property is associated with a motel as a spill over alternative again it should be except.

SERVICED APARTMENTS

Should be carved out, but a service must be provided.

PAPAKAINGA HOUSING

Any Maori development in any New Zealand city should be treated in the same way as any house in the wider community.

We are, as far as I am aware, living in a country that does not encourage separate development by race.

So, this should not be carved out.

Maoris like the rest of the population want their own homes and should therefore be included in the Legislation.

COMPANY STRUCTURES- NEW BUILDS VALUATIONS OF ASSETS

New builds for Companies that are deemed to be Residential Investment property.

With the focus on building homes any negative treatment will impact on the supply of homes to the market.

The deemed companies should have the same ability to deduct interest as a new home buyer and the same bright line test. (5 years)

As this is encouraging new builds no matter what entity holds the new build.

Valuations of assets within companies should be consistent. If the residential property is to be valued at market price so should the Business assets.

Valuation for property could be by rateable value.

OTHER ENTITIES

What is the status of an overseas buyer?

Will the exemption apply?

In my opinion there should be no exemption for overseas buyers.

FEEDBACK ON TRACING

Where significant sums are involved, say $ 50,000 plus tracing should be used.

REFINANCING EXISTING LOANS

In the murky waters of tax legislation clarity is everything.

Yes, a specific provision is necessary for refinancing pre-27 Loans

Refinancing with overseas loans should enable the borrower to deduct the interest

As long as the loan is solely for the Pre--27 loan amount.

Tracing Rules where the borrower does not have the records

Pre-27 Loan based on current assets. Loan balances as at 26thMarch 2021

Apportionment and Stacking:

Both the options around this portion of the tracing rules should be an option that any borrower can use.

Then adopt the one best suited to their assets.

Another alternative would be to continue to allow all of the loans that were pre-27 purely for simplicity.

REVOLVING CREDIT FACILITY

Using the examples 14 and 15, the application appears simple. So yes use it.

But then all accountants have to keep a record of the highwater mark level of all clients with a floating facility.

High Water Mark Concepts.

Agree in principal, but on a loan by loan floating facility basis.

Chapter 5:

What to do with the interest that you cannot claim on the sale of the property?

If you allowed all the non-claimed interest to be claimed on sale no matter the circumstances. Then this would be an important decision when selling the rental.

The rental sale should never result in a loss and the legislation intents only to limit the interest that could be claimed under normal accounting principles.

So I would agree that any non-deductible interest should be claimable on sale of the rental property.

Chapter 6

Development and related activities

When the property is held in revenue account it should be craved out of this legislation.

If the property held in capital account is used to add to the rental stock, then the funds used to create the rental stock should be carved out of this legislation.

NEW BUILDS

Overall, the proposed definition for new builds is satisfactory.

There should be no exception with papakainga or Heritage buildings.

When considering a change of use from unhabitable to habitable I expect some form of building permit would be required to bring the building up to standard.

So, this could be used as a tool to identify new buildings.

NEW BUILD EXEMPTION

To cover all the issues that are raised I suggest that ALL new titles that are issued as new builds should have an entry on the title for the period the new build exemption applies.

This would act as a reference for any professional preparing rental accounts and also a clear visual for the timeline the exemption applies.

5 YEAR BRIGHT LINE TEST.

Again I believe that the best approach for all buildings on a new or existing title is to state on the title that the 5 year bright line applies.

Once the property is sold then this would change depending upon the Bright Line test at the time.

By being on the title professional can clearly determine if the Brightline test is applicable.

Naturally with a new dwelling on the old title with an existing property another indicator would need to be added to the title.

ROLLOVER RELIEF -UPON DEATH

As suggested in this submission the period of interest would be clearly shown on the title so any subsequent owner via Matrimonial settlement or inheritance would be able to claim the interest for the remaining years as per the title.

TRUSTS AND TRANSFERING ASSETS FROM THE SETTLOR TO THE TRUST

The suggestions in para 10.57 are in my view the most common form of trust.

The one area not mention is adoption. They are no blood relatives but family.

THIS ADOPTION STATUS NEEDS TO BE CLARIFIED.

IT SHOULD BE INCLUDED.

TRUSTS AND MAORI AUTHORITIES

The trust rules are not applicable to Maori authorities as the iwi are too diverse.

So, an overview should be taken, and a register of the iwi needs to be maintained and be a public record.

If say 10% of the iwi die, then assets purchased by the iwi need to be reviewed and any assets that fall within the Brightline test attached to the property sale need to be reviewed and assessed.

Then only say 10% of the Brightline sum should be included as a taxable event in the Maori authority.

Transfer between Maori Authorities being the same iwi should not fall into this legislation.

If the Maori Authorities are not the same, then the Brightline test and the interest deductibility applies.

When Maori land is transfer to a European title then this and subsequent Brightline and interest deductibility rules apply.

Any transfer under the Treat settlement would be excluded from this legislation.

CHAPTER 11 INTERPOSED ENTITIES

The simple examples shown in this section are easy to follow. The complex ones are not.

These types of entities are not common in my Accounting Practice.

The reason individuals borrow at shareholder level is to separate the risk element of borrowing from the long term investment for the shareholders.

As all tax entities require annual accounts I would suggest that an annual calculation, their balance date for Tax purposes be used as the date the apportionment calculation is undertaken.

I agree that the suggested approach to LTC and Partnership as outlined in this document be adopted.

<u>LOSS RING FENCING RULES</u>

The issue is that the two types of approaches when looking at new builds contradict each other.

As the focus is to encourage new builds then the interest MUST be deductible in the year it is incurred.

So a new class needs to be created in the landlords tax return- interest claimed on new builds.

Naturally this would require a change to the Ring fencing of Losses.

<u>INTEREST LIMITATION ON MIXED USE PROPERTY</u>

The whole area of mixed used assets is a bit of a mine field.

So my suggestion is simplicity.

As the goal is to flow funds into new builds, any entity that has MUA's there will be no deduction of any interest in the entity.

In my practice we have no MUA's.

There must be a carve out for interest claimed in the home office calculation.

<u>ADMINISTRATION</u>

The questions under this heading, to some respects have been answered in this submission.

The concept of overtime removing the interest deduction for existing rentals and allowing interest deduction on new builds is not a simple task. As the document is 143 pages!!

Adding field to a Tax return is an ongoing thing since a Tax return has been designed, nothing new.

The sources that could be access to verify a new build and subsequent buyers could be:-

- A form with the bank as to why the funds are required
- A form with the builder confirming it is a new build for rent.
- A from with the lawyer required on settlement that it is a new build for rent.
- Once confirmed then this would appear on the Title.

The issue with CCC's is that in the countryside there are large numbers of building with no CCC's.

So relying on CCC's is this case is not practical.

<u>OTHER ISSUES NOT CONSIDERED IN THE SUBMISSION</u>

As a professional I have been asked many times what should I do and what are the consequences of this new law.

The trouble is it is currently not law.

SO, ANY LEGISLATION SHOULD INCLUDE A CLEAR STATEMENT AROUND ADVICE GIVEN BY ADVISORS UP TO THE TIME THAT THE LAW IS PASSED BY GOVERNMENT.

That the taxpayer, if the advice is incorrect is given one year to amend their position and any changes will not be subject to any part of the legislation this submission is about no penalties will be charged by the IRD to the client.

As I said at the beginning of this submission this law is a stick not a reward system.

Instead of creating a raft of additional condition you should be using a reward system to encourage new home buyers to buy.

Capitalise the Working for Families, give this to first home buyers on a lump sum.

Provide an incentive of say up to $ 7,000 to be given to first home buyers and not repaid if they keep the house as a home for more than 6 years.

BUT IF YOU DO NOT TAKE UP THIS IDEA THANK YOU FOR PROMOTING A COMPLEX NEW LAW THAT WILL ADD MANY CHARGEABLE HOURS OF INCOME FOR ME FOR YEARS TO COME.

THAT WILL TAX THE IRD WHO ARE REDUCING THEIR EMPLOYEE NUMBERS.

THAT WILL CREATE A RAFT OF SPECIALIST LAWYERS AND ACCOUNTANTS.

From:	s 9(2)(a)
To:	Policy Webmaster
Subject:	The stupidity of Labours housing policies continues unabated!!! A submission on interest deductibility
Date:	Monday, 12 July 2021 3:03:54 PM
Attachments:	The stupidity of Labours housing policies continues unabated.docx

The stupidity of Labours housing policies continues unabated!!!

Labours aggressive attacks on long term property investors retirement savings will have exactly the opposite effect to the stated intention. It will freeze the property market and lock up properties for longer terms that would otherwise have come to market and be freed up for redevelopment or other buyers. It will ramp rents to even further unaffordable levels and create more homeless. Here's why…

Property investors are now very aggrieved and rightly so, primarily by the aggressive verbal and political attacks they have received from the blind ideologue Grant (Robber) Robinson and the Labour party. Not only that, the proposal to implement ill-conceived property market policies driven by ideology rather than practicality are those that Robertson was advised not to implement, and for good reason. And who is going to pay for all of this blindness and idiotic ideology? It will come as a great shock to the Labourites, but property investors will not be paying a cent for this, it will be tenants, first home buyers, and people who still had the dream of buying their own home.

With the extension of the bright line test Labour have frozen the property market for the next 5 years, and the data coming through now shows that. New listings for properties for sale have now dropped 30% since this was implemented as property investors (who are around 30% of the market), and all other property owners have taken any of their properties they were considering selling off the market. Labour, stupidly stated, they were hoping to force property investors to liquidate their secure retirement savings and put the money into unsecure cash in the bank for no return what so ever. Meanwhile, in the real world, how likely do you think this is going to happen? In fact, it will be the last thing they consider or ever actually do! Because the bright line test has been extended a further 5 years, it has made investors lock in their existing investments for far longer terms, and they certainly will not be selling existing properties to upgrade what they own when there they are outside the 10-year test (and tax free), and then buying new ones that have to be locked in for 10 years. They will retain the existing properties; the market will freeze with property prices increasing further.

They in time will borrow more money as usual on their equity and lock properties away for even longer, 10 years or more, or depending on their age and stage, start using the increased rentals they will inevitably receive to start paying off debt and start receiving positive cashflow for their retirement. Further to, property investors have a far longer horizon than that of a fleeting finance minister, and will "look through" any increased costs that may be imposed, and await the inevitable political demise. Exactly the same as the reserve bank will have to "look through" any inflationary pressures in the next year, and be severely curtailed on any potential interest rate increases, as even slight increases will tank the economy. What has been failed to be realized is that a small increase in interest rates, now means a large increase in total cost, so a quarter or half % increase will have a far larger impact than it historically would have. Interest rates are going nowhere fast, and will be low for a very long time.

And as for the biggest mistake Labour has ever made, removing the interest deductibility offset against rental incomes on property investments. How expensive do they really want to make renting in this country??? Labours blind hope was that this will "force" the scourge of the earth, the "hard-working long-term retirement saving property investors" to liquidate their properties. I have news for them, that will be the very last thing on earth they do!!! But what Labour has done is ensure rents will increases in the order of 5-8% per year for the next 4 years at least, and probably longer until equilibrium returns. (I know it's a big word, look it up, you do need to understand what market forces and market equilibrium is to understand the impact you are having). The math's is very simple, the plan is to be implemented over 4 years, with tax being paid on 25% in the first year and then increasing 25% each year for 4 years. So, the actual increased cost per year is the tax rate the investor would pay, say 30-39% worst case on 25% of the rental income extra per year (and not all property investors are in a high tax bracket as the left wing would have you believe). Which is 7.5% - 9.75% maximum additional tax per year (less maintenance and other costs etc.) for the next 4 years. And why will rents go up, because the investors will be forced to pass these costs on. They will not sit there and absorb such abuse and financial attacks lying down, <u>and they will do everything humanly possible to retain their retirement savings and secure investments.</u> The choice for them is very simple, sit there and be finically extorted by this government or increase rents to cover the increased costs? This will be in the order of 4-5 time the current inflation rate, and way more than any income increases of tenants. So, what happened with the last set of government imposed additional costs on property investors, the rents went up a commiserate amount. We for example had no intention of putting rents up, but did to cover these additional costs, now that rental level is locked in. In reality the hardship this will create for tenants will be worse because it will create further tenant churn and change over, because the existing tenant will start looking elsewhere and there will be 100's of other desperate families to replace them if they don't accept the rent increase. More administration for the investor and changing tenants, more heartache for all concerned. Then we get Megan Woods pleading for the "nasty landlords" to have a heart after her lots heartless verbal and financial attacks the Labour government have dealt out to investors. Megan, there is news for you too. You have just created another swathe of homeless in this country, the complete opposite to what you set out to do. Rents go up at the top, homeless get pushed out the bottom, and when you declare and enact financial termism on a particular sector of society, they will not treat you kindly, or in any way do what you want.

Labour also do not understand about disintermediation of funding and people taking cash out of the banks to invest in property. A lot of property investors are now very cashed up with high equity positions. The banks represent very little security on any money invested over $100,000.00 and the changes in law to an "opt-in" arrangement under a bank failure has encouraged people to take their money out of banks and invest in alternatives. People are also lending directly to property investors for better returns. This disintermediation is now rendering the reserve bank policies, and now political agender implemented by Labour through the reserve bank far less effective. People are now ignoring the government and regulators, finding ways around them and getting on with business.

Labours obsession with first home buyers is creating huge market distortions in pricing and liquidity when every part of the market needs to work and function properly to help first home buyers. Again, the ownership of property needs to be liquid in all parts or categories to free up land, you need efficient, liquid markets to satisfy excess demand in a particular part of the market. The only thing that will satisfy increased demand is increased supply, trying to repress demand will not eliminate demand, it will only delay the satisfaction of that demand. When you have repressed demand like we have had in New Zealand for the 4 years from 2016 to 2020 and you throw reduced deposit rates and money liquidity at the market, what do you expect will happen. That pent up demand was released, you can't put the Genie back in the bottle. You also need to understand there is a huge amount of repressed demand still!

You also fail to realize that rental cap rates are now 2% or less in Auckland on rental properties, so the rental flow to capital investment is extremely low. For some time now, the deposit rates required for investors have been extremely high, they have very strong equity and cashflow positions or they would not have been able to buy. Any investor that has had property for a year or more would have just had the property increase by 33-40% in the last year, so they will "look through" a small tax increase in the short term, and look forward to a change in government and policy, as the opposition have already stated they will reverse these tax increase. The only other thing that may motivate investors to sell, is if they could buy other quality property, and with the market now frozen with nothing of quality coming to the market, there is absolutely no motivation to do so.

So, blind ideology and aggressive attacks both verbally and financially on law-abiding hard-working tax paying savers never works. Labour will pay for this in the polls when the penny drops for tenants and prospective home owners who will continue to be locked out of the market. And finally, how many houses did this build (in addition to the 12 already built by this government) and how many people did it get into new housing and out of emergency accommodation. None, and in fact it locked away land that developers would otherwise have bought to develop and build new housing. Great work Cindy, Robber-Robo and Meegs, go to the top of the class!

So, now, you are starting to have your first lessons in property market 101, the shame for New Zealand is that you are still learning on the job, and New Zealanders are having to pay for your mistakes. Further, something you will need to learn about markets is that lies, broken promises, and excessive taxation create market distortions and uncertainty, they paralyze decision making and freeze markets. This is what you will succeed in doing if you implement these policies, or carry on with them. The whole objective here should be to free up land for development into New Housing. This is actually very simple to do, but it would require a change in doctrine and thinking that we all believe you people do not possess, it will require a change in tax grabbing policies that are holding existing change back dramatically.

Now, bear with me here for a moment, the property market and property ownership in all its forms is a process over people's lifetimes. If you have and efficient liquid property market, people will move through all these stages of ownership if the government gets out of their way and allows them to do so. First home buyer, then upsizing for increased families, property investor for retirement savings, then property investment turning into development potential to build new housing and accommodate increased population, and the cycle continues. The part that is frozen at the movement is the stage from upgraded home owner to investors to property development, and there is very good reason for this. Draconian money grabbing TAX policies that stuffed this up long ago!!!

Let me explain. If a property investor or existing home owner wants to change the usage of his existing home or investment property from primary place of residence or long-term rental to use the land to develop and increase the supply of housing, he becomes a “developer” and everyone in this country knows for tax purposes that is the worst thing you can possibly do!!! Why? Because… If you become a developer, and change the status of your existing property and personal circumstances, not only do you have to pay tax on the historical capital gain you have made, you do not get a GST credit on today’s market value for the land. You have to pay GST on the full value on the property at today’s value, before you even start. So, this immediately puts existing property owners at a disadvantage in developing their own properties compared to a developer coming along and buying their property, who will get a gst credit from that vendor who is a non gst registered entity/vendor. Even worse than that, any individual who is then deemed to be a property developer is then scarred for life and taxed on any personal property or long-term investment property as if they are a developer, even if they never develop a property again. Now stay with me here, the best people to actually develop property and provide new housing is the long-term home owner or property investor as they are the existing owner and will be a lot less financially geared than a developer having to pay full value for the property up front. Even better still, provide a mechanism where the existing home owner or investor is not penalized by historic capital gains tax or gst. and they can go into partnership with a developer to provide new housing. This would have the best of both worlds, the home owner/investor has the equity and the developer/builder has the expertise to complete the project. A win-win for all. And Robber Robo, you will actually make more tax money out of this, because you will get gst. and tax on the development profit over and above the land input cost at today’s value. AND the really important thing, free up land and create new housing!!! You need to put existing property holders on the same footing as developers and give then a GST credit on todays value of land should they change a properties status to being developed, further you need to financially encourage them to take the next step and not screw them with capital gains tax if they provide new housing. Even better, give them that credit, and don’t penalize them for producing new housing, in fact incentivize them by allowing them to hold the properties that are developed to rent, and say if they keep them for say 2 years or more, they can then still sell them for no capital gain tax. You are trying to get property investors to invest in new properties, they will if you allow them to convert existing land holding to new properties and you don’t tax the shit out of them. Imagine how much property that would free up and how much housing it would create!!!

This is only part of the issue hard-working long-term retirement saving property investors are not to blame as the three musketeers would like everyone to think for their own political points scoring and expediency. Auckland Council and its prohibitive cost structure, time delays to get consents both resource and building along with the disabling regulation that is the Auckland Unitary Plan are also to blame. The appeals process being used as a punitive cost weapon and delaying tactic by Nabors and the Resource Management Act. You have created the perfect storm. Tax is not the answer, releasing the tax and regulatory burden is, but Labour do not possess the mental capacity to understand it or change their ideological ways.

In summary, Robber Robo has grasped the problem, land is not being freed up for new housing. However, his plans to implement two ill-advised and ill-conceived combative, aggressive tax reschemes against property investors as explained will fail miserably and have dire consequences for tenants and the homeless. What he has also failed to realize is that property investors are only 30% of the market, there is a whole 70% elsewhere that needs to be freed up as well. In case you haven't realized it yet, property investors and developers are the ones you want to get on your side and to help you and this county at the moment. Doing everything you can to shaft them and declaring war on them will not help you, and those properties will be locked away forever and a day and projects shelved. That is what we have just done ourselves!

Name and address withheld due to the fear of punitive tax repercussions should someone actually tell this government the truth!

From: s 9(2)(a)
To: Policy Webmaster
Subject: Design of the interest limitation rule and additional bright-line rules
Date: Monday, 12 July 2021 3:17:50 PM
Attachments: image458809.png
1038324_1-Submission - Interest Limitation and Bright-line Discussion Document.pdf

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Please find attached our submission on the discussion document.

Feel free to get in touch if any of these points wish to be discussed in more detail.

Thanks and regards

s9(2)(a)

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STAPLES RODWAY

7 July 2021

Deputy Commissioner, Policy and Regulatory Stewardship

By email: policy.webmaster@ird.govt.nz

RE: SUBMISSION ON THE DESIGN OF THE INTEREST LIMITATION RULE AND ADDITIONAL BRIGHT-LINE TESTS

We wish to make the following submission in relation to the recent Discussion Document released. We can be contacted by officials to discuss these points, if required.

Rollover Relief

1. We support the intention of the rollover relief proposals.

2. We wish to comment specifically on the rollover relief proposals relating to trusts and the bright-line test, contained in paras 10.53 – 10.67.

   Non-zero consideration

3. Paragraph 10.31 states that only disposals for non-zero consideration will be eligible for rollover relief.

4. It is commonplace for a transfer of residential property to a family trust to occur by way of a sale with a debt back to the settlor(s). The debt may or may not be forgiven by the settlors.

5. In the circumstance where the entire debt is immediately forgiven, we consider that this is effectively the same as a disposal for non-zero consideration. A property transferred to a trust in this manner should also be afforded rollover relief.

6. Further, even if the debt is not immediately forgiven, we consider that rollover relief should still apply.

7. The residential property may have been acquired with a loan from a bank, if transferred for nil consideration, there will be no ability for the trust to claim a deduction for the interest expense to the extent it is a new build (under the interest limitation rollover relief proposals). This is because the loan will remain with the settlors and the trust as a separate entity will not incur any interest.

   Beneficiaries

8. Paragraph 10.57 proposes that for rollover relief to apply every beneficiary will need to be associated with a principal settlor.

9. We agree that a modified set of association rules will need to be adopted – family circumstances vary greatly and it would be unfair to exclude the availability of rollover relief due to this.

10. We frequently see family trusts with the following classes of beneficiaries:

    – current/ future children (including adopted or children under whāngai care)
    – siblings
    – parents
    – nieces/ nephews
    – close family friends
    – charitable entities

Main Home Exclusion

11. Another issue that will need to be addressed for the rollover relief provisions is the application of the main home exclusion for the purposes of the bright line test.

12. The main home exclusion can apply to both individuals and trusts (in certain scenarios).

13. There could be a situation where the settlor has occupied the property as their main home for a number of years, and after a transferring the property to the trust it ceases to be that settlor's main home.

14. In this situation the main home use during the period of ownership pre-transfer to the trust, should be counted as main home use.

Application Date

15. In paragraph 10.32 the proposal is that the rollover relief provisions will apply to disposals occurring after 1 April 2022.

16. We believe this is unfair to taxpayers that have been caught out by the harsh rules and are yet to take a tax position.

17. We have encountered a scenario, where the rollover relief rules proposed will not help if they are introduced as intended on 1 April 2022.

18. The scenario is a couple purchased a property in their own name, for use as a main home in September 2013. The couple settled the property onto a family trust in May 2019 for asset protection purposes and continued to use it as their main home. The couple moved out of the property (to move to another city) and rented it for a time of less than a year, before an eventual sale in January 2021.

19. In the above scenario the property is caught by the bright-line test and the gain on sale is taxable to the trust. The main home exclusion doesn't apply because the property had been used as a rental by the trust for a slightly longer period than as a main home by the settlors.

20. In this case the property that has been owned for more than 7 years and used as a family home for the vast majority of that time. It will be taxed under current legislation. This is what the rollover relief proposals are intending to avoid.

21. An alternative and fairer approach will be for rollover relief to apply to disposals that give rise to income under the bright-line test and for which a tax position has not been taken at the date of this discussion document (10 June 2021).

22. This will allow taxpayers adversely impacted by the current rules to have relief, but also not open the floodgates for taxpayers that have already taken a tax position and dealt with the tax liability.

Please feel free to get in touch with us if you would like to discuss these points in further detail. We look forward to hearing your response.

Yours sincerely

s9(2)(a)

[redacted]

From:	s 9(2)(a) [redacted]
To:	Policy Webmaster
Cc:	s9(2)(a) [redacted]
Subject:	Design of the interest limitation rule and additional bright-line rules
Date:	Monday, 12 July 2021 3:23:02 PM
Attachments:	Design of the interest limitation rule and additional bright-line rules.pdf
Importance:	High

To whom it may concern:

NAME: s 9(2)(a) [redacted]

ADDRESS: s 9(2)(a) [redacted]

I submit this communication as a "Mum & Dad Landlord" and I own s9(2)(a) [redacted]

I believe the recommend amended law change be abolished for the following reasons:

- Being unable to claim interest expense on my rental properties affects my cash flow negatively.
- I am a very conscientious landlord and proud to offer good quality housing that meets Healthy Home Standards to New Zealanders in need of a home.
- I cannot afford to keep this property to the standard that the tenants should be able to enjoy, so I will cut corners and not maintain it as well if my budget is affected by the new tax laws. For example, I have a DVS system to help with humidity along with a heat pump. The DVS needs a larger system and I was about to upgrade it because my tenant has asthma, but I cannot afford it if I cannot claim my mortgage as a tax-deductible expense. The DVS is an extra but a much needed one, and a larger/better one would be appreciated by my tenant who's been with me for over a year and wants to stay.
- The flow on effect of this is that either tenants have a less-desirable, damp home (although it has a heat pump and meets health home legislation), or that I put up the rent to cover the DVS repair and the loss of tax relief on my mortgage so I can have the DVS fixed.
- My tenants do not want to move. It is hard for them to move. The stress on them is mental, emotional and financial to find a new home, pay cost of higher bond, moving, finding new schools for children, etc. So they must choose to either pay higher rents to me now OR live with asthma, and are worse off than before. That's not what I understand this Government to stand for. I thought they wanted to help tenants. My tenants standard of living will fall either by paying more rent, or by living without the DVS.
- How it might first home buyers: my son wants to buy his first home. He cannot afford one s9(2)(a) [redacted] so he wants to buy in an area outside his work where he does not live and rent it out. This is not an option for him if he cannot deduct the mortgage expense. He will not be able to hold a property for 10 years – that's not practical at his age when he's trying to get ahead, nor to have to pay income tax if he sells after 5 years. So, he will miss out and maybe never get on the property ladder. This tilts the market AWAY from first home buyers rather than towards them. That's not what I understand this Government to stand for. I thought they wanted to help first home buyers.
- Higher rents (as I described) means that many tenants (including my own tenants and my son s9(2)(a) [redacted]) will have a bigger struggle to save and less chance of saving for their first home. Again, this is not what I understand this Government to stand for. I thought they wanted to help first home buyers.
- I have concerns regarding how this law change will be implemented in practise. It is hard to follow tax law at the best of times This law seems convoluted, and I don't understand my obligations and how I fit into the new law, nor what my obligations will be.
- This law seems complex and difficult to legislate in practise. My accountant fees will go up as I'll need a more expert accountant to help me. That means even more cost on my rent to the tenants to cover the cost of the business of providing accommodation to NZ families.
- I have extra land on one property that I could build on to provide another home for a tenant. I'd need to sell one of my rental properties to fund that build. If I have to hold my existing property bought recently for 10 more years rather than 5 years, I cannot financially afford the new build. So an opportunity to provide one more family in NZ with a home goes away. That's not what I thought this Government stands for. I thought they wanted to reduce the housing crisis, not prolong it.

Respectfully, I ask you to consider this submission regarding the Design of the interest limitation rule and additional bright-line rules as in my experience and my considered opinion, as landlord and mother, this law change is not helpful to the housing crisis, the tenants, nor the first home buyers.

s 9(2)(a) [redacted]

From: s 9(2)(a)
To: Policy Webmaster
Subject: Design of the interest limitation rule and additional bright-line rules
Date: Monday, 12 July 2021 3:27:47 PM

The changes to the interest deductibility on rental investment property will have a huge financial impact on us, to the point where the changes will work against the government's stated aims of improving the supply of affordable housing for all New Zealanders.

*The changes introduce a level of unfairness in tax law, as we will be taxed on money that we do not have at a very high rate of 38%. This is different to all other business enterprises.

--The changes will destroy what has been a very successful enterprise, that has provided more than 20 new builds over the years. Affordable homes for New Zealanders.

We started out buying one rental many years ago, when we were a double income household. We built a house on the back of the property, then we had 2 rentals. We continued to build a substantial property portfolio, using this formula, slowly over the next 25 years. None of this could have happened without enormous personal motivation, hard work and calculated risk taking.

About 15 years ago, the size and time consuming nature of managing our portfolio became a full time job. One partner was by this time a primary caregiver of small children and the other gave up a well paid job to enable more energy to be put in to managing rental properties and developing properties. There were good and bad times financially. Developing can be a high risk, stressful occupation, where you can lose everything if you are not careful.

We are currently in the middle of a s9(2)(a) - an area of high housing need. This has been funded by borrowing against existing assets. However, the law change affects our cashflow so drastically, that it will be the last development we will ever do, because we will no longer qualify for loans from the bank. This is because the severe cashflow shortage caused by our need to pay more than $200,000 in additional tax, because the interest on rental investments is no longer tax deductible.

The $200,000 required is $40,000 more than income we currently have to live on annually. The situation will be even worse if we are considered a Property Rich Residential Investment Company and ineligible for deductions on the desperately needed new builds currently underway. We will have to fund this situation in two ways.

Firstly, by maximising rental income, thus putting more pressure on the tenant's households that can least afford it. Rent rises are the exact opposite of the government's stated aims of more affordable rents.

Secondly and we have begun the process already, we will need to sell down some of our properties (between 10 and 15) and pay down debt. The government may think "well that is exactly what we want - fewer investors more home owners". However, we wrote to all 40 existing tenants (many of more than 5 years duration) to ask if they wanted to buy the home they were living in. Some were interested, but none were in a position to do so. Of the 5 or 6 houses, we have sold or are under contract, all have been sold to investors of Asian ethnicity. Typically with low interest loans coming from family or banks in China.

Two of our previous tenants have moved to emergency housing. Is this what the government wants - more people in emergency housing?

The Interest limitation rule will also lead to more run down properties. If, for example, the landlord has to borrow to fund a roof replacement and the interest is not deductible, this may mean the landlord can not afford to do the remedial work. This will mean more leaky, damp and mouldy homes. Once again the opposite of the healthy homes that the government wants. We are proud that all our homes meet or exceed healthy homes standards. Maintenance work may be delayed or not done at all as a consequence of the new rules.

From: s 9(2)(a)
To: Policy Webmaster
Subject: Design of the interest limitation rule and additional bright-line rules
Date: Monday, 12 July 2021 3:28:44 PM

Dear Deputy Commissioner, Policy and Regulatory Stewardship,

I refer to the Government Discussion document titled: *Design of the interest limitation rule and additional bright-line rules* where comments from the public are to be submitted by 12 July 2021. The following are my comments on the interest limitation rule only preceded by a contextual statement.

Context:

1. I am a citizen of NZ who owns a residential house and small cottage. The latter I live in and the former I rent to tenants.
2. I have a significant mortgage on the house due to a relationship separation matter.
3. I rent my house to tenants in a socially-responsible way.
4. The existing tenants have rented the house for the past 5 years.
5. I have not increased the rent over those 5 years.
6. My perspective is as long as I have sufficient rental income to cover mortgage repayments, and other related costs such as rates, insurance, etc. and projected maintenance costs, then I will not increase the rent.
7. I support the introduction of a Capital Gains Tax from rental property as it appears unethical not to have this tax when income from (all?) other sources are taxable.
8. The Government in its plans to phase out interest as a tax deductible expense is now disturbing my financial relationship with my tenants.
9. I plan to increase the rent to compensate for the increase in tax that I will now have to pay to offset the phasing out of interest as a tax deductible expense.

My comments on the proposed changes to interest deductibility:

1. I consider interest deductibility to be an expense similar in kind to (all?) other expenses incurred in an incoming-producing venture.
2. Therefore, I consider the (phased) withdrawal of interest deductibility to be ethically unsound.

Sincerely,

s 9(2)(a)
[redacted]

From: s 9(2)(a) [redacted]
To: Policy Webmaster
Subject: Design of the Interest limitation rule and additional bright-line rules"
Date: Monday, 12 July 2021 3:29:16 PM

The changes to the law for interest deductions as a legitimate business expense seem very unfair.

Interest deductions

- They are a cost of doing business and every other business is able to claim the interest on a loan as a cost of doing business.
- It is incredibly unfair that a government owned rental supply entity (Kainga Ora) which is providing exactly the same service, will be exempt from these rules.
- We believe that essentially this is a TAX, as we are putting our rents up approx. $20 a week and it will not be increasing the amount of money we make. It will be passed on directly to the IRD.
- If we invest in Commercial property we are able to claim our interest as a business expense. What is the difference?

New builds

- What constitutes a new build? Is it just the date of the code compliance being issued?
- Why is there any bright line on a new build? If we build a house then we are increasing the housing stock which is what is wanted. Why are we being taxed for increasing house numbers if we sell now rather than in 5 years' time.
- If the main point of the changes in the rules is to enable new home owners into the market then why not exempt bright line rules, for a new home, if the owner is selling directly to a first home buyer?
- How long will a house be considered NEW? Will the exemption last for ever or will it only last 5 years? This is not clear.
- Is there any incentive for a person to buy an existing old home and redevelop the site so there is 2 new properties on the place of one old one. Maybe there should be as again the developer is increasing the housing stock and will be paying tax anyway?
- If an aim is to improve the quality of housing stock in NZ then why don't extensive renovations also qualify as exempt. s 9(2)(a) [redacted]

Bright line

- If the purpose of the bright-line extension is to allow New home buyers into the market then it seems counter productive to double the bright line to 10 years.
- The bright line rules should be exempt if selling to a first home buyer. I was asked by a tenant if they could buy the house they were in and I had to say no, whereas I would love to be able to sell it to them. As builders we could have used that money to build a new home to increase supply.
- If selling to a person where it is their only home (ie. not buying as an investment) then maybe the Bright line could be reduced back to 2 years.

- There are landlords out there that would sell to tenants if there was some sort of incentive.

From: s 9(2)(a) [redacted]
To: Policy Webmaster
Subject: Design of the interest deductibility rule and additional bright-line rules
Date: Monday, 12 July 2021 3:31:42 PM
Attachments: image001.png
image002.png
image003.png
image004.png

Dear Sirs

I have been attempting to advise a client as to whether their property will fall within the rules for a property acquired pre-27 March 2021, or after. As you know, this will determine whether the client will be subject to the phase out/grand-parented rules, as apply to a property acquired pre-27 March 2021, or whether the new rules will apply immediately, as will apply for a property acquired from 27 March 2021.

Although the subject property should fall within the pre-27 March rules, it appears, on the basis of the discussion document, that the loan may not, as it had not been "drawn down" before 27 March 2021. I request this is reviewed and updated to reflect the apparent intention of the legislation – being that properties acquired pre-27 March 2021 should be able to continue to deduct interest under the grand-parented phase out of interest rules.

Item for discussion: Chapter 2, Residential Property subject to interest limitation.

My concern is that I have a client who was unconditional on a property prior to 27 March 2021, however settled on the property at the beginning of June. Hence the loan was drawn down at the beginning of June. In theory, this property should be subject to the phasing/grand-parented rules, as a property that was "acquired" prior to 27 March 2021. However, this is a concern (page 8 of consultation doc):

High level outline

1.8 Deductibility of interest expenses incurred by residential property investors will be restricted from 1 October 2021. The amount of the restriction will depend on whether the interest is "grandparented" or not.

1.9 Grandparented interest is interest on debt drawn down before 27 March 2021 relating to residential investment property acquired before 27 March 2021. For grandparented interest, deductions will be gradually phased out between 1 October 2021 and 31 March 2025 as follows:

Confirm date loan must be drawn down by

If this was the case, essentially no property that was unconditional but not settled by 27 March would be grand-parented – as the loan would not have been drawn down before 27 March 2021.

I have reviewed this with other Specialists Tax Advisors who are also of the view the wording of the discussion document does not currently achieve what is the published policy intention of the legislation as to how the new rules will apply to pre-27 March grandaprented properties.

The reuslt – that although the client was unconditional on the property long before the new rules were announced, they may not be able to deduct any interest on the loan. This is inequitable as the client had no choice whether to proceed with the purchase after these rules were announced.

I am happy to be contacted with any questions.

Kind regards,

s9(2)(a) [redacted]

Connect with us now:

www.nztaxdesk.co.nz

From: s 9(2)(a)
To: Policy Webmaster
Subject: Design of the interest limitation rule and additional bright-line rules
Date: Monday, 12 July 2021 3:32:41 PM
Attachments: image003.png
Tax Legislation Submission 12 July 2021.pdf
Importance: High

As attached

s9(2)(a) [redacted]

Auckland Office Level 4, 165 The Strand, Parnell, Auckland 1010
PO Box 42073, Orakei, Auckland 1745

www.enable.me

enable.me
financial strategy & coaching

enable.me
financial strategy & coaching

12 July 2021

To whom it may concern.

enable.me – financial strategy & coaching has been advising New Zealanders on how to improve their financial position since 2007. Its primary goal is to help New Zealanders do better – whether that's helping them pay off their mortgage faster, prepare for retirement, build their wealth, or help their children. enable.me's clients face a similar situation to most New Zealanders in that they do not have sufficient resources to sustain them in retirement. That's why enable.me has supported many of them to invest in new build properties, leveraged against their family home - in a bid to close that gap in their retirement savings, while also providing quality accommodation for their tenants. We assist our clients to position themselves to hold their investment property for a period of at least ten years, and therefore chafe against the description of property investors as 'speculators'. It is for these reasons that enable.me's would like to contribute its perspective on the proposed design of the interest limitation rule and additional bright-line rules.

General objections

A principle of good tax policy is to clearly signal proposed tax policy changes within a general framework of predictable tax policy. In that regard, the Government's decision to move away from tax deductibility of interest for investment properties was a radical departure from longstanding tax policy in New Zealand. The sudden nature of the announcement, the speed of the timelines and the opacity of the rules created significant confusion and concern for enable.me's clients.

Impact of mortgage restructuring

One of the strategies for homeowners and investors with mortgages is to arrange an extension to the term of the mortgage. enable.me often recommends clients extend the term of investment property lending while the client is focusing on repaying mortgage debt associated with their family home.

This requires the bank to issue new lending documents for the client to action this change, which under the proposed design would trigger a loss of the ability to deduct interest costs, where that ability had existed prior to the debt restructure.

enable.me would like to see an exemption where a change in loan structure, or specifically the term, would not trigger a loss of ability to deduct the interest, when borrowers have made prudent decisions based on reducing debt on their homes.

Level 4, 165 Parnell Road,
Parnell, Auckland 1052
New Zealand
P: (09) 09 03 1306
www.enable.me

s 9(2)(b)(ii) [redacted]

Grandparenting arrangements

As mentioned, enable.me supports many clients to enter the property investment market by way of purchasing new builds. This approach offers clients a solid way to build wealth over the long term, while providing good quality accommodation to their tenants that complies with the Healthy Homes Standards. We believe that our offering of new build homes aligns well with the Government's policy objectives of improving housing quality and supply.

The decision to limit tax deductibility of interest to new builds where the Code Compliance Certificate (CCC) was issued on or after 27 March 2021 creates major inequity among property investors, like our clients, who participate in the market through the acquisition of new builds.

A client whose new build received its CCC prior to 27 March 2021 is markedly disadvantaged compared to a client who receives their CCC after 27 March 2021, through the application of the removal of interest deductibility and the extension of the "bright line" test. Each of these clients may have entered into agreements to acquire a residential investment property off the plans at similar times, but owing to differences in the speed of construction and therefore the timing of the issuance of CCC - both factors out of the control of individual investors - they become liable for very different tax obligations. These differences would be arbitrary at any time, but in the context of COVID-19, when building projects have been subject to delays owing to lockdowns and disruption in the supply of building materials, the arbitrary nature of this date has been magnified significantly.

One option to reduce the inequity created between new build investors would be to allow tax deductibility of interest for new builds that received their CCC after 30 September 2020. While it is acknowledged that there will continue to be an arbitrary element to the treatment of different new build investors, shifting the date acknowledges the particular context created by COVID-19 and would be in line with other COVID-19 related timeframe concessions made by Government.

While the extension of the "bright line" test from five years to ten years is unlikely to impact many of our clients, who enter property investment with an expected time horizon of ten years or more, there would be logic in also shifting the five year "bright line" test for new builds to apply to properties with CCCs issued on or after 30 September 2020, rather than 27 March 2021.

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enable.me
financial strategy & coaching

Conclusion

enable.me supports the Government's goals of providing an equitable tax system and increasing the supply of quality housing.

However, we also do not wish to see individuals' endeavours to prioritise repayment of their home mortgage unfairly impact the tax treatment of their investment property, or for inequities to be created between new build investors, particularly those who have been impacted by Covid-19.

As an organisation, not only do we have a track record and in-depth understanding of both the property market and tax system generally, but we also have thought leaders on our team who are well versed in the economic factors in question. We would welcome the opportunity to engage with the Inland Revenue further on these, or any other related issues.

Sincerely,

s 9(2)(a)

[redacted]

Level 4, 165 Parnell Road,
Parnell, Auckland 1052
New Zealand
P: (09) 09 03 1306
www.enable.me

From: s 9(2)(a)
To: Policy Webmaster
Subject: design of the interest limiation rule and additional brightline tests
Date: Monday, 12 July 2021 3:35:22 PM

To Deputy Commissioner Policy and Regulatory Stewardship
Inland Revenue Department

s 9(2)(a)
[redacted]

Dear Sir, I believe the new proposed **legislation is unjust and illegal for the following reasons**.

1. Non interest deductibility for residential property ownership does not make any legal sense since interest as an expense is no different from rates, insurance repairs and general maintenance in operating any business. How can interest deductibility be allowed for any other business other than residential such as a massage parlour, commercial property investor that normally earn a far higher income return on investment than a residential landlord?
2. Why are boarding houses to be exempted from this new legislation when they earn 5 to 20 times the income return of residential landlords on the same investment dollar?
3. Why does the proposed legislation give an exemption for Kainga Ora for interest yet they are also providing residential accommodation?
4. Why and how should new builds get an exemption from this new legislation when they are providing exactly the same service?
5. The properties we have owned in central locations in Auckland for 25-40 years are only achieving an income return after tax of less than 2% on their market value and this is with less than 3% of mortgages based on market value of the properties. If we were to sell these properties they would be sold for redevelopment and they would be replaced by $2 million to $4 million houses that would obviously not be available for low income people to rent. By putting impediments such as non deductibility of interest the government is forcing older landlords like us to sell up which will ensure less quality residential properties available to rent for people who cannot afford to purchase their own property in central Auckland.
6. If a residential landlord upgrades a property by for example putting in double glazing why is the interest not deductible?
7. The proposed legislation is not operating in Australia which is experiencing similar issues to NZ so why are the NZ government making up legislation on the foot where it has been enshrined for hundreds of years that interest is a tax deductible expense for any legal business.
8. I am happy to discuss these issues to discuss the points raised.

Yours faithfully,

s 9(2)(a)

From: s 9(2)(a)
To: Policy Webmaster
Subject: Design of the interest limitation and additional bright-line tests
Date: Monday, 12 July 2021 3:47:10 PM
Attachments: s 9(2)(a)

Dear Sir/Madam

Please find attached a submission from the Accountants & Tax Agents Institute of NZ Inc (ATAINZ) in relation to the design of the interest limitation and additional bright-line tests.

Stay Safe !

Kind Regards

s9(2)(a)

Website: www.atainz.co.nz
PO Box 87475, Meadowbank, Auckland 1742

Your trusted tax & business advisor

ACCOUNTANTS + TAX AGENTS INSTITUTE OF NZ

12th July 2021

Design of the interest limitation and additional bright-line tests
c/- Deputy Commissioner, Policy and Regulatory Stewardship
Inland Revenue Department
PO Box 2198
WELLINGTON 6140

Dear Mr Carrigan

Design of the interest limitation and additional bright-line tests

The Accountants & Tax Agents Institute of New Zealand (ATAINZ) is an incorporated society established in 1976. s9(2)(b)(ii) [redacted]

ATAINZ's objects include:

- to represent ATAINZ members;
- to advance and foster tax knowledge amongst members;
- to further and develop good business practice amongst members;
- to maintain the highest standards among ATAINZ members by restricting membership to suitably qualified people; and
- to consider, initiate, debate and make submissions on New Zealand tax laws.

At present ATAINZ has more than 400 members acting for approximately 150,000 taxpayers. These include business owners, self-employed, partnerships, companies, investors, salary and wage earners, superannuitants, rental income investors, farmers, estates and trusts.

s9(2)(b)(ii) [redacted]

Inland Revenue
12th July 2021

ACCOUNTANTS + TAX AGENTS INSTITUTE OF NZ

A. Summary of key points of submission

1. The complexity and detail of the proposals are of a level rarely seen recently and will have an impact on a significant number of taxpayers. We consider the proposals will impose an unreasonable compliance burden on the group of taxpayers most likely to be affected.

2. We therefore suggest the introduction of these rules should be deferred until the start of the 2022-23 income year to enable all taxpayers and advisors fully understand the implications and ongoing obligations.

3. We are concerned the proposals may have unintended consequences contrary to the Government's desired intentions particularly in relation to the proposed "new build" exemptions.

4. As a simplification measure, we suggest the interest limitation rules do not apply to taxpayers with gross residential rental income below $30,000.

5. Alternatively, rather than the eventual disallowance of all interest deductions (except for the "new build" exemption), interest deductions are limited to 50%. This would better reflect the current position that interest deductions are allowed in full even though gains from sales on capital account are untaxed.

6. We support an apportionment approach in relation to business premises based on existing tax principles.

7. We agree with the proposed approaches to generally rely on existing law on tracing of loans and for calculating the high-water mark level of pre-27 March loans.

8. In relation to the treatment of interest on sales of revenue account property we support Option B.

9. We support Option F allowing interest deductions for sales on capital account in order to ensure there is no over-taxation.

10. We support a broad definition of "development" and consider it should extend to one-off developments and remediation work.

11. We consider the proposed definition of "new build" is acceptable.

12. We consider the new build exemption should apply only to early owners and should apply for a minimum period of 25 years. We suggest allowing subsequent purchasers to qualify for the new build interest exemption may have an unintended distortionary effect.

13. We agree with the proposed apportionment approach where a new build and non-new build are on the same title.

14. We are pleased to see the proposed expansion of rollover relief. However, we consider the exemption is still too narrow and needs to be expanded to cover all transactions between associated persons. We understand Inland Revenue needs more time to consider a possible expansion of the relief and this is one reason we recommend deferring the start of these proposals until the 2022-23 income year.

15. We consider that the effect of the proposals is to require a property-by-property approach to determining interest deductions. Consequently, we consider the existing rental loss ring-fencing are no longer required and should be repealed.

B. General comments

16. These proposals have been developed outside the normal Generic Tax Policy Process. Although we acknowledge the Government's concerns over housing which prompted the proposals, we are concerned the consequently truncated consultation process may have unintended consequences and these may undermine the purpose of the proposals.

17. Within the objectives set out in paragraph 1.5 of the discussion document we have the following concerns:

    a. *Housing affordability and supply* We have concerns about unintended consequences.In order to not discourage new additions to the housing stock the exemptions for developers and new builds should be as wide as possible. However, this may have the unintended consequence of accentuating the existing ability for developers and investors to leverage their property portfolios and outbid first home buyers and other owner-occupiers.
    b. *Coherence* There is a risk that the new build exemptionand allowing deferred interest deductions to become deductible on a revenue account sale may create unforeseen arbitrage possibilities.
    c. *Complexity* ATAINZ considers the proposed rules are of a level of detail rarely seen recently. They will result in significant additional compliance costs for taxpayers and their advisors. These additional costs will fall on particularly heavily on smaller investors with one or maybe two investment properties. This is not a group who could be considered to be a significant driver of the issues putting house prices under pressure. Investors in this category are not able to leverage up significantly and outbid first home buyers. These are people that have decided to purchase an investment property for their retirement. Or it may be that a couple each owning a property have entered into a relationship and so they've moved into one property and rented out the other property. In all cases they do not have ready access to the necessary level of advice required to comply.

17. Bearing in mind the potential impact on smaller investors we suggest a simplification measure would be to exclude from the rules those taxpayers whose annual gross residential rental income is below $30,000. This is below the current annual average rental income of about $25,500.

18. Alternatively, rather than the eventual disallowance of all interest deductions (except for the "new build" exemption), interest deductions are capped at 50%. This would better reflect the current position that interest deductions are allowed in full even though gains from sales on capital account are untaxed.

19. Given the complexities involved, the significant policy impact and the short timetable before introduction, we recommend the introduction of these rules be deferred until the start of the 2022-23 income year. This short delay should give advisors and taxpayers more time to better understand the rules and their obligations.

C. Chapter 2 – Residential property subject to interest limitation

20. With regard to business premises and dual purpose buildings on the same title we consider a fairer approach would be to adopt an apportionment calculation allowing deductions in resepect of the business premises proportion of a dual purpose building rather than the all or nothing approach used by the bright-line tet. We support adopting the existing definition of business premises contained in section DD11[1] together with the exclusion from the land sale rules in section CB19.

21. We support carve outs for employee accommodation and student accommodation. In relation to short-stay accommodation, we are concerned a carve-out lead to a reduction in the availability of residential rental investment property. We suggest any carve-out is limited to accommodation which cannot be sold separately. We also suggest that it be a requirement for the provider of the short stay accommodation to be GST registered so as to put such persons on a similar compliance basis as owners of motels and hotels.

22. We support the intention to continue permitting a homeowner to take interest deductions where the homeowner rents out a room (or rooms) in their main home to flatmates, private boarders, or as short-stay accommodation.

D. Chapter 3 – Entities affected by interest deductions

23. We do not consider treating new builds and residential property covered by the development exemption as "residential investment property" for purposes of the "residential investment property-rich" threshold should cause issues for any developer companies.

[1] Unless otherwise stated all section references are to the Income Tax Act 2007

24. We suggest it would be a lower compliance cost approach to use accounting book value when calculating the residential investment property percentage for assets other than land, improvements and depreciable property.

E. Chapter 4 – Interestallocation: how to identify which interest expenses are subject to limitation

25. We agree with generally relying on the existing law on tracing with the exception of where it would cause transition issues.

26. We agree that it would be beneficial to have a specific provisionin relation to the treatment of a refinanced pre 27thMarch loan.

27. We consider it would be possible that at a future date it may be commercially beneficial to restructure a New Zealand denominated loan into a foreign currency if interest rates in the overseas currency are substantially lower than thoes available in New Zealand. Such an option would only be available to the most sophisticated of investors who would then be exposed to the operation of the financial arrangements regime.

28. We agreewith the proposed high water mark approach. We consider it would be more practicable to apply this to all loans.

F. Chapter 5 – Disposalof property subject to interest limitation

29. In relation to the treatment of interest on sales of revenue account property we support Option B: deductions allowed at the point of sale. If this is not acceptable to the Government in the alternative we support Option D – anti-arbitrage restriction for interest.

30. In relation to sales on capital account we support option F - no deductions allowedup to the amount of non-taxed gain with the excess deductible. This would be consistent with the General Permission in section DA 1 that expenses should be deductible to the extent they are incurred in deriving gross income.

31. As we consider the residential rental loss ringfencing rules should be repealed our preference would be to amend the bright-line anti-arbitrage rule to incorporate interest.

G. Chapter 6 – Development and related activities

32. We agree with the proposed cirteria for the development exemption to apply.

33. We consider remediation work should be included and we would support a broad interpretation of remediation work being adopted. We consider this should encourage improvements to below standard dwellings, therefore increasing the quality of the housing stock.

34. In relation to when property is not acquired for the purpose of development, we suggest interest should begin to be deductible when the Commissioner is informed of the intention to develop. This should apply to all previously non-deductible interest (rather like Option B in Chapter 5).

H. Chapter 7 – Definitionof newbuild

35. We support the government's proposed definition of newbuild. In relation to identifying when a dwelling that is completely uninhabitable has been improved significantly, we suggest this could be when the dwelling is now fully compliant with the building code and healthy homes standards.

I. Chapter 8 – Newbuild exemption from interest limitation

36. In the interests of simplifying compliance we suggest a new build exemption applies only to early owners. We suggest the exemption should be at least 25 years and we support an extended rollover relief in relation to such properties. Allowing subsequent owners the balance of an exemption period would lead to ongoing complexity in determining the relevant period.

37. We note the exemption may be counter-productive for first home buyers and other owner occupiers as position as developers and investors bid up prices of properties which are eligible for ongoing interest deductions.

38. We consider the suggested continued investment rule would be impractical on grounds of complexity and should not proceed.

J. Chapter 9 –Five-year bright-line test for new builds

39. We agree with the proposed approach requiring apportionment rules to be applied to complex new builds under the new build bright-line test.

K. Chapter 10 – Rolloverrelief

40. We welcome the introduction of a broader rollover relief exemption. In relation to the specific questions raised by the discussion document we consider rollover relief from interest limitation should be available for transfers on death and it should be for the balance of any unexpired exemption period. The conditions proposed in paragraph 10.57should cover the most common family trust situations. We would suggest two degrees of blood relationship should be permissible when determining whether a beneficiary and principal settlor are associated.

41. However, we consider the proposal to limit rollover relief for the bright-line test to instances where no consideration is provided to be not reconcilable with enabling

rollover relief for interest limitation purposes. We believe it would be fairer to provide rollover relief for bright-line test purposes for all transactions between associated persons. We consider the existing anti avoidance provisions in section BG1 should be sufficient to address any attempts use rollover relief to gain unfair tax advantages either for the brightline test or interest limitation purposes.

L. Chapter 11 – Interposedentities

42. We acknowledge the proposed interposed entities rules are required for integrity purposes but we consider they add greatly to the complexity of the tax system.

43. On grounds of simplicity we suggest the apportionment calculations for interposed entities that are close companies or trusts should be carried out quarterly.

44. We agree that the proposed interposed entity rules should not apply to look through companies or partnerships.

M. Chapter 12 – Implicationsfor the rental loss ringfencing rules

45. We consider the interest limitation rules should apply on a property by property basis in order to reflect the borrowing arrangements in relation to each property. We agree with the proposed approach of of applying the interest limitation rules to establish deductible expenditure and then applying the loss ringfencing rules.

46. Generally speaking, interest deductions represent the largest proportion of residential rental investorsdeductible expenses. Accordingly, we consider the introduction of the interest limitation rules effectively removes the rationale for continuing with the loss ringfencing provisions. We therefore recommend repeal abolition of the loss ringfencing rules effective as from the commencement of the interest limitation provisions.

N. Chapter 13 – Interest limitation and mixed-use residential property

47. We note that the existing complexity of the mixed-use assets provisions is now further complicated by the incorporation of the interest limitation provisions. See our comments in Section B above on the compliance issues arising from the proposals.

O. Chapter 14 – Administration

48. We acknowledge there may be a need for taxpayers to provide further information in relation to these proposals as part of their tax return. We repeat our concerns in Section B regarding the increased compliance burden. We also believe taxpayers should be assured by Inland Revenue that it has the resources to monitor and enforce these provisions. Failing to do so could threaten the public's perception of the integrity of the tax system.

Inland Revenue
12th July 2021

Please contact either of ourselves, or Terry Baucher, our Submissions Co-ordinator, if you have any queries regarding this submission.

Yours sincerely

s 9(2)(a)

Free Phone: 0508 ATAINZ | PO Box 87475 | Meadowbank 1742 | Auckland, New Zealand| www.atainz.co.nz

From: s 9(2)(a) [redacted]
To: Policy Webmaster
Subject: Design of the interest limitation rule and additional bright-line rules
Date: Monday, 12 July 2021 3:47:57 PM

Dear Sir/Madam,

My submission relates specifically to section 7, and the question posed on page 76.

"What do you think of the proposed definition of new build?"

I believe the proposed definition is not inclusive enough. It should allow for houses which were recently built and/or obtained a compliance certificate, prior to March 2021.
It could be based on several factors, such as a fixed age, say up to 5 years old, or perhaps those homes which still have an active Master Builders Warranty in place.

There will be many homes which just fall outside of the proposed March 2021 date, which clearly would still be classified as New Builds by many in society.
Landlords who own these homes which just miss out on the definition, would be unfairly penalised I believe.

I also think the current definition may be counter productive to the Governments goal to get more New Homes built and purchased.
In our case, we are first time investors, having just one property which received its code of compliance in September 2020.
It was our intention to see how things went for a few years, and then look to purchase another New Build.
Now that we are going to have to pay a lot more tax than we budgeted for when first planning, these plans are currently on hold, since it wont be affordable now.
We are not experienced investors, and we do not classify ourselves as wealthy. We are just trying to plan a good quality of life in retirement.

I do fully support a lot of the other initiatives, such as Healthy Homes, and believe tenants should be safe and warm in their home.
I also firmly believe that those less scrupulous landlords should be held to account.

This is why we primarily chose to invest in New Builds, to ensure compliance with new legislation, and to ensure a high standard of living for tenants.
Having been a tenant myself for many years, I am fully aware of the need for improvement in the New Zealand rental landscape.

I sincerely hope the Government will put some serious thought into what constitutes a new build in the proposed definition, and look to change the criteria to also include very recently constructed new homes.

Thank you

s 9(2)(a) [redacted]

PUB-0399

From: s9(2)(a) [redacted]
To: Policy Webmaster
Cc: s9(2)(a) [redacted]
Subject: Design of the interest limitation rule and additional bright-line rules
Date: Monday, 12 July 2021 4:00:00 PM
Attachments: Interest limitation proposals submission July 2021 FINAL.pdf

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To whom it may concern,

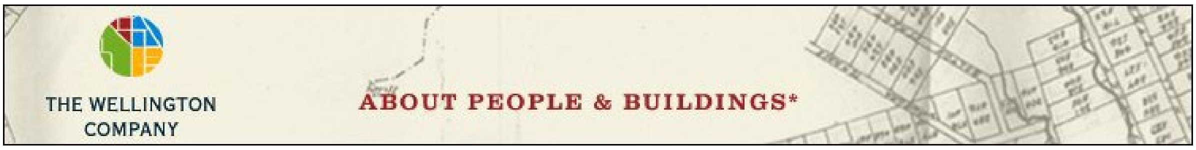
Please see attached our submission on the design of the interest limitation rule + additional bright-line rules

Please let us know if you have any questions or need further clarification on our submission

Kindest Regards,

s9(2)(a) [redacted]

s9(2)(a) [redacted]



s9(2)(a) [redacted]

C/- Deputy Commissioner, Policy and Regulatory Stewardship
Inland Revenue Department
P O Box 2198
Wellington 6140

By email: policy.webmaster@ird.govt.nz
12 July 2021

Design of the interest limitation rule and additional bright-line rules: a Government discussion document

Dear Sir / Madam

We appreciate the opportunity to comment on “Design of the interest limitation rule and additional bright-line rules: a Government discussion document” (“**the discussion document**”). Our specific submissions are outlined in the attached document. Unless otherwise stated, all legislative references are to the Income Tax Act 2007 (“**the Act**”).

Please contact us if you have any questions regarding our submission.

Yours faithfully

s9(2)(a)

Chapter 1 - Overview of proposals and process

Chapter 1 sets out the objectives of the proposed rules. The Government is seeking to address New Zealand's "long-standing housing affordability problem" and the proposals are intended to address "the role of tax in this problem". Specifically, the discussion document states the Government's objectives are:

- Ensure every New Zealander has a safe, warm, dry and affordable home – whether renters or owners.
- Support more sustainable house prices.
- Create a housing and urban land market which responds to population growth and changing housing preferences, that is competitive and affordable for renters and homeowners and is well-planned and well-regulated.

While we do not agree nor support the proposal to limit interest deductions on residential investment property only on the basis that this is against the widely accepted tax policy principles – specifically, cohesion, complexity and distortionary effects, we appreciate the effort to better articulate the objectives of these proposals.

We have therefore approached our submission points below by reference to the stated objectives of supporting more sustainable house prices and increasing housing supply for both renters and first homeowners.

Chapter 2 - Residential property subject to interest limitation

As a general comment, we support the recognition that certain properties should be outside the scope of these rules on that the basis that the inclusion of such properties does not align with the objectives of the proposals. However, we consider other categories of properties need to be excluded also.

Social housing

There is a recognition that the proposed interest limitation rules should not capture properties that are used to provide public and social housing (including emergency and transitional). We agree with this view as it would be contrary to the Government's general housing objectives of increasing housing supply and in particular to those that are most in need.

However, the analysis provided in the discussion document in relation to social housing providers is overly simplistic. In particular, there are a number of businesses currently providing social housing to a number of families in need that do not fall within the community housing provider tax exemption under section CW 42B. The application of the interest limitation rules would create further disincentives towards investing in properties that are used to provide social housing.

We consider there should be an exclusion for properties that are being used to provide social housing – ie interest deductions should be available to the investors. Our preference is that the exclusion should apply on a property-by-property basis as opposed to an entity-type exclusion. We further note that an exclusion could arguably make providing social housing more attractive than renting the property as a general residential rental. This could help alleviate the current issues faced by the Government due to the lack of social housing available.

Dual-purpose properties

We support the proposal to ensure interest expense incurred in relation to business premises remain deductible. Further, we support an apportionment approach rather than an "all-or-nothing" approach as the latter could result in over-taxation of dual-purpose properties on a continuous basis unlike the bright-line test which would apply to a specific transaction (ie the sale).

An apportionment methodology already applies in the GST context. Therefore, adopting a similar apportionment approach should not result in a significant increase in compliance costs.

Build-to-rent

The objectives of the proposals include ensuring there is a housing and urban land market which responds to population growth and changing housing preferences and to level the playing field for first homebuyers from residential property investors. With those key objectives in mind, we consider there is merit to exclude developments of build-to-rent properties which are owned by widely-held entities from the scope of the proposals.

Specifically, we note that the s 9(2)(b)(ii) widely-held companies which are managed by s 9(2)(b)(ii) are examples of this whereby the properties held were all build (or convert)-to-rent. Each of the s 9(2)(b)(ii) widely-held companies were offered as an investment opportunity to retail investors (ie each of the companies is a portfolio investment entity). Such properties, while residential, are not available for purchase by first homebuyers given the nature of their ownership (being widely-held) and therefore should be outside the scope of the proposals.

Furthermore, recognising build-to-rent projects as an excluded class is beneficial as to incentivise further developments of this kind which will result in further rental stock added to the market.

Chapter 4 - Interest allocation: how to identify which expenses are subject to limitation

Transitional rule – untraceable interest

It is proposed that a tracing approach is used to determine the deductibility of interest expense. In short, if the borrowing is used to fund a residential property then deduction for the interest costs will be disallowed.

Where certain borrowing drawn-down before 27 March 2021 is unable to be traced (i.e. between business use and residential-related use), the discussion document proposes either an apportionment or stacking approach.

We support the stacking approach as this approach would reduce compliance costs by not requiring a restructure to achieve the same tax outcome. We further note that the need to obtain a market value may not necessarily result in additional compliance costs for some taxpayers. In particular, for those where lenders may already require market valuations to be provided to support the borrowing.

However, we recognise that smaller scale investors may not have the same requirements to provide market valuations on a regular basis. On that basis, we see merits in allowing both options to be applied to give taxpayers flexibility as these rules will likely apply across a broad range of investors – from those that are sophisticated and well advised, to “mum and dad” investors who would have minimal access to external tax advice.

We further submit that this transitional rule be applied across all borrowings drawn-down before 27 March 2021. This would make any new rules more equitable by reducing the potential of retrospective application. As noted in the discussion document, it is foreseeable that taxpayers will maximise deductions by ensuring any new borrowing is traced to assets that are not residential investment properties. It would be overly harsh to not allow that opportunity for existing borrowing drawn-down before 27 March 2021, even if it can be traced to residential investment properties, as those taxpayers would have structured their borrowing based on the law at the time.

Chapter 5 - Disposal of property subject to interest limitation

The discussion document proposes a range of options on how denied interest deductions should be treated when the property is disposed of, ranging from continued denial to a deferred deduction against the sale proceeds.

We generally support the position that interest deductions should be made available when the property is sold. We agree that different approaches are appropriate between revenue account and capital account sales. As a general comment, while we recognise denying interest deductions altogether will likely have the greatest impact on the housing market, this needs to be balanced with the general fairness of the tax system. An absolute denial of interest deductions will result in gross over-taxation of rental income, not just any potential disposal gains that would not be subject to tax (the perceived “tax advantage” in relation to residential property investment).

We therefore support options D and F as we consider these two options best balance the desired objective of “levelling the playing field” between investors and first-home buyers and maintaining fairness in the tax system. We recognise that these options potentially create the most additional compliance costs, but in our view both options can largely be a voluntary system. That is, taxpayers will ultimately have the option to "forfeit" any interest deductions that they could not use at point of sale by not carrying them forward under the proposed anti-arbitrage proposals.

Chapter 6 - Development and related activities

Exemption for developers

We support the proposed exemption for interest incurred to undertake development activities. However, we consider a broader general exemption should apply to cover development activities that are captured by other land sale tax provisions – ie the activity is not captured by section CB 7.

We appreciate that the application of some of the land sale taxing provisions are time-period dependent (ie gains are only taxable if disposed of within a 10-year period). We therefore propose that the general exemption should be extended to situations where, at the time the interest expenditure is incurred, residential land is intended to be held on revenue account (ie any gains from disposal will be subject to tax). This will reduce uncertainty for those undertaking development activities that are subject to the land sale taxing provisions, other than section CB 7.

One-off development activities

For completeness, we strongly support that the exemption should apply to one-off developments also. We consider this exemption is important in ensuring one-off developers are not disincentivised to undertake development activities, as such activities will result in additional stock being added to the housing market.

Chapters 7 & 8 - New build exemption from interest limitation

Commercial to residential conversions

There is a recognition under the "new build" exemption that the conversion from commercial to residential should be excluded from interest limitation. However, this is based upon the issuance of a code compliance certificate (**CCC**). Based on our experience, it is entirely possible to convert a commercial property to individual residential units without the need to obtain a CCC. An example of this is where the property has been used to provide commercial accommodation (eg a hotel) and the level of conversion work required would not be as substantial when compared to other commercial use.

In our view, such conversions should qualify for the new build exemption as they would meet the objective of creating additional housing stock. We therefore propose that a supplementary test based on the GST change-in-use rules is included to the definition of a new build for commercial to residential conversions which do not require an issuance of a CCC. That is, the new build exemption will be available in the year where there has been a change-in-use adjustment made for GST purposes (switching from taxable use to exempt use). We consider there is low risk of arbitrage under such a supplementary test as there is a natural tension between the GST treatment and the income tax treatment – ie a GST output tax liability will likely result due to the change-in-use, therefore ensuring there is genuine new residential stock added to the housing market.

Early purchasers and subsequent purchasers

The discussion document proposes the following three options in relation to the availability of the new build exemption:

- available in perpetuity for early owners only;
- available in perpetuity for early owners and a fixed period for subsequent purchasers; or
- available for a fixed period for both early owners and subsequent purchasers.

We strongly support that the new build exemption is made available to subsequent purchasers as well as early owners. In our view, the absence of this could diminish the impact of the exemption to incentivise new development activities.

In particular, early purchasers (ie those that purchase within 12 months of a CCC being issued or undertake one-off development activities) will want to ensure their investments will have broad market appeal in the future and to the extent that there is uncertainty around this, it could impact on investment decisions.

Furthermore, there may also be an impact on the amount of funding that the early owners could obtain from lenders as the lack of interest deductions for subsequent owners could impact on the value of the investment. We therefore support a fixed period that would apply to subsequent owners and that the period will need to be sufficiently long enough as to not negatively impact on the value of the investment. In our view, a period of at least 30 years from the date of issuance of the CCC is required to minimise any negative impact and provide the necessary certainty for lenders.

From: s9(2)(a)
To: Policy Webmaster
Subject: Design of the interest limitation rule and additional bright-line rules
Date: Monday, 12 July 2021 4:02:17 PM

Hi

I strongly agree that Heritage buildings and Earthquake prone buildings be treated as new builds. Please see below comment on two sections of the proposal.

s9(2)(a)
[redacted]

Section 7 Definition of new build

Questions for submitters
Comments on all aspects of the proposals are welcomed. Below are several questions that the Government would specifically like to seek feedback on from submitters:

• What do you think of the proposed definition of new build?
• Are there any issues that you think the Government should consider in relation to the definition of new build and:
– papakāinga housing?
– heritage buildings? Yes - a heritage building should be permanently exempt from the interest rules. This should apply irrespective of the issue of a CCC on the grounds that heritage buildings are costly to own and maintain. Allowing ongoing deductibility will have very little policy impact but will have a significant benefit to maintaining our built heritage.
Without permanent deductibility, there will be a financial incentive to demolish heritage buildings.

The definition should be:

- Buildings that are identified in the The New Zealand Heritage List/Rārangi Kōrero -
- Buildings that are part of a Historic Area Identified in the The New Zealand Heritage List/Rārangi Kōrero

• Is there some tool that could be used to identify when a dwelling that is completely uninhabitable has been improved significantly, such that it has added to housing supply?

For Buildings that have been issued with an Earthquake Prone Building notice -

- Buildings that have been assessed as Earthquake prone and are being strengthened to 67% or more of NBS (the full cost of all works to be interest deductible as if it was a new build) This assumes that strengthening from 33% to less than 67% does not effectively increase the housing supply. 67% is the level generally acceptable to banks and insurance companies and a building with a rating greater than 67% has long term value. Those less than 67% have limited long term use

For buildings that are rated between 34-66% of NBS, and are being strengthened to more than 67% of code:

- Only the costs (proportion of costs/interest) associated with strengthening works (including consultants and consents) should be eligible for interest deductible. This encourages building owners to upgrade their buildings and extend their usable life, but excludes all other remediation that might occur, much of which is deferred maintenance.

For other forms of buildings that are uninhabitable, it would be very difficult to have a nationwide consistent assessment method. The volume of residential properties that are uninhabitable and are not Heritage listed or Earthquake prone, is possibly very small (unknown). It is difficult because a building owner could deliberately cause a building to be classified as dangerous or insanitary. Or a building alteration that fails its CCC could be deemed to be uninhabitable, but easily rectified.

A rule that states that if a building has been uninhabited for a continuous period of 2 or 3 years and is redeveloped or substantially rebuilt, would be treated as a new build.

The rationale for this is that the loss of earnings over two or three years would be greater than the benefit of interest deductibility so there is no incentive for people to intentionally keep their building unoccupied. It can be inferred that the building is uninhabitable and any new build or rebuild adds to the housing stock. A definition of substantial rebuild could be defined as works that cost more than 50% of the finished value.

What apportionment rules should apply?

8.27 Where a new build and a non-new build that are on the same title are purchased, existing apportionment principles would apply. The new build exemption would only apply to interest on the portion of the purchase price borrowing that relates to the new build.Agree

8.28 Where a taxpayer adds a new build to land that already has a non-new build on it, the taxpayer would be allowed interest deductions for all borrowings incurred to add the new build to the land. Interest deductions for borrowings used to acquire the land, and any interest costs for other borrowings that relate to both the new build and the existing dwelling, would need to be reasonably apportioned between the new build and the existing dwelling. Apportionment would be on the basis of existing principles.Agree

8.29 The Government invites your views on whether you support apportionment applying for complex cases, or if you would prefer a different approach. If apportionment were not allowed, then separate title could be required for any new build added to land, so that any new builds are not on the same title as old builds. Alternatively, a predominant test could apply, so in cases where more land area is covered by a new build than a non-new build, the new build exemption would apply to allow deductions for any interest that relates to the land (including the non-new build on the land).
Requiring a separate title is highly complex and can raise a multitude of compliance and cost issues that could stop a development from proceeding. A Predominant test seems reasonable.

SUBMISSION ON DESIGN OF THE INTERST LIMITATION RULE AND ADDITIONAL BRIGHT-LINE RULES

s9(2)(a)

Firstly let me say it is great to see action being taken to help New Zealanders into owning their home. This policy has a great objective, however there are some situations where this policy will inhibit people either buying a house, or adversely impact their career and life options after purchasing a house, that need to be reviewed and hopefully amended.

There will always be a need for ongoing rentals in the market place, so we need to address the need to maintain quality ongoing rentals. Taxation also needs to recognise the long term “Ma & Pa” investor, who are not after high turnover capital gains, but invest as part of their ongoing retirement plan, that is already in place.

BRIGHTLINE COMPLICATIONS:

Holiday swap – rental

Where a family rent out their home while they are away themselves. When used, this is often how owners help fund their holiday and spend money stimulating the economy further. However, if their houses were to become the subject of a bright-line test for this occasional rental, it may inhibit this option, as when the family home is sold, paying tax on a portion of the increased sale price would adversely affect their purchasing power going forward.

Non Owner Occupied First Home Exemption

Once a house is purchased, if life’s circumstances have people needing to move town, either by promotion, to be near sick family, etc, people will need to move. Renting in their new location they retain their own home and rent it out. People will often take some time before they are comfortable with their new location, or it could be the new location’s property price are more expensive and a time of saving to step up in price bracket is required. Not willing to lose their place in the property market means they will rent out their family home at their old location, in order to help cover the mortgage and costs, while they rent elsewhere.

Also, some families as they progress, outgrow the owner/occupied house, rent out their own smaller house, and rent a larger house nearby, as they can’t afford to purchase a bigger house.

For the above groups, to then have to pay tax when selling, will limit their purchasing power going forward, they will not be on an equal footing with many others, and have them unfairly further behind.

Impact on Elderly
Often elderly moving into a rest home, don't want to lose the comfort of owning their own home. It can be an emotional step too far on top of the move. These houses are often rented out until their passing and an estate sale ensues. This additional bright-line tax falling onto the benefactors (usually their children) adds additional distress and emotional harm to the elderly. There motive is not profit, but making changes in small manageable pieces.

Recommendation: I don't believe the impact of the above situations (Small holiday swap, Non owner occupied first home, Elderly) is the intention of the policy, but this unforeseen consequence needs to be addressed. Ownership of the first home, regardless of whether it is owner occupied or not, should be exempt from the bright-line test as an easy way to avoid complicated administration and to help ensure people can get onto and remain in the housing market.

Consideration could be given to allowing interest deductions for non-owner-occupied houses, where the property is a person's first home, and alternate accommodation costs are proven to be more expensive. If they are living elsewhere, their rent may well include covering their landlords interest costs. They would have them effectively paying interest twice. This would help people maintain their position of house ownership.

Interest deductibility at point of sale
At point of sale when tax falls due on the increased portion of the sale price, interest costs should be deductible as it has been a direct cost associated with the income being received. To not allow this, could inhibit the ability to purchase or build again, maintain well or upgrade the existing house during the term of its rental.

Sometimes landlords wish to update their rental housing and not being able to deduct this interest cost could see this becoming a barrier, as they can't afford to sell and buy in the same market with these additional costs. A longer term degradation in rental housing stock could ensue, which is not the intention of the policy.

Whilst the intention is to see more people own a home, we need to ensure NZ's housing stock is maintained and not degrading. These increased costs could see not only a long term reduction in quality, but have investors looking at other investment options and reduce building of new housing stock and long term increasing rent prices due to availability issues.

Recommendation: Interest costs incurred should be deductible at the time of sale to ensure ongoing investment and maintenance of quality housing stock. This should be applicable whether sold before or after the bright-line timeframe, to encourage investors to stay in a property, giving tenants longer term stability in landlord/ongoing rental.

Interest Costs Exceeding Gain

Interest costs are a direct cost in creating rental income. The idea to delay claiming these costs to put owner/occupier on the same daily level as an owner occupier is fair. However, if interest costs exceed capital gains at time of sale, it should be recognised that this was an expense incurred in the overall investment and be deductible, as it is with all other investments, to ensure the landlord investor is not going backwards and unfairly disadvantaged compared to other investment options. To not allow this would place the landlord investor in an unequal position to an owner occupier who chooses to invest money in other sectors.

Recommendation: The purpose of the noninterest charge ensuring the landlord investor does not have an advantage over an owner occupier is a good idea. To not allow this deduction if interest costs exceed cost of a capital gain, means the landlord has effectively paid more tax on rental income than other forms of investment options. It must be remembered that there will be a need for ongoing rentals, no matter how the property market is performing. An absence of investors down the track, could lead to excessive pressure on the rental market rates further hindering renters saving a house deposit. Subsequently this interest should be deductible.

Replacement housing stock

If an investor needs to change their housing stock, i.e. They are moving and like rentals nearby in order to maintain them, or land is re-zoned and necessitates selling, etc., or they wish to update with newer housing, the bright-line tax would hinder the purchase of an equal replacement property.

Recommendation: An exemption to the bright-line tax could apply when selling a rental and buying one of equal or greater value. If the new property costs less than the one sold, then bright-line tax should only apply to the surplus.

Large Investor's vs Small Investors
The policies attempt to curb the rising house prices, will affect both large and small investors equally. However, the small investors have to a large extent, not been the ones benefiting on quick turnover and large profits. I believe there will be some unintended victims of the policy, that should be considered.

- Family grouping together to buy their parents a home for retirement.
- Parents co-owning properties with children to help them into the market.

There will be other groups, as New Zealand has a wide variety of ethnicities, values, situations and lifestyles.

It could be considered that smaller investors, do not have the same impact on housing prices as large investors, and often they will not have the same resilience to overcome these additional interest costs and bright-line taxes. It could be that owning a second house is exempt, so "ma and pa" investors, family helping family, etc., are not pushed out of the market. Also, exemptions beyond a second home should be accessible in certain approved situations, e.g. If parents are helping more than one child into the housing market.

Recommendation: The new policy could be exempt to owning not just your own home but a second house. This could eliminate administration complexity, and not target those who have not had a great effect on pushing up and profiting from capital gains on housing turnover, but for whom the new policy could adversely affect their ability to help others, i.e. family into the housing market.

Unoccupied Property
Investors having unoccupied "ghost houses", is reducing the available housing stock. These homes are usually being retained for the purpose of increase in value. Often these vacant properties are poorly maintained to the detriment of the neighbourhood.

Recommendation: To discourage the reduction of liveable housing stock, i.e. "ghost houses", the bright-line test should go beyond 10 years, and be to whenever the house is sold, for any property that has had long term vacancy (this ensures the property is not rented for a brief period before sale). A higher tax rate should be considered on the bright-line test, as an additional disincentive to leave properties vacant.

Interest Costs on Pre 27 March Loans That Can't Be Traced
When assessing what portion of a loan, taken for multiple purposes, had the repayment allocated to, whether rental property, personal or commercial portion of the loan, it is reasonable to assume people would repay the portion with the highest costs first, both in interest and tax.

Recommendation: People looking to reduce costs and maximise profit will organise finances to their best benefit (within the law). It is fair and reasonable so to assume the portion of the loan outstanding applies largely to the part that would have the greatest interest and tax deduction. The most expensive portion being paid off first.

Revolving Credit Mortgage
Where a revolving credit mortgage for a rental property has had significant personal investment by the landlord to reduce costs, prior to 26 March '21, with the intention of drawing down the funds later for personal and or rental use, this interest cost should be deductible when drawn down after 27 March, (as per the phased deductions) as debt originally related to the rental property. Their effort to keep debt to a minimum should not be punished above someone else who did not have the same ethos.

Recommendation: The watermark should not be determined solely by the level of debt on 26 March. People looking to minimise debt and reduce interest costs with the intention of redrawing the money later should not be adversely affected compared to someone who maintained a higher debt level, watermark, throughout, simply because the policy has changed in the interim.

Interest on Refinancing pre March '21 Loans
Refinancing if loans should be available to ensure the investor owner can realign their repayments to suit the new policy expenses. Also fixed term loans will fall due and are normally refinanced. To exclude this options places ongoing investment returns on the sheer luck of how loans were structured prior to the Policy announcement. It may also give banks unfair leverage if people can't refinance.

Recommendation: Loans taken before 27 March '21 should be able to be refinanced to ensure equality across all investors and not advantaging those who may have structured mortgages differently, to enable investors flexibility to meet the increased expenses the new Policy will have them incurring, and to prevent banks holding people to outdated loan structures as the economy changes.

Uninhabitable House Improvement

As the government intention is to increase quality housing stock, it is apparent that seriously upgrading an unhabitable house to bring it onto the housing supply should be encouraged.

Recommendation: Upgrade of housing stock from uninhabitable to habitable should have the same exemptions as a new build. Consideration should be given to houses affected by a serious natural disaster, being upgraded at time of repair, also having some of the same exemptions.

From:	s9(2)(a) [redacted]
To:	Policy Webmaster
Cc:	s 9(2)(a) [redacted]
Subject:	Design of the interest limitation rule and additional bright-line rules
Date:	Monday, 12 July 2021 4:05:56 PM
Attachments:	BTR submission Final 210712.docx

s9(2)(a) [redacted]

MCCONNELL PROPERTY LIMITED

M . +64 275 087 820

Viaduct Quay Building, Level 2, 204 Quay Street, Auckland CBD

s9(2)(a) [redacted]

Submission on the Government discussion document on the design of the interest limitation rule and additional bright-line rules

16 July 2021

1. Summary of views

1.1. In our view, specific exemptions for Build-to-Rent ("BTR") developments are justified and required given the ultimate goals of the Government in dampening investor demand for existing housing stock, and improving affordability for first-home buyers, renters and existing homeowners.

1.2. As elaborated on below, BTR developments are additive to the total housing supply, have intensified housing production internationally, and exist outside of the market that first home buyers and owner-occupier buyers compete in. To the extent that BTR developments grow in popularity in New Zealand, the overall pressure on the existing housing market will lessen.

1.3. We therefore believe that disadvantaging these developments in comparison to other developments will reduce the overall intended impact of the proposals included in the discussion document ("proposals").

1.4. We set out our specific requests in section 5 below.

2. Background & context

Our background

s9(2)(b)(ii)

[redacted]

International context

2.5. Internationally, large-scale BTR developments are either funded and managed directly by large international investment institutions or developed within (often close-ended) development funds. These BTR funds typically have a fund life of 10-12 years, during which the underlying assets (i.e. the residential rental properties) are typically on-sold to investment funds or listed in a REIT.

2.6. The later model is popular and required where international real estate funds are prohibited by their mandate from assuming any development risk, but who still wish to invest in BTR as an asset class. As a result, BTR development funds are required to provide these real estate funds with a 'channel' to acquire the underlying residential rental assets, and are therefore critical to the end-to-end development and sustainability of this sector. As the target investment institutions operate internationally, New Zealand based BTR developments must generally follow suit.

3. The specific challenge posed by the proposals

3.1. We expect that these proposals will significantly reduce the international competitive viability of New Zealand based BTR development funds, s9(2)(b)(ii) [redacted]

3.2. **<u>The BTR sector needs its own specific, clear and permanent exemption to avoid this much needed sector stuttering before it even starts.</u>**

3.3. As noted above, the investment case for many international investment institutions relies on the ability for those institutions to eventually acquire the rights to the underlying asset. Prospective investment institutions assume that, at the time they were to acquire those assets, that the operating and revenue models would not change.

3.4. We view the application period of the new build exemption as the greatest risk in this respect. The value of BTR developments in New Zealand will depreciate as the proposed exemption period reduces for subsequent owners. For example, were the Government to implement rules that did not pass the new build exemption to subsequent purchasers, the value of investment into a New Zealand based BTR fund significantly decreases.

3.5. To the extent that the Government implements rules that allow subsequent owners to utilise the new build rules for a period, the length of that period will significantly impact value. Our models will need to account for the reduction in the potential market value of assets, which is directly impacted by how long prospective purchasers would be able to deduct interest on loans against that property.

3.6. Furthermore, funds that develop their assets could be required to value their portfolio on a 'divestment' basis (i.e. what the next buyer will pay, on the basis they won't necessarily have an exemption forever). We believe that this would inhibit the advantage of BTR funds retaining the assets as "new builds" as the underlying value (and therefore the attractiveness of the development) is still reduced regardless of whether the fund wishes to retain them for a prolonged basis. This has a further flow on effect to the viability of the sector in general.

3.7. s9(2)(b)(ii) [redacted] We outline the policy rationale for mitigating the impact on BTR developments below in section 4.

4. BTR – positive impact on total housing supply

4.1. BTR developments generally target vacant or underutilised land within heavily urbanised areas. For the scale that BTR operates at, these areas provide the greatest certainty that demand for tenancy will be high, while also receiving scale benefits for the management of these assets.

4.2. BTR developments do not generally compete with developers of build-to-sell properties. In reality, large scale BTR developments compete with the development of commercial and retail premises on metropolitan and business-use zoned land. Commercial and retail developers seek many of the same amenities as BTR developers for the construction of an office complex, for example. As a result, BTR developments generally develop land with additional dwellings that would otherwise have been used for non-residential purposes. BTR, under the present proposals, will be disadvantaged when competing against commercial and retail asset developments that have the benefit of interest deductibility; therefore, reducing their ability to compete for land.

4.3. Internationally, BTR has already been proven to assist in alleviating supply pressures. Within the UK (and specifically London) BTR developments have already added more than several thousand homes to the total supply, with several thousand more already in planning and production[1]. We note that the Ministry of Housing New Zealand has recognised that growth, and has consulted with the Property Council New Zealand on how they might accelerate the sector for similar growth in New Zealand. We believe that currently these proposals work contrary to that objective.

4.4. Lastly, BTR developments increase competition in urban rental markets that are often undersupplied – such as Auckland and Wellington. As BTR developments generally operate at the scale of 50 dwellings or more, each development creates material downward pressure on regional rental increases. This in turn decreases the attractiveness of investment in the rental market by private investors, and overall operates to increase affordability of residential property for owner occupiers.

5. Proposals in relation to the new build exemption

5.1. To the extent that the Government believes that BTR developments assist them in achieving their residential property development targets, then further exemptions will be required to mitigate the impact of these proposals. In our view, all options presented in the document reduce the viability of the BTR sector to various degrees. Without blanket/ specific BTR exemptions, the proposals will reduce the total activity of the sector, and therefore reduce the number and supply of constructed residential dwellings; which is the single biggest factor that is driving house price growth.

5.2. Therefore, we request that the Government consider the following amendments to their proposals:

- That residential property developed as BTR assets be exempted from the interest limitation rules until the property is purchased and occupied by an owner-occupier (i.e. no longer meets the BTR criteria); and has therefore passed outside of the investment/ long-term service based model at scale that BTR developments are built upon.

- Failing that (and emphasising that we consider any exemption below a full BTR exemption as a limit on the sectors' growth), that the Government extend the new build exemption for properties constructed by BTR developers beyond the default length otherwise adopted. We believe that a duration of 50 years would go some way to reducing the impact of these proposals to a competitively viable level.

We would be happy to engage directly with the Government and Officials to provide more specific detail as to how the BTR sector operates internationally, and what we consider is needed to support the growth in this much needed sector for New Zealand;

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[1] https://bpf.org.uk/about-real-estate/property-development/build-to-rent-map/

and not end up in the perverse position where our BTR development plans are inhibited, reduced or moth-balled by proposed law which at the very heart of it seeks to create affordable housing.

5.3. We would be happy to discuss these proposals with you in further detail. Please s9(2)(a) d ll in the first instance if we can be of assistance in this regard.

6. Additional considerations - GST

6.1. Whilst not directly related to the discussion document, we consider there is an opportunity for the Government to amend the GST rules to put BTR developments on a level playing field with build to sell developments. Under the existing rules, there is not a GST cost in relation to build to sell developments (GST being fully recoverable up front on costs, including land and development costs) whereas BTR developments result in a significant GST cost unless the accommodation to be provided in the development is in a “commercial dwelling” for GST purposes (GST on costs not being recoverable where they relate to provision of accommodation in a “dwelling”).

6.2. Given the significance of up front GST costs, we consider the current rules disadvantage BTR developments (with only those that will supply accommodation in a “commercial dwelling” being entitled to GST recovery). The ability to recover GST up front on exempt BTR developments (i.e. those that will be supplying accommodation in “dwellings’), potentially with an obligation to repay the GST over the life of the project, would assist in removing the current disadvantage. Such a change would not impact GST revenue (just the timing of receipt).

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12 July 2021

Deputy Commissioner
Policy and Regulatory Stewardship
Inland Revenue Department
PO Box 2198
WELLINGTON 6140

By email

Email: policy.webmaster@ird.govt.nz

SUBMISSION – DESIGN OF THE INTEREST LIMITATION RULE AND ADDITIONAL BRIGHT-LINE TESTS – BUILD TO RENT

Overview

1. We refer to the Government discussion document titled *Design of the interest limitation rule and additional bright-line tests* issued by the Ministers of Finance and Revenue on 10 June 2021 ("**Discussion Document**").

2. Evans Randall Investors, s9(2)(a) [redacted] wishes to make a submission regarding the interest limitation proposals in the Discussion Document and our key recommendations are summarised in this letter. We would welcome the opportunity to discuss our recommendations in further detail and invite interested Officials to contact us to discuss these issues further.

Who are we?

s [redacted] s9(2)(a) [redacted]

[redacted]

[redacted]

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6. s9(2)(a) [redacted]

[redacted]

What is a "build-to-rent"?

8. "Build-to-rent" businesses are large scale residential businesses investing substantial long-term capital where all of the dwellings or units are designed specifically for long-term rental and are retained by the owner and leased out on a long-term basis (as opposed to being sold off to multiple owners as per the traditional "build-to-sell" model). They include shared amenity and are professionally maintained and managed, treating the residents as customers. These businesses have been successful for many years in the US, Europe, the UK and more recently in Australia.

9. s9(2)(b)(ii) [redacted]. We see this as critically important for the future long-term housing supply and associated social good for New Zealand.

10. As part of that objective, it is also critical that a high degree of certainty is provided to developers and investors regarding the income tax position and economic viability of such developments. It is for this reason we are making a submission on the Discussion Document.

Summary of key recommendations

11. In summary, our submission is that:

(a) A specific carve out or exemption from the interest limitation proposals should be provided for legislatively defined "build-to-rent" businesses that are of a sufficient scale. Where a business satisfies that definition, there would accordingly be no requirement to consider and apply the new interest limitation rules to the debt funding for that business. The usual interest tax deductibility rules would apply.

(b) The definition of "build-to-rent" for income tax purposes should be framed around a set of objectively defined and measurable criteria. We propose a working definition based on that formulated by Property Council New Zealand:

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(i) an asset specifically designed, constructed or adapted for long-term residential tenancies;

(ii) accommodation comprised of a portfolio of minimum 50 self-contained dwellings and include some form of shared amenity;

(iii) dwellings let separately but held in unified ownership and dedicated to residential tenancies for a minimum eight years; and

(iv) professional and qualified management, with oversight under a single entity.

(c) The deductibility of interest for such projects should apply in perpetuity and should not expire upon a new institutional or other investor acquiring all or part of a project or providing further investment (as is being contemplated for the "new build" exemption). Deductibility of interest would cease to apply to the extent the dwellings or units were no longer employed as qualifying residential rental accommodation.

(d) There should similarly be a carve out or exemption from the bright-line test for a qualifying "build-to-rent" business or project that is sold by an approved professional operator to another. Frequently build-to-rent projects are consolidated with others or transferred to new operators and such transactions should not give rise to an income tax liability.

Analysis and further comment

Background

12. First, we note that it is an established principle of New Zealand's income tax laws that, where debt funding is used as part of a business to create income-earning assets, a deduction is available for interest costs on that funding. In the case of companies, the law provides additional certainty and adopts an approach to interest deductibility whereby the use of the particular funds borrowed is irrelevant to the question of interest deductibility - a deduction is available anyway.

13. The current proposals destabilise that established position by imposing limitations on such deductions where the funds borrowed are used to invest in residential property. In addition, the proposed exemptions for "development" and "new builds", and the time limits for those exemptions, will not go far enough for the build-to-rent sector.

14. We understand the Government's broad objective to support more sustainable house prices and improving affordability for first-home buyers. However, the provision of housing supply via build-to-rent projects does not undermine that objective. Rather, the stable and long-term accommodation provided by build-to-rent directly advances that objective and the Government's other key housing objectives (see paragraph 1.5 of the Discussion Document), being to:

(a) ensure that every New Zealander has a safe, warm, dry, and affordable home to call their own – whether they are renters or owners;

(b) create a housing and urban land market that credibly responds to population growth and changing housing preferences, that is competitive and affordable for renters and homeowners, and is well-planned and well-regulated.

<u>Certainty of tax position required to attract investment</u>

15. Build-to-rent developers need clarity regarding tax deductibility of interest expenditure to ensure the sector remains attractive for investment and continues to gain momentum. Aligning the tax treatment of the build-to-rent sector with similar large-scale commercial property investments and treating that sector as a separate asset class in its own right, will help to encourage this investment.

16. In our view, the existing proposals to provide exemptions for "development" and "new builds" will not provide sufficient certainty for build-to-rent developers and investors. The definitions are likely to be complex and require an element of judgement as to whether they apply to a particular build-to-rent project and for what periods or tax years. Therefore, a specific carve out or stand-alone exemption from the proposed rules is justified - tax issues should not be an impediment to the large-scale increased housing supply arising from such business.

In terms of timing, we submit that a deduction for interest should be available in perpetuity for build-to-rent projects provided the dwellings or units continue to be employed as long-term residential rental accommodation. The carve out or exemption must also be available to subsequent purchasers or investors. There should be no time limit on the carve out or exemption as is currently being contemplated for the "new build" exemption. Otherwise, the risk is that build-to-rent properties are "locked-in" with the original developer or never eventuate in the first place due to being unattractive to investors.

17. For equivalent reasons, there should also be a carve out or exemption from the bright line test for build-to-rent projects that are sold by an approved professional operator to another. It is often the case that build-to-rent operators will consolidate their portfolio or dispose of particular buildings for commercial reasons. The imposition of an income tax liability would make such transactions uneconomic resulting in inefficiency in the market and again make build-to-rent unattractive to investors. This type of portfolio adjustment between qualifying and professional operators is not the type of transaction that the bright line was introduced to address. A carve out or exemption should apply accordingly.

<u>Advantages of specific build-to-rent exemption</u>

18. There would be numerous advantages in providing a specific exemption for build-to-rent projects (which are directly consistent with the objectives summarised in paragraph 1.5 of the Discussion Document). Build-to-rent businesses stimulate housing supply and would deliver critically needed long-term housing in New Zealand (as has been the case overseas).

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19. A further key advantage of build-to-rent businesses is that they remove the inefficiencies of a private rental market dominated by small scale individual property owners, the majority of whom own one to two rental properties. In particular, build-to-rent would offer:

    (a) Better quality and healthier properties – unlike "build-to-sell" developments where the risk of properties is passed onto the first purchasers, build-to-rent operators retain the risks associated with the quality of the properties as they will own and operate them as rental properties for many years after the initial build. Such operators are therefore incentivised to build high quality and sustainable properties.

    (b) Lower costs and economies of scale in terms of maintenance contracts, repairs, and general upkeep of the properties.

    (c) More sophisticated and professional maintenance and management of the properties on a more tenant-friendly and customer facing basis. Tenants are generally offered longer and more flexible term leases, rather than the short and inflexible leases that are currently common in New Zealand. Tenants also have the benefit of market rental rates without the ongoing concern of unexpected rent rises.

    (d) Greater community and social good – build-to-rent typically offers shared spaces which may include parks, kitchens, and games rooms, with the community of neighbours connecting and thriving through various community-focused activities.

20. Finally, we note that a tenancy in a build-to-rent property would provide a valid alternative to retirees that are not in a financial position to take a position at a retirement village or rest home. Notably, retirement villages are an asset class specifically excluded from the current tax proposals. This is not an insignificant consideration in the context of New Zealand's currently aging population and future housing needs. Build-to-rent also provides a significant social and affordability benefit for those in this age bracket.

We look forward to discussing the above further with you following your consideration of the submissions on the proposals.

Yours sincerely

s9(2)(a)

[redacted]

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s9(2)(a)

[redacted]

From: s9(2)(a)
To: Policy Webmaster
Subject: Feedback on the interest limitation rule
Date: Monday, 12 July 2021 4:18:01 PM

To whom it may concern,

I fundamentally disagree with the proposed interest limitation rules for residential rentals.

I dont see why one type of business should be treated differently where a legitimate cost cannot be claimed.

Not only that, this initiative wont help first home buyers or renters as i dont believe house prices will come down and rents will rise. So how is this anything but a revenue generating exercise for government that will hurt the most vulnerable members of society.

Regards,
s9(2)(a)

From:	s9(2)(a)
To:	Policy Webmaster
Cc:	s9(2)(a)
Subject:	Design of the interest limitation rule and additional bright-line rules
Date:	Monday, 12 July 2021 4:20:49 PM

Good afternoon

My name is s9(2)(a) and I own and manage existing build to rent accomodation.

I oppose interest deductibility removal and bright line test for build to rent accomodation.

Build to rent accomodation has always existed. Blocks of units were built comprised of between 4 and 12 units in each block.
The sole purpose of these blocks of units was to provide affordable rental accomodation for short or long term stays.
They were solidly constructed using brick and tile or hollow block or wood panelling. Easy to live in and easy to heat.
They were built near transport routes and shopping areas.
Most were 2 bedroom, but some were 1 bedroom or 3 bedroom.
Because of the density of these blocks finance to purchase these blocks of units is viewed by the bank as business lending and Insurance premiums are charged at commercial rates.
I would propose that these existing build to rent properties should retain interest deductibility and be exempt from the bright line test as they are commercial ventures providing affordable accomodation and will never be anything other than that.
As the owner of such blocks I can attest to the need for affordable accommodation and the community they provide. The removal of the interest deductibility and the introduction of the bright line test may increase rents for those that can least afford it.

Yours sincerely
s9(2)(a)

From: s9(2)(a)
To: Policy Webmaster
Cc: s9(2)(a)
Subject: Design of the interest limitation rule and additional bright-line rules - NZBA submission
Date: Monday, 12 July 2021 4:26:35 PM
Attachments: image001.png
s9(2)(a)

Good afternoon

Please see attached NZBA's submission on the design of the interest limitation rule and additional bright-line rules discussion paper.

Let us know if you would like to discuss our submission further.

Kind regards
s9(2)(a)

[redacted]

[redacted]

NEW ZEALAND BANKERS ASSOCIATION

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NEW ZEALAND
BANKERS ASSOCIATION

Submission

to

Inland Revenue

on the

Design of the interest limitation rule and additional bright-line rules – discussion document

12 July 2021

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About NZBA

1. The New Zealand Bankers' Association (**NZBA**) is the voice of the banking industry. We work with our member banks on non-competitive issues to tell the industry's story and develop and promote policy outcomes that deliver for New Zealanders.

2. The following seventeen registered banks in New Zealand are members of NZBA:
   - ANZ Bank New Zealand Limited
   - ASB Bank Limited
   - Bank of China (NZ) Limited
   - Bank of New Zealand
   - China Construction Bank
   - Citibank N.A.
   - The Co-operative Bank Limited
   - Heartland Bank Limited
   - The Hongkong and Shanghai Banking Corporation Limited
   - Industrial and Commercial Bank of China (New Zealand) Limited
   - JPMorgan Chase Bank N.A.
   - Kiwibank Limited
   - MUFG Bank Ltd
   - Rabobank New Zealand Limited
   - SBS Bank
   - TSB Bank Limited
   - Westpac New Zealand Limited

Introduction

3. NZBA welcomes the opportunity to provide feedback to Inland Revenue (**IR**) on its discussion paper, *Design of the interest limitation rule and additional bright-line rules* (**Discussion Document**). NZBA commends the work that has gone into developing the Discussion Document.

Contact details

4. If you would like to discuss any aspect of this submission, please contact:

s9(2)(a) [redacted]

[redacted]

Summary

NZBA acknowledges IR's significant work preparing the Discussion Document, particularly given the limited time since the Government's housing policy announcement in March 2021. We appreciate IR's proactive stakeholder engagement and are pleased to see the Discussion Document released for consultation in a timely manner. Our members require time to implement any changes that the new legislation requires. For that reason, our submission requests that draft and final legislation implementing this policy be made available as early as possible.

Consumers and lenders will benefit from timely publication of the legislation

Lenders will need to take account of the tax legislation changes, particularly when assessing customers' income as part of loan affordability assessments. Lenders may need to change their processes and adapt their systems to ensure lending assessments reflect the updated legislation. Such changes require time, and we expect it will be difficult for lenders to appropriately refine their processes until they have certainty as to the final rules as set out in legislation.

Even once the legislation is finalised, we expect that lenders may take some time to understand the rules given the likely complexity (illustrated in part by the length and detail of the Discussion Document). Additionally, lenders will need time to assess how these rules interact with other legislation and regulations that they are subject to (particularly in light of new consumer credit laws coming into effect at the same time as these tax changes).

We note that this lack of certainty has the potential to frustrate the Government's policy objectives. One example relates to the objective that these rules should not discourage new additions to the stock of housing (Discussion Document, page 8). To further this objective, the Government has decided that "new build" residential properties should be exempt from the proposed new interest limitation rules and subject to a five-year bright-line test (rather than a ten-year test). If lenders are uncertain as to the definition of "new build" because the final legislation has not been released, the effectiveness of this policy may be impacted.

We ask that legislation be drafted and finalised promptly, and ideally before 1 October 2021 (being the date the Government has signalled the rules will take effect from even if legislation has not been passed) to reduce uncertainty for customers and enable lenders to refine their processes as needed to take account of the final rules.

From:	s9(2)(a)
To:	Policy Webmaster
Subject:	The interest limitation rule - line rules
Date:	Monday, 12 July 2021 4:32:58 PM

- I disagree with the propose interest limitation rules
- Capital account property holders who are caught with the taxable sale should be able to deduct interest for the whole period of ownership in the year of sale

- Rollover relief should be included and should be broadened to include LTC elections and all related party transfers, including share transfers. This should also be back dated to 29/3/18

OVERALL – I disagree with the proposed interest limitation rules. It does nothing to help with the supply of housing, and does nothing to achieve one of the governments key housing objectives, which is to ensure "affordable home to call their own". I believe rents will increase over time as more existing rentals are sold to personal house owners.

- LTC share changes, between related parties, including to Trusts and between individuals
Roll over relief should also be back dated to 29/3/18 as there are a lot of rental property owners who unintentional have been caught by these very complicated rules

MAKE IT SIMPLE – 143 page of discussion document, shows that these rules are already too complicated and will be an unfair burden on taxpayers to comply with the rules. The new rules need to be simple and easy for all to follow.

From: s9(2)(a)
To: Policy Webmaster
Subject: Design of the interest limitation rule and additional bright-line rules
Date: Monday, 12 July 2021 4:33:12 PM
Attachments: Design of the interest limitation rule and additional bright-line rules letter s9(2)(a)

Dear Sir/Madam

Please find enclosed our submissions in respect of the design of the interest limitation rule and additional bright-line rules.

Yours sincerely

s9(2)(a)

s9(2)(a) [redacted]

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287-293 Durham Street
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Date: 12 July 2021

By email: policy.webmaster@ird.govt.nz

Dear Sir/Madam

Design of the interest limitation rule and additional bright-line rules

Thank you for the opportunity to comment upon the proposed framework for the interest limitation rule and additional bright-line rules as it applies to residential property.

We would like to echo the concerns of many tax practitioners, tax commentators and our clients that the proposed legislative change is not representative of good tax law.

In particular, we consider the proposals:

- Are complicated and contrary to current tax framework;
- Create an unequitable distortion not just between "new" and "old" builds, but also between residential and commercial property;
- Are effectively retrospective in application, disadvantaging those who own "old" residential property and those who would hold "new" residential property (but for the proposed definition);
- May not meet the desired outcome of the Government.
- Ironically, may offer an opportunity to revisit and simplify the wider land taxing provisions as they are currently drafted.

We make specific submissions below in respect of the following areas:

1. The ability to claim interest deductions upon disposal (including resulting losses);
2. The definition of "new build" and period of application;
3. Short-term accommodation;
4. Rollover relief.

We acknowledge the Honourable Grant Robertson's comments in February of this year, that "Bold" moves were afoot for residential property; he has not missed the mark!

Yours sincerely

s9(2)(a)

[redacted]

Chapter 5 – Disposal of property subject to interest limitation

The new rules limiting interest deductibility are stated to remove a "tax advantage" for residential property. Specifically, a deduction for interest while the resulting capital gain on disposal was generally not taxed.

Fundamentally, this issue is less likely to arise under current policy settings.

Firstly, the bright line test has been extended to 10 years meaning that the gain on disposal of many residential properties will be taxed.

Secondly, the impact of negatively geared properties which incurred tax losses in the early stages of ownership has already been adequately addressed by the loss ring-fencing rules. There is no need for an additional provision to deny the interest deduction to remove the perceived tax advantage as the measures have already been introduced.

To disallow a deduction would be unfair and may result in an illogical outcome (an economic loss overall, but positive taxable income).

If an interest deduction is to be denied, then we submit the interest incurred (and disallowed a deduction against rental incomes) during the period of ownership is deductible:

1. If the resulting property sale is taxable further to the bright-line rules; and
2. The deduction is available at the point of derivation of income from the bright-line sale.

The proposals contemplate that a deduction could alter taxpayer behaviour, i.e. there could be an incentive to sell property within the bright-line period to create a loss (or to wait until after the date for a capital gain).

We consider that any issue in this regard is adequately dealt with by quarantining any resulting loss such that it is available as a deduction against other income from current or future land sales. This maintains the status quo in relation to existing ring-fencing of loss rules as they currently apply to residential property.

Apportionment

With respect to the application of the bright-line rules and the main home exemption, we recommend that a similar pro rata calculation be adopted to establish a fair proportion of interest deductibility. The interest cost effectively "consumed" while the residential property is subject to the main home exclusion would not be available as a deduction upon disposal.

Alternative Approach

We offer an alternative for simplicity. If it is determined the interest is not deductible, which we disagree with, we recommend a taper relief reducing the taxable profit by, say, 10% for each full year the property is held following the fifth year of ownership. The seeks to address any inequity, however this alternative does offer a wider advantage to residential property owners who are not leveraged.

Chapter 7 – Definition of "new build"

We acknowledge that the policy intent seeks to encourage additional investment in new housing and thereby increase supply. To this end it is proposed that owners of "new builds" will be subject to:

- A five-year bright-line test; and
- An exemption from the proposed interest limitation rules.

The definition of what qualifies as a "new build" is therefore of importance.

We agree with the submission that a "new build" is to be defined by the timing of when a dwelling has received a code compliance certificate ("CCC").

We consider that a "new build" should be referenced solely to an increase in the number of residential dwellings. On this basis, we are not sure that there is a need to identify: "simple new builds", "complex new builds" and "commercial to residential" conversions (on the presumption these also require a CCC).

If the objective is to focus upon those activities which increase the housing supply, then we disagree that replacing (and demolishing) an existing single dwelling with a new single dwelling would meet the criteria to be exempt from the interest limitation rule, unless the old dwelling was not fit for purpose.

We consider that insurance may be a useful indicator in determining whether a dwelling that is completely unhabitable has been improved significantly (and therefore adds to the housing supply). For example, dwellings for which the insurer has determined as uninsurable as a result of earthquake damage.

Chapter 8 – New build exemption from interest limitation

It is proposed that the new build exemption will apply only to CCC received on or after 27 March 2021. The proposal includes a transitional rule is offered for certain new builds. This proposal seeks to apply the exemption to persons who:

- Acquired the land on or after 27 March 2021; and
- No later than 12 months after the CCC is issued.

We welcome a transitional rule, however we have concern that this approach may result in distorting taxpayer behaviour. For example, it could be advantageous to dispose of land acquired prior to 27 March 2021 to an associated entity (notwithstanding resulting bright-line considerations), where the CCC was issued within 12 months of 27 March 2021 (unless the transfer is disregarded with reference to rollover provisions and Chapter 10).

We therefore recommend consideration be given to extending the exemption for new builds where the CCC was issued within 12 months of 27 March 2021 (and perhaps this should be extended to five years).

It is further being considered whether the exemption should apply:

- In perpetuity for early-owners;
- For a fixed period for subsequent purchasers (a ten to 20-year time horizon);
- For a fixed period for both (again a ten to 20-year time horizon.

The merits of this approach revolve around an economic model and whether this would achieve the desired outcomes. We do not have sufficient information in this regard. However, we are concerned that providing a new build exemption for subsequent purchasers will create a fundamental bias from an income tax perspective, where the exemption will disadvantage “old builds” over “new builds” retrospectively.

We submit that extending the exemption to subsequent purchasers is overly complex and difficult to manage with multiple subsequent purchasers (how do you keep track of timeframes across multiple subsequent purchasers). Instead, we recommend a property acquired within 10 years of a CCC being issued would be simpler to administer.

Chapter 2 – Residential property subject to the limitation

With respect to short-stay accommodation we consider that it would be difficult to avoid a substitution effect and exclude short-stay accommodation that cannot be substituted for long. To this end we recommend a definition of short-stay (including serviced apartments) that references to the occupant’s length of stay, i.e. define “short”.

We offer occupancy of four weeks or less to represent “short”.

Again, an apportionment could be considered if there is a substitution. However, this again would add to the complexity.

Chapter 10 – Rollover relief

The Discussion Document touches upon certain family transactions. For example, it refers to the situation whereby parents may help their children to acquire property by gifting a residential land or selling to them for cost.

The problem faced here is that the legislation will deem these transactions to occur at market value, thereby creating an unexpected tax liability ("unfortunate taxation").

Providing assistance to allow the next generation to become a first home buyer should not be disadvantaged by a tax liability being imposed on a transaction within a family economic group.

We recommend an appropriate rollover relief be legislated, such that the transaction is ignored where there is no economic advantage to the vendor (parent). We note the same outcome could be achieved by property being held within a family trust.

From:	s9(2)(a)
To:	Policy Webmaster
Cc:	s9(2)(a)
Subject:	s9(2)(a) Submission on the design of the interest limitation rule and additional bright-line rules
Date:	Monday, 12 July 2021 4:38:21 PM
Attachments:	image001.png s9(2)(a) submission on design of interest limitation rule and additional brightline rules.pdf

Good afternoon,

Thank you for the opportunity to submit on the *Design of the interest limitation rule and additional bright-line rules* Government discussion document. A copy of our submission is attached and we are happy to discuss our submission with you further.

Please contact s9(2)(a) in the first instance regarding our submission.

ngā mihi
s9(2)(a)

[redacted]

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Design of the interest limitation rule and additional bright-line rules

A Government discussion document

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AUSTRALIA + NEW ZEALAND

12 July 2021

Hon David Parker
Minister of Revenue, Environment, Oceans and Fisheries
Associate Minister of Finance
Attorney General

By Email: policy.webmaster@ird.govt.nz

Dear Minister Parker,

Design of the interest limitation rule and additional bright-line rules

Chartered Accountants Australia and New Zealand (CA ANZ) appreciates the opportunity to make a submission on the "Design of the interest limitation rule and additional bright-line rules – A Government discussion document".

CA ANZ represents more than 128,000 financial professionals, supporting them to make a difference to the businesses, organisations and communities in which they work and live. Chartered Accountants are known as Difference Makers. The depth and breadth of their expertise helps them to see the big picture and chart the best course of action. We actively engage with governments, regulators and standard-setters on behalf of members and the profession to advocate in the public interest. Our thought leadership promotes prosperity in Australia and New Zealand.

We acknowledge that Government has a legitimate right to set tax policy direction. This said, we believe that the ad hoc measures introduced and proposed do not accord with good public policy design. The focus to "level the playing field" for first home buyers by damping residential investor demand for existing housing stock is unduly narrow and will lead to unintended consequences.

The un-signalled decision to broadly deny interest deductions on residential investment properties undermines investor confidence. The interest limitation on residential property coupled with the proposed bright-line interest concession for "new builds for residential investment purposes" will create boundary issues and complexity. Un-signalled decisions by Government also raises uncertainty when taxpayers, including non-resident investors, make long term investment decisions. New Zealand has had a long history of stable and predictable tax policy settings. This change raises uncertainty and could make taxpayers more reluctant to undertake such investments which will lower NZ future economic growth.

The focus of our submission is to ensure that the proposed measures are workable, as simple as possible and that compliance costs are kept to a minimum. We are very aware that many taxpayers who will have to apply these rules will not be sophisticated taxpayers and if the rules are overly complex, there will be wide spread non-compliance.

Key issues arising from the discussion document which need to be addressed include:

- Residential property boundary issues,
- Treatment of non-deductible interest on disposal and losses,
- Appropriate period for new build interest concession,
- Application of any change to the definition of closely held company; and
- Treatment/limitations placed on interposed entities.

A comprehensive and coherent review of the land taxing provisions is overdue and should be added to the tax work programme as a priority item.

Extension of the bright-line test to 10 years significantly changes the function and dynamic of the test. It was originally introduced as a two-year bright-line to buttress the section CB 6 purpose and intention test – to catch people that were speculating in residential property and was subsequently extended to five years. This extension of the bright-line period from 5 years to 10 years will result in far wider application of the taxing provision to residential property. This wider application will exacerbate existing issues with the land taxing rules more generally as well as those specific to the bright-line test. However, this could also provide an opportunity to simplify and consolidate the land taxing rules as they apply to residential property.

Extension of the bright-line period coupled with the proposed denied interest deduction will also impact the loss ring fencing rules and mixed-use asset rules. Whether these rules are still required (to remove the layering effect) or can be simplified should be considered in conjunction with any wider land review.

We are happy to discuss our submission further, and any questions can be addressed to

s9(2)(a)

Yours sincerely

s9(2)(a)

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Chapter 1

Overview/summary

A coherent review of the land taxing provisions is overdue.

A public education campaign is required to set out when the main home exclusion is available.

The loss ringfencing rules should be repealed.

Coherent review of land taxing provisions required

In recent years there have been a series of piece meal changes to the land taxing provisions. We recommend that a coherent review of these provisions be undertaken to streamline the provisions and ensure that they are and/or remain fit for purpose. At a minimum, given the extended reach of the bright line test there must now exist opportunities to consolidate and simplify the land taxing provisions as they apply to residential property.

We recommend that:

- Consideration is required on whether the 10-year rules are fit for purpose, e.g. tax outcome for a project undertaken by a developer compared with tax outcome for a project undertaken by a non-developer; appropriateness of resetting the clock for all improvements under the 10-year rule for builders;

- A review is needed of all the exemptions to the land taxing rules. There are currently several separate exemption rules for both the main home and business premises exclusions. These exclusions should be standardised and consolidated to provide consistency and to avoid confusion.

Other issues to be reviewed and clarified should include:

- deductibility of holding costs;
- seismic costs, weather tightness costs and healthy homes costs;
- application of the associated persons rules including whether the semi-permanent tainting rule in section CB 15(1) is still required when the trading stock rules apply to land on revenue account;
- implications of death and involuntary sales;
- rollover relief provisions.

Existing bright line issues

Existing bright line issues/impracticalities that are further exacerbated by the extended bright line period include: overreach and limitations placed on existing family and trust arrangements; an inability to undertake family restructures without triggering a tax liability and resetting the bright line period; and unavailability of inheritance relief on death of settlor/beneficiary where property ownership is held through a trust structure. Chapter 10 of the discussion document proposes that rollover relief be provided in limited circumstances with the proviso that there is no consideration. This proviso would severely restrict the application/workability of the proposed relief mechanism.

Consideration should be given to extending rollover relief in defined circumstances such as transfers between associated persons or providing a carve-out from the bright line rules for family related restructures. We provide further comment in chapter 10 of our submission.

Issues with the new bright line test as enacted – the main home exclusion

The new bright line test introduces a change of use concept in relation to the main home and will bring to tax on a pro rata basis gains derived where the property has been used for another activity for a continuous period in excess of 365 days, where sold within the bright line period. The 365-day continuous period (of which there can be more than one) is viewed as a "safe harbour" to allow for various circumstances where it may not be possible for the homeowner (taxpayer) to physically reside in the home. The new main home exclusion is premised on the basis that the homeowner always occupies the property whereas the previous exclusion was based on predominant (greater than 50%) use.

The Inland Revenue special report states that the new main home exclusion:

> *is* intended to provide leeway for moving in or out of a property *(for example, there may be vacant periods between settlement and moving in, or between moving out and sale). It* also covers periods of up to 12 months where the taxpayer is not using the property as their main home *(for example, if they rented the property out while overseas and it was no longer their main home for that period).*

> *If a period of non-main home use exceeds 12 months,* the entire period for which the property was not used as a main home is subject to tax *(emphasis added).*[1]

In our view the new main home exclusion and change of use mechanism is more likely to catch out homeowners including those homeowners who do not file tax returns (as they have no untaxed income such as rental income) and have no proximity to these tax rules. These taxpayers will be exposed to the stress of unexpected tax liabilities, use of money interest and potentially penalties.

It will also bring with it greater compliance costs. Examples where the 365 day "safe harbour" will not be sufficient to enable use of the main home exemption include:

- Construction (including design/plans, consent and build) of a house that takes more than 12 months to complete.
- Homeowner undertakes a major renovation of the property and does not live in the home for 12 months. This could cause homeowners to remain living on site during the renovation even if that is not an optimal outcome from a health and safety perspective which runs counter to other public policy objectives;
- Natural disaster (Flood, fire, earthquake) involving insurance claim and substantive repair to family home (where home is inhabitable during this process);
- Homeowner lets family member live in the property (no rental) before they move into the property;
- Homeowner goes on an OE for more than 12 months (and house remains empty);

[1] Inland Revenue Special Report, *Taxation (Annual Rates for 2020-21, Feasibility Expenditure, and Remedial Matters) Act 2021*, p.12.

- Homeowner takes a secondment/work transfer for more than 12 months. The new bright line main home exemption means if the employee accepts the secondment some of the capital gain on sale of that property (assuming it goes up in value and is held for less than 10 years) is taxable. This is the case even if the house sits empty which might mean the employee declines the secondment opportunity;
- The person contemplates a move to a new city and buys before the move, it takes them 12 months to move in (delays with employment relocation, undertaking work to the property prior to moving in);
- The homeowner goes into a rest home and the property is vacant for 12 months before sale (this could start out as a short-term placement and then turn into a permanent relocation). Work may be required to the property to maximise sale price/increase marketability;
- The homeowner goes into a rest home and the purchaser requires an extended settlement. The combination of both factors results in the property being vacant for more than 12 months.

The first fundamental step is the need to address a lack of appreciation by the general public that the family home in which they normally reside could in fact be subject to the bright line rules if their situation falls outside the main home exclusion.

A number of practical compliance related issues arise where the main home exclusion is not available either over part or the whole bright line period. These issues are likely to be more pronounced where the residential properties in question are used for private purposes rather than to derive rental income.

Outside of residential properties already used to derive taxable income, record keeping by homeowner's subject to the bright line test is likely to be minimal or non-existent. People are unlikely to track periods of time when they are not using their main home for the purposes of the 365 day "safe harbour" but will be required to retrospectively determine whether such periods have been breached if there is a sale within the bright line period.

The practical requirement to keep records for 10 years in case the property is sold within that time frame (which exceeds the standard record keeping period of 7 years) will result in an increased compliance burden and verification related issues for the taxpayer and Inland Revenue.

Even where there are detailed records, the bright line test raises issues regarding deductibility where the house is primarily private, and the bright line only applies due to vacant use (i.e. in circumstances where the main home exclusion is unavailable). Examples include:

- What holding costs will be allowed as a deduction against sales proceeds? The fact sheets provided at the time of the bright line extension announcement indicate that in addition to the original purchase price such costs may be limited to legal costs arising on both purchase and sale, costs of capital improvements and realtor fees/selling related costs.

Inland Revenue's prior work on holding costs (not completed and current status unclear) would suggest that interest, repairs and maintenance, rates and insurance costs etc may also be deductible. The final formulation will need to strike an appropriate balance between permitted deductions for property treated as being on revenue account and the simplicity of calculation/compliance cost/burden.

- What will be allowable as deductions for capital improvements? This will be more pressing if repairs and maintenance costs are not separately allowed to be claimed at time of disposal.
- Whether there is a need to track if capital improvements still form part of the property at time of sale? Arguably if a capital improvement for tax

purposes has been made to the property during the bright line period that should be sufficient (subject to holding relevant receipts) to claim a deduction at the time the property is disposed.

Denied interest deductions

The Government has clearly stated its intention to legislate to deny interest deductions on borrowings for residential investment properties acquired on or after 27 March 2021 and to phase out interest deductions on existing properties (acquired before that date) from 1 October 2021. There is no consultation on the phasing out of interest on borrowings for pre-27 March 2021 properties.

It has also announced that it will publicly consult on:

- A proposed exemption to enable interest deductions to be claimed on borrowings for "new builds" acquired as a residential investment property; and
- Whether all people who are taxed on the sale of a property (including by virtue of the bright line tests) should be able to deduct their interest expense at the time of sale (now clarified to state that is subject to the private expenditure limitation).

In terms of the discussion document we make the following observations/high level comments pertaining to the deductibility of interest:

- It is imperative that mechanisms to allocate allowable interest deductions are as simple as possible and accord with current banking practices/limitations (types of borrowing available and commercial practicalities as to the numbers of separate loans that can be taken out);
- We support the intention to use tracing as a general approach;
- Where a property has a dual use (residential/non-residential) there should be an option to apportion interest costs;

- The transitional rules proposed for interest costs for interposed entities are too difficult.

Repeal of the loss ring fencing rules

In our experience residential rental losses have historically been generated by the deduction of interest and building depreciation (up until it was effectively removed). Without these types of deduction substantial repairs & maintenance (R&M) would have to occur within a given income year for that alone to give rise to an overall loss.

Given the Government's stated intention to remove interest deductions from 1 October for residential investment properties (with the potential exception of new builds for residential investment) acquired on or after 27 March 2021 and to phase out interest deductions on existing loans for all other residential investment properties acquired before 27 March 2021, we recommend that the residential loss ring fencing rules be repealed.

Repeal of these rules is appropriate as:

- The policy rationale for both regimes is the same – to ensure that investment in residential property is not tax-preferred because of the taxpayer's ability to generate losses through borrowing.
- For new residential property acquisitions, it can be expected that rental income will exceed allowable deductions;
- For existing investments, there may still be losses as interest is phased out, but it is most likely that by the time only 50% is allowed, there should be taxable income. If not, it will be due to other deductible items like R&M (which should be encouraged for tenants' wellbeing), insurance and rates where there is no policy reason for denying loss

offsets. (If there are concerns in relation to the quantum of interest deductions the repeal could be delayed for income years after 31 March 2024);

- For new builds, the ability to offset losses should encourage further investment in them (or at least not discourage when compared to an alternative investment) which seems to be the government's overriding policy concern. Deferral of excess (amorphous) deductions where loss ring fencing rules are retained would dilute this investment incentive;
- It will simplify the compliance process and increase taxpayer certainty;
- There seems a policy disconnect between the Government encouraging/requiring the upgrading of residential properties to make them warmer and dryer and the denial of tax deductions relating to the funding of those residential property improvements;
- If we simply introduce the interest limitation regime we will have three very complex regimes (mixed use assets, residential loss ring fencing and denial of interest) applying to relatively unsophisticated taxpayers. Any way to simplify the rules should be considered.

If our recommendation to repeal the residential loss ring fencing rules is not actioned, the proposed denied interest deduction rules should have no application to existing ring-fenced losses when offset against future rental income.

Chapter 2 - Residential property subject to interest limitation

Overview/summary

The proposed definitions seem consistent with the Government policy. We have highlighted some boundary issues which illustrate the arbitrary nature of the proposals and likely difficulties with compliance.

Policy objectives and broad scope

We agree that housing of a type that is substitutable for long term residential housing should be captured.

Paragraph 2.11 suggests that the test would be whether "the property is of a type that would normally be available for owner-occupiers". This test seems sensible. We agree that use of the current definition of "residential land" and "dwelling" are appropriate. The current definition of "dwelling" focuses on the capability of the place to be used as a residence, rather than actual or intended use. This is consistent with the stated policy intent of capturing accommodation that is substitutable for long term residential housing.

As the document notes, there will be some issues at the margins. We provide our comments under the headings below.

As we have previously noted, many of those applying the rules will be Mum-and-Dad landlords with little tax experience. The rules should be made as simple as possible to encourage compliance.

Proposed approach

We agree that all of the following should be excluded from the proposed rules:

- Farmland;
- Business premises;
- Care facilities;
- Commercial accommodation; and
- Retirement villages and rest homes.

As mentioned above, the exclusions will create boundary issues. These have been highlighted in the Discussion Document and we comment on these below.

Business premises and dual-purpose buildings on the same title

We agree that business premises should be excluded from the rules.

"Predominant" vs apportionment

At present "business premises" is defined in section DD 11 for the purposes of the entertainment rules and the land sales provisions, although the exclusions in sections CB 19 and CB 20 do not refer to the definition in part DD. Where the property is mixed use, a "predominant" test is applied. By consequence, a property is either business premises or not. We believe this is simple to apply and could be retained but should be amended to allow an option for greater accuracy and flexibility.

It is common for a landlord to own a building with commercial use on the lower floors and residential on higher floors. An all or nothing approach (like with the current definition of "residential land") could create behaviour that is inconsistent with the Government's policy of encouraging housing supply. For example, if a mixed-use building had predominantly apartments with some commercial (business premises) use, the owner would be incentivised to turn some apartments into commercial space. While more complex, apportionment seems fair in an interest limitation context.

Apportionment is well ingrained in the Income Tax Act 2007 (the Act) especially in relation to deductions (i.e. "to the extent to which the expenditure or loss" used in section DA 1 and the antecedent provisions). Taxpayers and advisors should therefore be familiar with apportioning deductions at least in non-company settings. Therefore, the existing rules should be able to be used. The rule should allow tracing first, then apply apportionment (possibly on an area basis). Common examples of apportionment calculations are home office claims and interest calculations in a non-company context.

Therefore, apportionment would also be appropriate in the case of buildings that are dual use. That said, the apportionment method should be as simple as possible and should not require the building owner to obtain a valuation year on year.

We recommend that the rules include an option for the taxpayer to apportion. Where the business portion is greater than 50% of the total premises, the taxpayer could choose to apportion.

This option would be simple and would reduce compliance costs for those who have only a small proportion of business use compared with residential use, or who do not wish to carry out apportionment calculations.

We recommend the apportionment rule require a method of apportionment that provides a "fair and reasonable result", similar to the requirement in sections 20 and 21 of the GST Act. This would allow the taxpayer to apportion based on rental value, land area, floor area, or another method – without the legislation having to specify all possible methods.

Scope of definition

The existing definitions in sections DD 11, CB 19 and CB 20 are too narrow. They generally apply only to owner-operators and not landlords who let to someone else for use as their business premises. The definition should also include the latter type of business. "Business premises" could be defined negatively to include all business activities except those that derive income, or intend to derive income, from residential land.

Boundary issues

This proposed rule regarding dual-purpose buildings will raise issues where a lease on the site is dual purpose but in respect of only one residence. For example, a lease for an apartment and a separate lease for the underground carpark. In that case the carpark would form part of the accommodation. However, if the carpark was leased from a different supplier the answer might be different even though the actual use is the same.

This treatment could also encourage landlords to separate out supplies or make them through other entities – for example, a separate lease for the fridge or washing machine, to ensure that any interest relating to the appliances is deductible.

Summary on business premises

Overall, we believe the proposed rule will reflect the political policy intent. However, the boundary issues we have discussed show that the arbitrary nature of the rule may make it difficult to comply with and enforce. We believe that the predominant test should be retained, with optional apportionment and sufficient flexibility in apportionment methods to ensure ease of compliance.

Employee accommodation

We agree that employee accommodation should be excluded from the rules and believe that the current exemption in section EL 13 is a good starting point. However, we believe EL 13 should be clarified confirming that it also applies to accommodation owned by an associate of an employer.

Student accommodation

We agree that the rules should include an exemption for student accommodation because it is not usually substitutable for long term residential housing.

We agree that the requirements in sections 5(1)(h) and 5B of the Residential Tenancies Act (RTA) are appropriate. We are however concerned whether the requirements in the RTA capture all student accommodation. We think in addition to this; student accommodation should include all leases to secondary or tertiary institutions as we understand that some large properties are leased to such organisations who then sublease to students. It is not clear the lease to the secondary or tertiary institution meets the RTA.

However, if the Government wishes to encourage higher-density housing developments such as shared housing, or unit titled apartments with communal living spaces, the exemption should be widened to include those. This will be a political decision.

Short stay accommodation substitutability issues

We agree that short-stay accommodation that is not substitutable for long-stay accommodation should be carved out. In our view, the test of whether the accommodation is capable of being used as long-stay residential accommodation is the most appropriate. This could include whether the apartment has a kitchen and laundry.

Serviced apartments

In our view, there should be a carve-out for serviced apartments as these are generally not substitutable for long-term accommodation. Most are more similar to hotel accommodation, which is excluded.

The boundary between hotel accommodation and serviced apartments is porous. Developers commonly construct complexes designed for short term accommodation in which the units are then on-sold to individual owners on the condition that they are put back into the pool to be rented out. The units may be configured as either hotel rooms or serviced apartments and the two may be interchangeable depending on the market. If serviced apartments were not excluded, it is likely that many serviced apartments would simply be converted to hotel accommodation.

The distinction between a serviced apartment and a normal apartment is the "service". Serviced apartments are only rarely used as long-term accommodation because the additional services are not needed or not affordable over the longer term. The definition of a serviced apartment should include an element of service, over and above the supply of accommodation.

In our view the definition in the GST Act would be a good starting point, as that requires that the supplier provide goods and services over and above the accommodation. This would be consistent with the definition of student accommodation, which also requires additional services to be provided (such as student pastoral care).

Maori collectively-owned land

It is our understanding that land owners of collectively-owned Maori freehold land are not able to borrow against the land because it is owned by multiple owners and, because the land is ancestral, it cannot be sold. Therefore, any borrowing is against the building only (a chattel mortgage).

More owners of Maori collectively-owned land are providing housing for whanau – which is in essence social housing (similar to Kāinga Ora). It is sensible to exempt Kāinga Ora as the core of what they do is to provide housing to those in need. The exemption helps to ensure equity in the rule – those with a basic human need are not penalised and those who are growing their asset bases are contributing to the tax system accordingly.

It is our understanding that most development of Maori collectively-owned land is done in conjunction with Te Puni Kokiri (TPK) under the Maori Housing Network. TPK will often provide a grant for some of the costs (including infrastructure) and the remainder will be a bank loan. This may take the form of a government-underwritten loan provided by Kiwibank (the underwriting is through Kāinga Ora) or may be a normal bank loan. Either way, the loans are structured in the same way as other bank loans – generally with commercial interest rates and a "table" structure.

The loan will be to either the land-owning trust (for rental housing) or to the house owner (for owner-occupied housing). The loan is secured against the building rather than the land.

We understand that developments of this kind can also occur on land that is held under general title.

We are not aware of any specific kaumatua housing developments outside of papakāinga housing.

Papakāinga housing is usually defined as that being provided to the community to live in the manner of Te Ao Maori (the Maori world).

Questions

Business premises and dual-purpose buildings on the same title		
Predominant use	Would an all-or-nothing predominant use approach for business premises used by the bright-line test be appropriate for interest limitation, or would an apportionment approach be more suitable?	A predominant use test with an option for apportionment where the business use is greater than 50%
	Should it follow general tax principles, or is there another approach that might be more appropriate?	General tax principles
	Are there any apportionment calculations regularly done by landowners for other purposes (for example, insurance and mortgages) that might be useful in this context?	Yes – home office and interest (where the land owner is not a company)
Definition	How might "business premises" be defined for the purpose of interest limitation?	Any premises used for business activity that does not include an intention to make a profit from residential land
	To what extent is it possible to reuse the	The existing definitions in sections

Business premises and dual-purpose buildings on the same title		
	definitions outlined above for this purpose? What issues might this cause?	DD 11, CB 19 and CB 20 are too narrow as they generally apply only to owner-operators and not landlords who let to someone else for use as their business premises. The definition should also include the latter type of business.

Employee accommodation		
Carve-out	Should a carve-out for employee accommodation be provided under the interest limitation rules?	Yes
	Does the employee accommodation carve-out in the residential ring-fencing rules provide a useful basis for an interest limitation carve-out? Can you see any issues with using these rules?	Yes but needs clarification

Student accommodation		
Carve-out	Should a specific carve-out be provided for student	Yes

Student accommodation		
	accommodation? Is it necessary?	
	Are there any issues with using the regulatory framework in sections 5(1)(h) and 5B of the Residential Tenancies Act 1986 as a basis for this carve-out?	No, but the exemption should be made wider
	Could a carve-out encourage the conversion of regular residential rental properties into student accommodation? How could this risk be mitigated?	By requiring additional services be provided

Short-stay accommodation substitutability issues		
	Should short-stay accommodation that is not substitutable for long-stay accommodation be carved out from the interest limitation rules and why?	This would be consistent with the Government policy
	How could this carve-out be designed to avoid capturing short-stay accommodation that could be substitutable for owner-occupied housing?	As above, by requiring additional services to be provided

Maori collectively-owned land		
Carve-out	Would a carve-out for papakāinga housing be appropriate to support the aims of papakāinga and the Government's wider housing objectives?	Yes
Identification	Is papakāinga housing straightforward to identify?	Yes, in general – although there may be some differences
	Are there certain characteristics that could assist with identification?	If the housing is built to allow the occupants to live in accordance with Te Ao Maori (the Maori world)
	How common is it for papakāinga housing to be provided on general title land (as opposed to Maori land)?	This is not common but does occur
	Is it possible to easily differentiate between papakāinga housing on general title land from standard rental properties?	In our experience there are no particular legal tests; however, papakāinga housing should support a community to live in a way that reflects Te

Maori collectively-owned land		
		Ao Maori (the Maori world)
Rental to others	Can housing on Maori land be rented to non-whanau and how common is this?	Not to our knowledge. The housing is provided at the discretion of the land-owning trust and only those with a connection to the land are eligible to live on the land
Financing	How are papakāinga housing developments structured and financed?	Usually with a partial grant from the Maori Housing Network and debt financing for the remainder of the development
	How common is it for papakāinga housing to be provided through a registered charity?	This does happen, but most is not provided through registered charities
	To what extent is interest incurred on lands related to papakāinga housing?	To the extent that there is debt financing

Maori collectively-owned land		
		for the building, there will be an interest cost.
	Are bank loans the most common form of debt finance used? What other forms of debt finance are used?	Yes

Chapter 3 - Entities affected by interest limitation

Overview/summary

CA ANZ does not support the proposed amendment to the definition of close company.

Companies

> *The Government proposes to override the general rule in section DB 7 for residential investment property owned by close companies and residential investment property-rich companies".*

Unless an exemption applies interest deductions will be limited to the extent that the company's borrowings are traced to residential investment property purposes.

Close company

To avoid having a "close company" the share ownership could be split between many trusts, settled by the same person. It is therefore proposed the definition of "close company" be amended by treating all trustees of trusts settled by the same person (or their associates) as a single trustee.

It is not clear whether the proposed amended definition of close company will apply generally, or solely for the purposes of the residential interest limitation.

Comment

CA ANZ does not support this proposed change. It is not clear whether this is a real problem or a hypothetical or potential problem. If a taxpayer implemented this structure for the purposes of sidestepping the closely held company rules, then it would likely be subject to the general anti avoidance rules. If there is an issue, this should be consulted by way of a technical paper outlining what is the problem, why the avoidance rules don't address this and what the change should be. This should not be progressed as part of these reforms.

Closely held company should also be defined as not including a widely held company. That is a closely held company that has more than 25 shareholders should not be treated as a closely held company.

Should Government proceed with this change we recommend the definition apply solely for the purposes of the residential interest limitation.

Residential investment property-rich company

Where a company's residential investment property exceeds 50% of its total assets, the company will be classed as "residential investment property-rich". The classification will apply on a company-by company basis. However, companies that are part of a tax consolidated group will be treated as a single company.

Companies that qualify as "residential-investment property rich" will be subject to the interest limitation proposal.

It is also proposed to treat all ownership interests (for example, shares) in a residential investment property-rich company as "residential investment property" for the purposes of the "residential investment property-rich" threshold. Rather than looking through chains of companies to determine the value of residential investment property held by each subsidiary Government consider this is a simpler approach.

For the purposes of the "residential investment property-rich" threshold "new buildings" should be treated as residential investment property. If a company's portfolio consists of new builds and existing rental properties to calculate what interest deductions are limited it should need to trace its borrowings.

Similarly, residential property under development should still be considered "residential investment property" for the purposes of the residential investment property-rich" threshold.

Comment

CA ANZ is concerned with the requirement that a taxpayer will need to trace their borrowings if their portfolio consists of new buildings and existing rental properties to calculate what interest deductions are limited. In many cases tracing the flow of borrowed funds is not practical. In fact, it can be difficult, if not impossible. Taxpayers may already have funding facilities in place and for commercial reasons it may not be desirable to enter into new and separate loan agreements when new or additional properties are added to the portfolio.

We also submit that a closely held company should be carved out of these rules where it is not a residential investment property-rich company. In all likelihood if a closely held company has less than 50% of its assets in residential rental accommodation it should be able to structure its debt so that it is not subject to these rules. It is questionable why the rules will require such taxpayers to undertake complex and compliance cost intensive restructures to ensure full interest deductibility.

We query why a closely held company that does not meet the threshold for being residential investment property-rich is caught by the rules whereas a non-closely held company can disregard these rules.

Limited partnerships are often used in a similar fashion to widely held companies. The rules should carve out limited partnerships with say 25+ partners unless they are "residential investment property-rich". Treating these as transparent will cause problems.

Valuation

For determining the residential investment property threshold, the Government proposes that the following values be used:

- Land - the later of its most recent capital or annual value as set by a local authority or its acquisition cost, or market value if acquired from an associate.
- Depreciable property – the property's adjusted tax value; and
- Other property – where market value cannot be obtained, there may be merit in allowing accounting or tax book values.[2]

Comment

Legislation should make it clear at what point in time the value should be measured.

The use of accounting or tax book values for other property would simplify the calculation and reduce compliance costs. However, consideration should be given

[2] As per the rules for residential loss ring-fencing (section EL 19). with the exception of other property

to whether the use of these values will skew the threshold calculation negatively or positively.

Kāinga Ora

The Crown agency, Kāinga Ora-Homes and Communities provides public housing for people in need of assistance. It is not a charity or a community housing property provider and unlike many other community housing providers it is not exempt from income tax. The Government proposes to exclude Kāinga Ora and its wholly owned subsidiaries from the interest limitation rules.

Comment

The proposal to exclude Kāinga Ora from the interest limitation rules seems appropriate if housing provided by Kāinga Ora is substitutable for community housing. However, to the extent that Kāinga Ora and its subsidiaries provide housing to recipients who would not qualify for subsidised state or community housing, then an exclusion from the interest limitation rules should not apply. In this case, an exclusion from the interest limitation rules would defeat the objectives of taxing Kāinga Ora and its subsidiaries. It would give Kāinga Ora an unfair advantage over private investors who provide residential rental properties.

Other organisations

It is not proposed to exclude other entities from the interest limitation rule. However, exemptions for land being developed and for new builds are proposed.

Questions

Companies		
Valuation	Do you prefer to use accounting or tax book values for calculating the residential investment property percentage for assets other than land, improvements and depreciable property? Why	Small to medium size entities generally use tax book value for accounting purposes. Further thought should be given to what effect revaluation will have if assets have been revalued for accounting purposes.

Chapter 4 - Interest allocation: how to identify which interest expenses are subject to limitation

Overview/summary

The interest limitation rules must be simple and easy to comply with.

Tracing can result in complexity whereas a more simplistic approach may unfairly penalise some taxpayers.

A transitional approach which provides taxpayers with a choice of apportionment, stacking or tracing would be preferable.

Denying a taxpayer transitional interest deductions when a NZD loan is refinanced with a foreign currency loan is discriminatory and un acceptable.

An offset account and a revolving credit facility are not similar.

Proposals

Tracing approach

The Government proposes that a tracing approach be used for the interest limitation rules.

The tracing approach involves identifying what money has been borrowed by the taxpayer and determining how that money has been applied. Subject to exemptions for new builds and developers, interest on loans used for residential investment purposes will be non-deductible.

Borrowings for residential investment purposes is not limited to loans used to fund the purchase of a residential investment property but also includes loans used to pay expenses incurred in deriving the residential rental income, for example repairs and maintenance, rates etc.

The deductibility of interest may change if the use of the loan changes and it is traced to a new use.

A question arises, how repayments of a loan should be allocated when that loan is used for both deductible and non-deductible purposes. There is no statutory ordering rule prescribing how repayments should be allocated. Case law provides if the debtor makes no appropriation at the time of payment, the creditor then has the right to appropriate the payment. Where neither debtor nor creditor has made an appropriation, a FIFO basis of applying receipts against withdrawals is appropriate.[3]

Essentially, money is fungible and because it loses its particular identity when combined with other money this could mean it may be difficult for many taxpayers to match borrowed funds to particular assets.

Comment

CA ANZ acknowledges that it is possible to make tracing easier by keeping loans for different types of assets separate.[4] However, as noted above this is not always practical or a viable option. Some taxpayers who have existing funding facilities in place for commercial reasons may not wish to or may not be able to easily enter into new loans. Tracing is likely to result in greater compliance costs and may

[3] Falk v Haugh (1935) 53 CLR 163, Devaynes v Noble (1816) 35 ER 781 (Clayton's case); Foskett v McKeown [2001] 1 AC 102 (HL) and Re Registered Securities Ltd [1991] NZRL 545 (CA).
[4] paragraph 4.8 Discussion Document

produce arbitrary results. For taxpayers with identical portfolios and financing arrangements tracing can result in completely diverse outcomes. Practically, only those taxpayers who cannot plan around it, or who do not know how to, will be affected.

Refinancing

Interest on new loans for residential rental properties will generally not be deductible. It is proposed an exception will apply for refinancing pre-27 March loans that apply to property held (or acquired) before 27 March 2021. If the new loan is larger than the existing loan, whether the interest on the additional funding is deductible or not will be determined by using a tracing approach.

> *"this proposal will allow borrowers to restructure their funding sources when it is commercially sensible to do so."*

The exception will not apply when a New Zealand dollar (NZD) loan is refinanced with a loan denominated in another currency. The interest or foreign exchange movements on these foreign currency loans will not be deductible or assessable.

Comment

In our view preventing a taxpayer from obtaining an interest deduction for the transitional period if an NZD loan is refinanced with a loan denominated in another currency is discriminatory and unreasonable. Taxpayers may wish to refinance with a loan in a foreign currency because it is a less expensive source of finance.

Transition issues

As it may be difficult to trace a pre-27-March loan, to make compliance easier two alternative rules are proposed for taxpayers to allocate their pre-27 March loans across their assets. These rules are optional. Taxpayers can still trace if it is possible.

1 *Apportionment*

Apportion loan balances at 26 March 2021 across the taxpayer's assets based on original cost including any improvements. Repayments after that date would be allocated to assets in the same proportions.

Increases in loan balances would be treated as a new drawdown for which tracing should be applied.

2 *Stacking*

Allocate pre-27 March loans, excluding any loans for private purposes, first to assets that are not residential investment properties. Stacking will be based on the market value of assets as at 26 March 2021.

Comment

Apportionment can avoid problems associated with tracing and it will prevent taxpayers from allocating any loans against assets that are not subject to the interest limitation rules.

The idea behind stacking is quite simple and offers a pragmatic response to a transitional issue.

In our view a transitional approach which provides a choice of apportionment or stacking or tracing would be preferred.

Issues caused by specific types of loans and high water mark proposal

Revolving credit and other variable loans

Any expenditure on or after 27 March 2021 made from a revolving credit facility, including all interest charged under that facility, will be treated as new lending. Interest on that lending will not deductible after 1 October 2021 unless it can be traced to a deductible use.

Offset arrangements

An offset arrangement is a type of lending arrangement where the borrower also maintains a deposit account with the lender. Instead of receiving interest on the deposit account, the interest payment due on the loan is calculated only on the net balance of the loan minus the deposit account. If the interest and other expenses are funded by a withdrawal from a deposit account, this would not constitute new borrowing.

At paragraph 4.32 it is stated that it is clear that an offset account can result in more deductible interest than an equivalent revolving credit facility even though both products are very similar economically.

> *if there is no special rule for revolving credit facilities, the outcomes for individual taxpayers in similar circumstances could be quite different depending on their funding arrangements. Taxpayers with offset accounts may have higher interest deductions than taxpayers with revolving credit*

> *facilities and taxpayers may have higher interest deductions if they can fund expenditure by deferring principal repayments they would have otherwise made.*[5]

To remove the inequity, reduce compliance costs, remove the incentive to defer principal repayments and align the treatment of different funding products the Government proposes a high water mark approach.

High water mark proposal

Interest on pre-27 March loans will be deductible subject to the signalled phase out of deductions (phasing). Borrowing to fund expenditure on these properties after this date will be subject to the interest limitation.

The high water mark approach would operate for each loan as follows:

1. Determine the high water mark
   This is the amount of funding allocated to residential rental property on 26 March 2021 using tracing or the transitional provisions.
2. Adjust the loan balance for private and other deductible expenditure after 26 March – not applicable if the loan has only been used for a pre-27 March residential rental property
3. Determine the amount of borrowing that generates deductible interest subject to phasing
   If the adjusted loan balance is:

   - lower than the high water mark, all interest on the adjusted loan balance is deductible subject to phasing; or

[5] Paragraph 4.34 Discussion Document

- higher than the high-water mark, interest up to the high water mark is deductible subject to phasing.
- Deductibility of interest on the loan balance above the adjusted balance will depend on the purposes it has been traced to.

The loan balance for a revolving credit loan would be the amount drawn down rather than the total credit limit that could have been borrowed.

It is proposed the high water mark proposal apply on each loan separately rather than a portfolio basis.

Comment

In our view this issue is not that straight-forward. The inequities arise as a result of a taxpayer's deliberate choice of funding products. Furthermore, a revolving credit facility involves one taxpayer whereas an offset arrangement may involve more than one taxpayer. For example, an offset arrangement could include a trust who is the borrower, and the settlor's personal savings accounts. The tax outcome from an offset arrangement should be respected and not overridden. The arrangement would have been put in place for good reason and a Government announcement on 23 March could not have been foreseen. An equally incorrect outcome occurs where a taxpayer had residential borrowings at 27 March but cash in the bank (not subject to offset)

Foreign currency loans

It is proposed that any interest on a foreign currency loan that funds a pre-27-March residential rental property would become non-deductible on 1 October with no phasing period. This is because it is considered there would be significant complexity in designing transitional phasing rules for these loans.

However, the refinancing exception would allow a foreign currency loan to be refinanced with an NZD loan.

Comment

We reiterate our earlier comment. Denying taxpayers an interest deduction during the transitional phase for a foreign currency loan is discriminatory and unreasonable. This also ignores that all loans are subject to the financial arrangement rules. To overcome any complexity, the transitional phasing rule for these types of loans could be as simple as allowing taxpayers to convert the interest payments into NZD using the appropriate exchange rates (e.g. as published by Inland Revenue).

Hedges

It is proposed gains and losses on a hedge would not be deductible/assessable to the extent it is a hedge of a foreign currency loan covered by the interest limitation proposals.

Comment

We recommend an exception also apply so a gain on an interest rate swap is not taxed to the extent the interest is non-deductible.

Conclusion

It is imperative that mechanisms to allocate allowable interest deductions are as simple as possible and accord with current banking practices/limitations (types of borrowing available and commercial practicalities as to the numbers of separate loans that can be taken out).

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We support the intention to use tracing as a general approach where it is possible and where the deductible interest has to be determined from a wider loan. In addition, we would support any taxpayer friendly measures that simplify required calculations.

We recommend the implementation date be moved to 1 April 2021 to make compliance easier.

Questions

Tracing		
Tracing	Do you agree with the proposed approach to generally rely on the existing law on tracing except where it would cause transition issues?	Tracing is not always practical or viable. Refer above.
Other issues	Are there any other issues with applying tracing that have not been identified in this discussion document? The Government is interested in issues that are particular to interest limitation, and not issues that already exist more generally.	Taxpayers with existing funding facilities in place may not be able to enter into new and separate loans to purchase another property.

Refinancing		
Specific provision	Do you agree that a new loan to refinance a pre-27 March loan would benefit from a specific provision?	Yes. This would make it absolutely clear refinancing is an acceptable option.
Restructure NZD loans	Are there any commercial reasons a loan that is in New Zealand dollars would be restructured to a loan in a foreign currency?	A loan denominated in a foreign currency may be a less expensive

		source of finance.
Other Issues	Are there other issues with refinancing that we have not considered?	

Pre-27 March loans that cannot be traced		
Apportionment or stacking	Which of the proposed approaches do you prefer?	Taxpayers should be allowed to choose either approach.

High water mark		
Proposed approach	Do you agree with the proposed approach to a high water mark?	No, we do not agree with the proposed approached. Refer above.

Chapter 5 - Disposal of property subject to interest limitation

Overview/summary

CA ANZ supports Option B. Interest deductions should be allowed in full at the point of sale.

CA ANZ does not support either Option E or Option F. The tax treatment of interest costs at the point of sale should be consistent irrespective of whether the gain or loss is taxable or non-taxable.

The Government should take this opportunity to also specifically address holding costs for land (not used to generate income) where sale proceeds are subject to tax. This then provides one coherent set of rules

Introduction

> *Interest deductions for residential investment property are to be disallowed from 1 October 2021, unless the property qualifies for the development or new build exemption".*

Where property is sold questions arise as to whether a deduction should be allowed at the time of sale:

- for the interest, if the sale is taxable (on revenue account); or

- for some of the interest if the interest incurred exceeds the non-taxable capital gain.

When considering the above questions, the rental loss ring-fencing rules and the bright-line arbitrage rules need to be taken into account.

Proposals

Options for treatment of interest when sales are on revenue account[6]

Four options are being explored:

- Option A – deductions denied
- Option B - deductions allowed at point of sale
- Option C – deductions allowed at point of sale to the extent they do not create a loss
- Option D – anti-arbitrage restriction of interest

Option A – deductions denied

With the exception of interest deductions allowed under the developer or new build exemptions, all interest deductions would be permanently denied in all circumstances.

[6] Would include those properties taxable under the bright-line test

Option B – deductions allowed and deferred to point of sale

Interest deductions would be allowed in full at point of sale.

Option C - deductions allowed at point of sale to the extent they do not create a loss

Deductions would be allowed at point of sale only to the extent that they do not create a loss. Any interest in excess of this would be non-deductible.

A variation to this would be to restrict the loss limitation to bright-line property and property acquired with the intention of disposal.

Option D – anti-arbitrage restriction of interest

Interest would be deductible at the time of sale subject to restrictions. Excess interest would be deductible against other income from revenue account property derived in the same or a later income year.

Comment

CA ANZ supports Option B. Otherwise deductible interest (in the absence of the residential dwelling limitation) should be allowed as deductions in full at the point of sale

Options for treatment of interest when sales are on capital account (gain is non-taxable)

Option E – No deductions allowed.

All interest deductions associated with the property would be forfeited.

Option F – No deductions allowed up to the amount of non-taxed gain with the excess deductible

Interest deductions are forfeited to the extent of any untaxed gain. Deductions in excess of a non-taxable gain can be deducted.

Comment

CA ANZ does not support either Option E or Option F. We agree with paragraph 5.14 that permanently denying deductions could raise a question around fairness and coherence.

Permanently denying interest deductions discriminates against investments in residential rental properties.

In our view there should be a consistent tax treatment for interest costs (that have been denied as a result of the interest limitation) at the point of sale irrespective of whether the gain or loss is taxable under the bright-line test or is non-taxable. If this is not accepted, we favour option F. If the interest costs exceed the capital gain, then the taxpayer has made real losses. We also do not believe there needs to be any anti-arbitrage rules, taxpayers will not incur considerable sale costs for the potential (as the sale price will not be known) for income tax deductions.

Consideration needs to be given to how denied interest will be allocated to the property sale where multiple properties are held.

We note the private limitation will prevent taxpayers from obtaining an interest deduction at the point of sale if the property has been used for private purposes.

Questions

Rollover relief		
Interest limitation	Which option for the treatment of interest on sales of revenue account property best balances housing market incentives, efficient and fair taxation, and protection of the tax base against arbitrage risk?	Option B. All interest that has been denied under the interest limitation rule should be deductible at the point of sale.
Intention of resale	Should the bright-line anti-arbitrage provision be extended to sales taxable under s CB 6 (purchased with the intention of resale)?	No.
Capital account property	Should some interest deductions be allowed when property is sold on capital account?	Yes. All interest that has been subject to the interest limitation rule should be deductible at the point of sale. Refer above.
Anti-arbitrage provisions	How could anti-arbitrage provisions be incorporated? Do you have any preferences between amending the bright-line anti-arbitrage rule to incorporate interest, or the residential rental loss ringfencing rules to incorporate a revenue account loss? Do you have another approach to suggest?	We do not believe anti-arbitrage provisions are necessary. Refer above.

Chapter 6 – development and related activities

Overview/summary

CA ANZ supports an exemption for interest on debt used to acquire property/fund development with respect to new builds for residential investment. We favour one exemption for development and purchase of constructed new builds to eliminate boundary issues around timing and complexity

Government decision on a development exemption

The Government has agreed in principle that property developers should be provided with an exemption from the interest limitation rules.

Government decision on a development exemption for non-property developers (e.g. building to rent) is unclear and will cause a number of boundary issues.

Proposals

Design of the exemption

It is proposed that the exemption should be wide enough in scope to cover development activity which may result in the construction of a new build (as to be more widely defined for the purposes of the bright-line and interest limitation rules).

Intended that the exemption will apply where the development meets the exemption requirements regardless of whether the person holds their property on revenue account. Ability to obtain an interest deduction would still however be subject to the interest limitation.

The development exemption is to apply on a property rather than a taxpayer basis. This will allow for one-off developments to additionally be eligible for the exemption.

Comment

We agree that the development exemption should be sufficiently wide to allow for one-off developments as well as for developments undertaken by parties in the business of property development. It is also important that the exemption reflect the extent of activities which will more widely be considered to constitute development for the purposes of these rules.

That said introducing new concepts or moving beyond currently well understood activities constituting development for the land tax rules more generally will add complexity and create the potential for confusion. The intention to include the separate activity of erecting buildings within development solely for these rules is a case in point.

The requirement to apply a development exemption for the life of the development and then to switch to the new build exemption seems an overly complex solution.

We support the proposal to apply the development exemption on a property rather than a taxpayer basis.

Developments to which exemption would apply

It is anticipated that most people who develop residential property will hold that property on revenue account under section CB 7 by virtue of being in the business of dealing in land, subdividing or developing land, or erecting buildings.

The document proposes that residential investment property held on revenue account under section CB 7 should qualify for the development exemption., creating a safe harbour for debt. It also queries however whether land dealers caught under section CB 7 should be excluded from the proposed safe harbour.

Intended that the development exemption will also apply for:

- One-off developments by people not in the business of developing land; or
- Development activity on land not caught by section CB 7 (for example where the land was not acquired for the purpose of a development business); and
- That development creates one or more new builds on the land.

Comment

Land dealers caught under section CB 7 solely by virtue of their property dealing activities should be excluded from the proposed safe harbour. In their capacity as dealers they will not be undertaking wider development work for the purposes of creating a new build.

s9(2)(a)

We query the value in creating a safe harbour based around section CB 7 when: it is necessary to carve out persons in the business of dealing; other land taxing provisions will also be applicable in defined circumstances; and the development exemption is also intended to be available where the development is not in the nature of a business.

A simpler approach for a safe harbour may be to link to revenue account property given that any interest deduction will still be subject to the private limitation.

The development exemption would then need to deal with relevant development where the land is held on capital account and/or retained. It would need to include the erection of new builds where the land is held for residential investment (i.e. land owner builds to rent and there is no disposal).

Remediation

Remediation in the form of structural improvements extends the life of housing and adds to housing supply in the longer term. One option is to allow the development exemption where remediation work extends the life of a building or makes it habitable. Remediation would also include the conversion of a building from non-residential to residential.

Any exemption for remediation work would only be available for interest on debt to fund costs that will be capitalised.

Comment

In our view interest on debt funding of material remediation work should be covered by the development exemption. We would also caution against unduly limiting the scope of this exemption by referencing specific activities such as earthquake strengthening or weather tightness remediation. Material remediation work may be required to make a property habitable following a significant natural disaster event.

Timing

It is proposed that the development exemption would apply while the property is being developed up to the earlier of when the property is sold (settlement date) or the code of compliance certificate (CCC) for a new build is issued.

The Developer may qualify for the new build exemption from the time the CCC is issued until the property is sold (where the property is held pending sale or for rental).

Where there is building remediation and no CCC is issued, the development exemption would apply until the remediation work is complete.

Comment

Our preference as stated at the outset of the chapter is for a single exemption to keep compliance simple. It is therefore important that the transition between the development and new build exemptions is clear and obvious and makes practical commercial sense.

Limiting the application period for the development exemption to the earlier of settlement date or CCC issuance will force developers to apply two separate exemption provisions. Is an earlier of requirement necessary?

Where property is acquired with an intention to develop, we support the proposal that the development exemption apply from the time the property was acquired. Where an intention to develop is subsequently formed, the exemption should be available from when the funding was required to commence the activity. Funding facilities will often need to be put in place before substantial work can commence.

Amount of interest qualifying for development exemption

Where property is acquired for a land business and developed it is proposed that the exemption should apply for interest related to the acquisition cost.

Where property is not acquired for a land business but an intent to develop the land arises later, the exemption will apply to interest on debt to fund the development activity. The exemption will also apply to interest on the debt used to acquire the property from the time the development activity started.

Comment

This treatment is appropriate and reasonable.

Questions

Chapter 6 questions	
Are there other types of developments or activity which should be covered under this exemption?	Refer above.

Chapter 6 questions	
Should land dealers (who are included under section CB 7) be carved out from the proposed section CB 7 safe harbour?	Yes (refer above).
Do you agree with the proposed criteria for the development exemption to apply?	Broadly agree with criteria but have issue with safe harbour being developed around/limited to CB 7.
Should remediation work be included? If so, what types of remediation work should be included? If some remediation work is included, how would this relate to the new build exemption? How does partially including remediation work impact heritage buildings?	Yes, material remediation work required to make a property habitable or extend its life. Adds to housing stock (even if long term view). New build exemption should apply where undertaken for residential investment (including where heritage buildings converted to residential).
When should interest begin to be deductible when property is not acquired for the purpose of development, but that intention is formed later?	At the time the development activity commences. This is a trade-off – but easier to objectively determine.
What is the amount of interest on debt that should qualify for the exemption when property was not acquired for the purpose of development, but development activity commenced some time later?	Both the interest on debt to fund the acquisition and to fund the development should qualify (the former from the time the development activity commenced).

Chapter 7 - Definition of new build

Overview/summary

The definition of 'new build' should not be solely prescriptive and should include a statement of principle.

Renovating an uninhabitable dwelling so that it becomes habitable should be *included in the definition of 'new build'.*

Proposals

The key objective of the rules for 'new builds' is to help increase the residential housing supply. Broadly, if a property qualifies as a 'new build' it will be subject to a five-year bright-line test ("new build bright-line test") and will be exempt from the proposed interest limitation rules[7].

'The discussion document proposes to define a 'new build' by establishing three categories:

- Simple new builds – adding one or more self-contained dwellings to bare residential land (e.g. adding a dwelling to bare land; or replacing an existing dwelling with one or more dwellings);
- Complex new builds – adding one or more self-contained dwellings to residential land that already has an existing dwelling on it, without separate title being issued for the new build portion of the land (e.g. adding a

[7] This concession broadly applies to new builds for residential investment purposes. The private limitation would deny an interest deduction for borrowings to purchase a private home.

standalone dwelling without changing the existing dwelling; attaching a new dwelling to an existing dwelling; splitting an existing dwelling into multiple dwellings); and

- Commercial to residential conversions – changing commercial buildings into self-contained dwellings (e.g. converting an office building into apartments).

The discussion document acknowledges that, in principle, renovating an uninhabitable dwelling so that it becomes habitable seems similar to replacing an existing dwelling with a new dwelling. However, on the basis that it would be difficult to differentiate between this and other renovations, it is proposed to exclude these properties from the definition of 'new build'.

Definition of 'new build'

The proposed categories of 'new build' appear reasonable. However, it is not clear from the discussion document whether the definition will be strictly prescriptive (as stated in the discussion document) or whether it will include a broad statement of principle. We recommend the latter be added to provide flexibility in the legislation so that it can respond to building industry trends and practices, and societal changes as they evolve/happen.

Renovation of uninhabitable dwelling

We do not accept the proposal to exclude from the definition of 'new build' the renovation of an uninhabitable dwelling so that it becomes habitable. Allowing this activity to be included would further the underlying objective of the proposals – to increase residential housing supply.

In our view, the reason put forward to exclude the renovation of an uninhabitable dwelling to be habitable from the definition of 'new build' does not justify the outcome. The discussion document is silent on the extent of analysis carried out and/or data reviewed in concluding that it would be too difficult to differentiate between renovating to make an uninhabitable dwelling habitable and other renovations. We recommend further work be carried out, including consulting with relevant experts/councils/professional bodies in the building industry.

Something that could be investigated is the possibility of adopting the process applied in the event of disaster (e.g. flood, earthquake, tornado) where a building/residential property is deemed unsafe to live in. Obtaining one of these assessments before the work begins could be a simple/cost effective way of verifying that the residential property was uninhabitable. We suggest officials consult with local Councils, the Ministry of Business, Innovation and Employment, and the Earthquake Commission in this regard.

Also, depending on the extent of the work, a code compliance certificate or some other form of approval/certification may be required before people can move into the property. This requirement should be sufficient to support the view that a completely uninhabitable dwelling has been improved significantly such that it has added to housing supply; and therefore, falls within the definition of 'new build'.

Limiting the definition to exclude substantial work on what may be an uninhabitable dwelling will provide an incentive to demolish to obtain a better tax outcome. This would have unintended consequences for heritage buildings.

Questions

Chapter 7 questions		
Definition of 'new build'	What do you think of the proposed definition of new build?	Appears reasonable
Papakāinga housing and heritage buildings	Are there any issues that you think the Government should consider in relation to the definition of new build and papakāinga housing, or heritage buildings?	Excluding from the definition of 'new build' work carried out to make an uninhabitable property habitable would risk incentivising demolition of heritage buildings
Uninhabitable dwelling improved	Is there some tool that could be used to identify when a dwelling that is completely uninhabitable has been improved significantly, such that it has added to housing supply?	Health and safety assessments following disaster/adverse event. Issue of a CCC

Chapter 8 - New build exemption from interest limitation

Overview/summary

CAANZ prefers the second option – the new build exemption would apply to an early owner in perpetuity (effectively being until the date they sold the property) and a fixed period would apply for subsequent purchasers.

The new build exemption should have a fixed period such that there is a clear end date.

CAANZ supports the proposal to apply apportionment rules on the basis of existing principles in relation to the new build exemption where there is a new build and a non-new build on the same title.

CAANZ does not support the inclusion of the continued investment rule in the new build exemption as it would make the exemption too complex, would be very difficult to comply with and challenging for Inland Revenue to monitor and enforce.

Proposals

It is proposed that interest on funds borrowed relating to a new build (as defined) for residential investment will be exempt from the proposed interest limitation rule (the new build exemption). This will include interest on borrowings to acquire residential land that a new build is on, to construct a new build, or to fund other expenses relating to a new build (e.g. maintenance, rates, insurance). The new build exemption will not allow interest deductions that are not available under the current law (e.g. interest on funds borrowed to build a new home for the taxpayer to live in will continue to non-deductible because of the private limitation).

The underlying rationale of the new build exemption is to incentivise continued investment in new housing.

Apportionment

For complex new builds (i.e. where one or more self-contained dwellings is added to residential land that already has an existing dwelling on it, without separate title being issued for the new build portion of the land), it is proposed that apportionment of the interest will be required. Only the interest in relation to the new build will be deductible under the new build exemption. Apportionment would follow existing principles. Alternatively, a predominant test could apply. Under this approach if more land area is covered by a new build than a non-new build, the new build exemption would apply to allow deductions for any interest relating to the land.

Principal rule

The discussion document puts forward a general rule and a transitional rule. Both centre around the application date of the Government's announcement of the bright-line and interest deduction changes (27 March 2021), and when a CCC is issued.

- General rule – broadly, only a new build with a CCC issued on or after 27 March 2021 will qualify for the new build exemption.
- Transitional rule – a new build with a CCC issued before 27 March 2021 will qualify for the new build exemption if the new build is acquired on or after 27 March 2021 and no later than 12 months after its CCC is received.

Definitions and application

The questions of who (e.g. 'early owner', subsequent purchaser(s)) and for how long the new build exemption would apply is also considered in the discussion document. In this part reference is made to an 'early owner', being a person who:

- acquires a new build off the plans (before a CCC is issued for the new build);
- acquires an already constructed new build no later than 12 months after the new build's CCC is issued;
- adds a new build to bare land;
- adds a complex new build to land; or
- completes a commercial-residential conversion.

For an early owner, it is proposed that interest will be deductible from, depending on the circumstances/type of new build, either the date of acquisition of the new build or from the date a CCC is issued for the new build (refer to Table 3 of the discussion document). When the new build exemption will expire for an early owner has not been decided.

A 'subsequent purchaser' will generally be defined as a person who acquires a new build more than 12 months after a CCC for a new build is issued. It is proposed that interest will be deductible for a subsequent purchaser from the date of acquisition of the land with the new build on it. If allowed, the new build exemption for a subsequent purchaser will be available for a fixed period – the length of which is yet to be decided. Furthermore, the exemption for a subsequent purchaser will not apply to a new build that received its CCC before 27 March 2021.

Options

Three specific options for the new build exemption are highlighted in the discussion document:

- In perpetuity for early owners – the new build exemption would apply for the entire time an early owner retains their interest in the land. Subsequent purchasers would not be entitled to an interest deduction.

- In perpetuity for early owners and a fixed period for subsequent purchasers – the new build exemption period would start from the date the CCC is issued and would not reset when the land is sold. The early owner would be allowed interest deductions for the whole of the period that they own the new build. If the early owner sold the new build within the exemption period, subsequent purchasers would be able to deduct interest they incur in relation to their purchase of the new build for the remainder of the exemption period, if any. If the early owner sold the new build after the exemption period has ended, no deductions would be available to subsequent purchasers. There would be no limit to the number of subsequent purchasers a property could have within the fixed period.

- For a fixed period for both early owners and subsequent purchasers – the new build exemption period would start from the date the CCC is issued and would have a fixed time limit that applies to both the early owner and subsequent purchasers.

Impact of use as a main home (continued investment rule)

The discussion document considers whether a property should cease to qualify for the new build exemption once it has been lived in by an owner-occupier (this is referred to as the continued investment rule).

Under the continued investment rule, if an early owner of a new build:

- Lives in the new build – the new build exemption will never apply.
- Uses the new build as an investment property initially for a period and then moves into it – no exemption would be available for subsequent purchasers.
- Uses the new build as an investment property and then sells the new build to a subsequent purchaser who lives in it – the new build exemption will be unavailable once the purchaser starts to live in it, even if the purchaser later sells the property to an investor.

Who the new build exemption should apply to and for how long

Of the three options put forward in the discussion document, CAANZ prefers the second. Under this proposal the new build exemption would apply to an early owner in perpetuity and a fixed period (from the issue of the CCC) would apply for subsequent purchasers.

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To clarify, the reference to 'in perpetuity' means that for an early owner the new build exemption would apply until the date they sold the property .In our view option 2 is the simplest option as the early owner is not required to take any further action /keep track of the period of time the property has been held in order to ensure an on-going interest deduction.

We are aware that some are of the view that the simplest option suggested in the discussion document is the third. Under this proposal the new build exemption would apply for a fixed period for both early owners and subsequent purchasers. We would also support this option.

Practically under both options the early owner will likely be entitled to the new build exemption for as long as they own the property given average length of property holdings and likely interest deduction period).

For certainty it is critical that the new build exemption have a fixed period such that there is a clear end date. When setting how long that fixed period should be (e.g. 10 years, 20 years, 25 years from the issue of the CCC) it would be appropriate for it to be based on relevant data such as the average length of a mortgage. The period should reflect what is occurring in the market. An additional factor to consider would be possibility of lock-in if the period was 'long' and the effect that would have on the objective to increase housing supply.

Based on discussions that we have been a party to it would appear that 20 years would be a minimum starting point.

New build and non-new build (apportionment)

CAANZ supports the proposal to apply apportionment rules on the basis of existing principles in relation to the new build exemption where there is a new build and a non-new build on the same title.

An apportionment rule in this case would, in most cases, be fair and reasonable and provide certainty for taxpayers.

We also suggest including an optional de minimis approach. The taxpayer could choose to adopt the de minimis approach where a new build is constructed on land that is on the same title as a non-new build and the land pertaining to the non-new build is less than, say, 50% (or other acceptable threshold) of the total area. In this situation, apportionment would not be required to determine the amount of interest that would qualify for the new build exemption. All the interest would be deductible. This option would be simple and reduce compliance costs.

Continued investment rule

CAANZ does not support the inclusion of the continued investment rule in the new build exemption. Including this rule would make the exemption too complex.

As stated in the discussion document if the continued investment rule were to be incorporated it would require a subsequent purchaser to ascertain whether the property had ever been owner-occupied. This would likely be an onerous exercise and may give rise to uncertainty regarding warranties between the vendor and purchaser. This is particularly fraught where there have been multiple sales and the actions of an earlier vendor are at issue.

Obtaining the required proof and validation of owner-occupation may also be difficult and impracticable. For example, what would happen if the vendor did not disclose that they had lived in the property? How would the purchaser confirm or independently verify the vendor's assertions/actions? What if the period of owner occupation was 'short' or temporary (for example, to carry out repairs and maintenance in between tenancies)? Furthermore, it would be inequitable if a purchaser is denied the new build exemption should it later be discovered that contrary to representations made at the time of sale a previous owner had occupied the property.

The continued investment rule may also inadvertently encourage demolition of property (including heritage buildings) and discourage the continued development of existing property. For example, it would not be uncommon for an existing property to have been occupied by the owner at some point before or during its development. It would be in line with the policy objectives of the proposals to allow an interest deduction where the owner re-fits an existing house rather than demolish and rebuild, as the outcome would be the same.

Not only would the continued investment rule be difficult to comply with, but it would also be challenging for Inland Revenue to monitor and enforce.

Questions

Chapter 8 questions		
Who new build exemption should apply to	Should the new build exemption apply only to early owners, or to	Early owners and subsequent purchasers

Chapter 8 questions		
	both early owners and subsequent purchasers?	
Application period	What application period for the exemption do you think best achieves the objective of incentivising (or not disincentivising) continued investment in new housing? The options are: in perpetuity for an early owner only; in perpetuity for an early owner and for a fixed period for subsequent purchasers; or for a fixed period for both the early owner and subsequent purchasers.	In perpetuity for early owners and a fixed period for subsequent purchasers
Apportionment	How should the new build exemption from the interest limitation rule apply where interest relates to both a new build and a non-new build? Do you	Support an apportionment approach but should also allow for the optional use of a de minimis

Chapter 8 questions		
	agree with the proposed approach (which would require apportionment rules to be applied, or do you prefer an alternative approach (such as requiring separate title or applying a predominant test; ref paragraphs 8.27 to 8.29)?	
Proof of eligibility	Do you have any suggestions for simple ways to prove that a person qualifies for the new build exemption, or ways that Inland Revenue could use existing data to check eligibility?	Sale and purchase agreement; deposited plans; CCCs; resource/building consents
Relying on CCCs	What issues might result from relying on CCCs to verify that a person (and their land) is eligible for the new build exemption? Are there particular integrity issues the	In some situations, a CCC may not be issued or there may be a delay with it being issued. Alternative verification

Chapter 8 questions		
	Government needs to consider?	methods should also be allowed
Acquiring off the plans	What could be used to verify that a person who acquires a property off the plans is eligible for the new build exemption, if that person wants to deduct interest before a CCC is issued?	Signed sale and purchase agreement; copy of deposited plan
Continued investment rule	How practicable is the continued investment rule? Do you think the rule is a good idea (considering the criteria mentioned in paragraph 8.26)?	Rule is impracticable and do not support it

Chapter 9 - Five-year bright-line test for new builds

Overview/summary

The proposals for the new build bright-line test appear consistent with the Government announcement on 23 March 2021.

The proposal that the new build bright-line test have the same settings as the general 10 year bright-line test is sensible.

Limiting the new build bright-line test to apply only to early owners of new builds is sensible.

Applying apportionment rules for complex cases appears reasonable; however, we recommend an optional de minimis rule also be included.

Proposals

It is proposed to introduce a bright-line test for new builds. The key features of the test will be:

- The test will apply to all or part of a piece of residential land that has a 'new build' on it, but only if the land is acquired on or after 27 March 2021.
- The bright-line period will be five years.

- The new build bright-line test will have the same settings as the ten year bright-line test (for example, 'residential land' as defined in section YA 1 of the Income Tax Act 2007, main home exemption, determination of bright-line start and end dates).
- Only an early owner of a new build (as will be defined for the purposes of the new build interest exemption) will be able to qualify for the new build bright-line test.
- In order to apply the new build bright-line test, a CCC for the new build must have been issued by the time the land is sold by the early owner.

The proposed new build bright-line test could potentially apply to all residential land that has a new build on it, regardless of what the land is used for, unless an exclusion applies (e.g. the main home). This means that the rule could apply to a second home, a holiday home and a vacant home. It could also apply to a residential property that is rented out as short-stay accommodation.

For a complex new build (as will be defined for the purposes of the new build exemption) where a new build is on a piece of residential land that has both a new build and a non-new build dwelling on it the discussion document proposes to require apportionment of the gains on sale.

Key features

The proposals for the new build bright-line test appear consistent with the Government's announcement on 23 March 2021.

The proposed application date to residential land acquired on or after 27 March 2021 also aligns with the announcement.

Settings

It is appropriate that the new build bright-line test have the same settings as the 10 year bright-line test (excluding the length of time for the bright-line period). This would provide consistency and coherence to the bright-line rules.

Who the new build bright-line test applies to

The proposal to limit the new build bright-line test to apply only to early owners of new builds is sensible.

Heritage buildings

As stated in our submission under chapter 7, "Definition of new build", there is an increased risk that heritage buildings would be demolished rather than renovated/repurposed for residential housing. This is because the proposed definition of new build put forward in the discussion document will exclude projects that convert an uninhabitable property into a habitable one. These concerns are also held if land with a heritage building on it is purchased on or after 27 March 2021.

Apportionment

The proposal to apply the apportionment approach for a complex new build where a new build and non-new build are on the same title seems appropriate.

In relation to land purchased on or after 27 March 2021, to avoid encouraging demolition rather than new builds, we suggest including an optional de minimis approach. The taxpayer could choose to adopt the de minimis approach where a new build is constructed on land that is on the same title as a non-new build and the land pertaining to the non-new build is less than, say, 50% (or other acceptable threshold) of the total area. In this situation, apportionment would not be required and both properties would be subject to the new build bright-line test. This option would be simple and reduce compliance costs.

Questions

Chapter 9 questions		
New build bright-line test and heritage buildings	Are there any issues that specifically relate to the new build bright-line test and heritage buildings?	Risk of encouraging demolition rather than refurbishment if the land is purchased on or after 27 March 2021
Complex new build	How should the new build bright-line test apply to complex new builds (where a new build and non-new build are on the same title)? Do you agree with the proposed approach, which would require apportionment rules to be applied, or do you prefer an	Apportionment appropriate but should also consider a de minimis approach

Chapter 9 questions		
	alternative approach (such as applying a predominant test)?	
Entitlement	Are there any simple ways to prove that residential land a person owns qualifies for the new build bright-line test?	Sale and purchase agreement; deposited plans; CCCs; resource/building consents
CCCs as verification	Are there issues with relying on CCCs to verify that a property is eligible for the new build bright-line test? Should special rules apply if a CCC for a new build is not issued until some years after construction finishes?	Consider accepting alternative forms of confirmation of construction/completion of the new build, e.g. certificate of acceptance

Chapter 10 – Rollover relief

Overview/summary

We recommend that consideration be given to a possible carve out from the bright line rules for family related restructures. An alternative approach would be to allow for roll over relief in defined circumstances such as transfers between associated persons.

We consider that an associated person definition that is wider than two degrees of blood relationship is necessary.

CA ANZ believes zero consideration is unrealistic and will be an extremely limiting factor.

Introduction

Should rollover relief be provided where there is largely no change in economic ownership that would otherwise result in the bright-line test applying or interest deductions being denied?

What is rollover relief?

> *In the context of the bright-line test, rollover relief defers the taxing point until there is a subsequent disposal of the property that does not qualify for*

> *rollover relief. .... The recipient is deemed to take on the transferor's original date of acquisition*[8]*.*

Rollover relief in respect of the interest deductibility proposal would involve disregarding transfers or disposals in defined circumstances.

Proposals

Bright-line test

Rollover relief is proposed where residential land is disposed of within the bright-line period for zero consideration. It is proposed that it will apply to a disposal that occurs on or after 1 April 2022. The recipient will be treated as having the same acquisition date and cost base as the transferor.

Comment

The suggestion that rollover relief will only apply where there has been no consideration will mean that a purchaser can never have interest and bright line rollover relief. We do not understand why this limitation is desirable.

Interest limitation

It is also proposed that rollover relief apply to allow the continued deduction of interest expenses during the phase-out period where the economic ownership of

[8] Paragraph 10.11 Discussion Document

the land has not changed. This would apply to land transfers on or after 27 March 2021 where the land was first acquired by the person disposing of it before 27 March 2021.

Relationship property settlements

No changes to the treatment of relationship property settlements under the bright-line test is proposed.

It is proposed rollover relief apply to the continued deduction of interest expenses during the phase-out period where pre-27- March land is transferred under a relationship property settlement.

Transfers on death

No changes to the treatment of transfers of residential land upon the death of an owner under the bright-line test is proposed.

Comment

In our view rollover relief should apply to the continued deduction of interest expenses during the phase-out period where pre-27 March land is transferred upon the death of an owner and the beneficiary assumes responsibility for the debt. We understand it is proposed the availability of rollover relief for transfers on death would be limited to once.

Company amalgamations

No changes to how rollover relief is provided under the resident's restricted amalgamation rules for residential land subject to the bright-line test is proposed.

It is proposed rollover relief for interest limitation would apply to a company amalgamation if the amalgamation qualifies as a resident's restricted amalgamation.

Natural persons who dispose of land to themselves

> *"The Government considers that natural persons transferring land to themselves should not be caught by the bright-line test to the extent that there is no ownership change in economic substance".*[9]

For example, a person who owns land transfers it to joint ownership with another person. There is no ownership change as to 50% of the land.

It is not clear whether a change to the Income Tax Act 2007 is required to achieve this outcome.

If a law change is required rollover relief should also apply for the purposes of the interest limitation rules for land acquired prior to 27 March 2021.

[9] Paragraph 10.49 Discussion Document

Comment

In our view a change from joint tenants to tenants in common is a taxable event. The owners' interest is quite different.

Trusts

It is proposed that full rollover relief apply in relation to settlements or resettlements of residential land on a family trust. A subsequent disposal by the trustee (including a distribution) within the bright-line period may be taxable. For rollover relief to apply three conditions would need to be satisfied:

- every settlor of the land is also a beneficiary;
- at least one of the settlors of the land is a principal settlor of the trust; and
- every beneficiary (excluding the beneficiaries who are also principal settlors) is associated with a principal settlor.

It is also proposed that

- a modified set of association tests be applied to determine whether a beneficiary is associated with a settlor;
- rollover relief apply where land is disposed from one trust to a different trust where the beneficiaries of the two trusts are identical. If beneficiaries are added after the disposal occurs, the land-rich trust avoidance rule would deem a trustee to have disposed of residential land at market value.

Similar to the rollover relief proposals outlined above for the bright-line test it is proposed that these conditions apply for the purposes of rollover relief for the proposed interest limitation rules.

Comment

CA ANZ believes zero consideration is unrealistic and will be an extremely limiting factor. In our experience it is common for intergeneration transfers to require some consideration. For example, property may be distributed to a beneficiary subject to a beneficiary taking over the loan associated with the property or property may be transferred at market value to protect from downstream relationship property claims for current value.

The requirement that every beneficiary be associated with the principal settlor means rollover relief will not be accessible to many trusts who include charities as a class of beneficiary. Many family trusts include entities associated with the natural person beneficiaries.

We consider that an associated person definition that is wider than two degrees of blood relationship is necessary.

Look through companies (LTCs) and partnerships

Where property is transferred between an LTC or partnership and its owners, it is proposed that rollover relief for the bright-line test and the interest limitation test apply, provided the property continues to be owned in the same proportions.

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Comment

We recommend consideration be given to extending rollover relief to a company electing into the LTC regime and vice versa.

Partial rollover relief should apply if property is transferred between an LTC or partnership and its owners and the property is owned in different proportions prior to the disposal.

Maori collectively-owned land

The rollover relief proposals set out above would only apply to Maori authorities that are trustees. A question arises whether the trust proposals may be too narrow considering the way Maori authorities are typically set up and used.

Conclusion

The proposed rollover relief in respect of transfers to associated persons favours trusts as opposed to individuals or other entities. Rollover relief should apply to all transfers to associated persons, including the taxpayer him or herself. In our view as we move towards a "creeping capital gains tax" the case for extensive rollover relief for associated persons becomes more compelling. Should there be any integrity concerns section BG 1 can be used to prevent abuse of the rules.

There are many situations where family arrangements or restructures occur which inadvertently reset or trigger the bright line rules or result in other unintended tax consequences. Some common examples include:

- Parents buy home for children as children cannot borrow the funds from a bank (or parents don't want to lend funds due to matrimonial issues), when the children are in a financial position to take ownership, the home is transferred to the children triggering the bright line (if within the bright line period). Similar examples occur when the children buy a home for the parents;
- Parents help children buy a property. The property may be in the children's name(s) (potentially subject to relationship property claim) or the parents/trust name and later transferred to the children. If in the children's name(s) main home exemption applies, if in the parents/trust name then likely to be transferred to the children at some stage – but can't because of bright line (requirement to wait out bright line period as main home exemption will typically not be available). The parents are precluded from transferring the property at cost (no intention to make a profit) as land is trading stock (section GC 1 transfer required to be at market value);
- The establishment of a new trust for asset protection purposes (with residential property transferred into the trust);
- Trust set up and holiday home transferred in (due to length of time held bright line not triggered). There was an error in the drafting of the terms of trust and the settlor wants to unwind the trust. The transfer out however will give rise to bright line issues. The alternative is to retain the property in an inappropriately structured trust for now up to 10 years;
- Review of trust structures/resettlement of trust property in response to new Trusts Act triggering bright line tax liability;
- Trust owns a house which is the main home of a beneficiary (and settlor either deceased or does not have a main home). The beneficiary lives in it for 12 months then dies. House sits empty for 18 months as children sort out what they want to do, market and sell the house. Old rules – fully taxable as not predominantly (greater than 50%) used as main

home. New rules 60% taxable. Inheritance relief does not apply because of trust ownership.

We recommend that consideration be given to a possible carve out from the bright line rules for family related restructures. An alternative approach would be to allow for roll over relief in defined circumstances such as transfers between associated persons.

We recommend the use of the aggregation rules in the associated person tests i.e. spouses are treated as owning their spouses shares

Rollover relief should extend to wholly owned corporate group transfers, e.g. restructures, where 100% same economic ownership (outside of amalgamations which already have relief or consolidation rules).

Questions

Rollover Relief		
Interest limitation	Should rollover relief from interest limitation be provide for transfers on death?	Yes. Refer above.
New Builds	If rollover relief is provided for properties subject to the new build exemption on death of an owner, does there need to be a time limit on the availability of relief?	There should be a time limit which matches the exemption period.

Trusts		
Conditions	Are the conditions proposed at paragraph 10.57 appropriately targeted at the most common family trust situations? Are there any alternative criteria that you would suggest?	No. Refer above.
Association	What number of degrees of blood relationship should be permissible to determine whether a beneficiary is associated with the principal settlor?	An associated person definition that is wider than 2 degrees is necessary. Refer above.

Chapter 11 – Interposed entities

Overview/summary

CA ANZ view is that the proposed interposed entity rules are necessary. However, the taxpayer does not always have a choice of borrowing entity, so we do not believe the rules should be punitive.

Overall comments

We agree that, if the Government wishes to introduce rules that limit interest deductibility for a type of business or asset, it will need to introduce interposed entity rules.

The Discussion Document notes that the interposed entity rules are primarily aimed at maintaining integrity. They suggest that the taxpayer would have a choice to borrow in the asset-holding entity if they wanted to avoid the complexity of the interposed entity calculations. In our view this is not correct. Lending is often to a shareholder rather than the company itself, particularly in the early stages of a business when it has very few assets and the shareholder is able to borrow personally by using private assets (such as their house) as collateral.

In addition, as we have previously mentioned, some large corporates may also be close companies under the proposed definition. If a shareholder borrows to buy into the company, the interest cost is non-deductible, unless the holding is less than 10%. Again, in situations where a shareholder is borrowing to buy in, the interest cost will be at shareholder, rather than company, level.

We agree that the rules are necessary but do not agree that the taxpayer always has a choice of borrowing entity. Therefore, we do not agree that the rules should be punitive in nature.

Proposed interposed entity rules

The Discussion Document proposes two sets of rules: one that applies to close companies and trusts and a different rule for other entities. For close companies and trusts, the rules would apply to ownership interests above 10% and for other entities the relevant percentage is 50%

The reasons for the difference are well explained but the actual percentages arrived at seem arbitrary and it is not clear how each was determined.

Affected assets percentage

We agree that an asset percentage is more appropriate than a turnover percentage. An asset ratio can also be made easy to calculate and thus reduce compliance costs.

The largest compliance cost in calculating an affected assets percentage is valuation. Therefore, the valuation rules must be simple and straightforward. The taxpayer should not be required to commission a valuation every year. Taxpayers should be able to rely on the council valuation.

Most SMEs will use tax book values for accounting purposes, so this would also be simple to comply with. There may be issues where accounting valuations are used, and revaluations are in place. If there is more than one valuation basis, the rules will need to include a provision to specify when the taxpayer is allowed to change basis.

Close companies and trusts

There may be some large corporates who are close companies, under the current definition, including land developers. This rule would mean that if a shareholder borrows to buy into that company, the interest cost is non-deductible.

One issues that seems unclear is the extent to which an LTC may be treated as transparent. Paragraph 11.23 states that "The transparent nature of LTCs and partnerships in effect requires a full tracing approach…" We are not sure that this is correct. The interposed entity rules in the loss ring-fencing regime extend to LTCs and partnerships (albeit on a modified basis). The debt remission rules likewise require an owner to take into account debt forgiven to an LTC. This issue needs further consideration.

Apportionment calculation

We agree with the statement in the Discussion Document that most rental properties are held as long-term investments. Therefore, we believe that the most appropriate calculation period would be annually (as the least frequent option available).

It is possible that an anti-avoidance mechanism may be needed, such as the "quick sale" rule in the FDR rules. This could be applied when a property is both bought and sold within the year. Officials should gather more evidence regarding the need for this.

Other residential interposed entities

This section discusses widely-held companies whose affected assets exceed 50% at any point during an income year, regardless of the taxpayer's interest in that company. The Discussion Document proposes that all borrowing to invest in an entity of this nature be treated as borrowing to acquire affected assets and that interest deductions be limited.

This seems arbitrary and could lead to some strange outcomes – for example it is possible that Fletcher Building would have an affected asset percentage above 50% and therefore all borrowing to buy Fletcher Building shares would be disallowed. Many widely-held land-rich entities may also be carrying out property development, which the Government would like to encourage. It may also be difficult for a minor shareholder to obtain the information regarding the company's assets.

In addition, it is in our view most unlikely that a shareholder would borrow to invest in a widely-held residential land company to avoid the application of the interest deduction rule. Once the investment is into a widely-held vehicle, there would be too many investment variables for the investment to be comparable with a direct holding in residential land.

We agree that it is simpler than a tracing rule and will be easier to comply with. However, due to the arbitrary nature of the rule, we do not believe it should proceed.

Look-through companies and partnerships

We agree that it is appropriate to have a specific provision to address borrowing to invest into LTCs and partnerships.

However, it is not clear how this would interact with the loss ring fencing rules and we recommend that these should be repealed going forward. This is discussed in the next chapter.

Tax treatment when taxpayer no longer holds interest in interposed entity

Paragraphs 11.26 and 11.27 note that there will be no clawback of previously disallowed deductions. Paragraph 11.27 states that this is on the basis that the rules are aimed at maintaining integrity and taxpayers have a choice of borrowing entity. We disagree with this assertion and believe there are many valid situations where taxpayers will have the borrowing at shareholder level, particularly in the case of start-ups. Overall, we agree with this proposal on the basis of simplicity but, as stated above, the taxpayer does not always have a choice and we do not believe the rules should be punitive.

Interposed entities	
What do you think of the interposed entity rules proposed above?	That they are necessary
In your experience, how common are interposed entities in the residential investment property context?	This is common
What are some of the commercial reasons why, for close companies, taxpayers may prefer to have their borrowing at the shareholder level instead of the entity level?	For start-ups, it is often easier to borrow at shareholder level. For those borrowing to buy into a company, again, the borrowing would be at shareholder level.
Do you prefer to use accounting or tax book values for calculating the affected assets percentage for assets other than land, improvements and depreciable property? Why?	Most SMEs will use tax book values for accounting purposes
What is your preferred frequency for the apportionment calculation for interposed entities that are close companies or trusts - daily, monthly, quarterly, annually?	Annually
Do you agree that the proposed interposed entity rules should not be applied to LTCs or partnerships?	Yes

Interposed entities	
Are there any commercial reasons why a taxpayer might borrow funds and on-lend them to an interposed company at a lower interest rate?	Interest deductibility is based on the prospect of earning income. Sometimes income will be linked to profitability.

Chapter 12 - Implications for the rental loss ring-fencing rules

Overview/summary

The underlying policy behind the loss ring-fencing rules was the same as or similar to the current proposals. CA ANZ view is that the loss ring-fencing rules should be repealed either entirely.

Overall comments

Overall, the proposals included in the Discussion Document are too complex for most rental property owners to comply with. This chapter of the Discussion Document and the next demonstrate the complicated nature of both the proposed rules and the existing regimes. Compliance will be difficult or impossible for the average rental property owner. The rules should be simplified significantly before legislation is introduced.

As the loss ring-fencing (RLR) rules will be largely superseded by the interest limitation rules, we believe that the best option would be to discard the RLR rules. As the Discussion Document notes, the existing residential loss ring fencing rules exist to restrict the ability of rental property investors to derive tax benefits from investing in rental properties. In our view, that previous restriction is superseded by the new rules outlined in the Discussion Document. There is no need to have two regimes.

The principal beneficiaries from any repeal of the RLR rules would be those with property outside of New Zealand. The RLR rules apply to property outside of New Zealand, whereas the interest limitation rules would not. This is surprising considering both sets of rules have a similar policy intent. In our view the two regimes should be consistent in any case i.e. if the interest limitation rules do not apply to property overseas then the RLR rules should not either.

The main question that would arise from the repeal of the RLR rules would be the status of any losses that are currently ring fenced. In our view, these should be grandfathered and remain ring fenced until the time of sale (either of the property or the portfolio) but that properties purchased following 27 March 2021 should be subject to the proposed interest limitation rules instead.

As a secondary option, the Government could consider whether it is possible to "turn off" the RLR rules where the interest limitation rules apply and retain the RLR rules for only those taxpayers who are not subject to the interest limitation rules. However, this option would create a policy issue as to whether the RLR rules should be retained for new builds. We assume that the RLR rules should not apply to new builds because Government has concluded that the supply of residential housing will be increased if a taxpayer is allowed an immediate interest deduction for new builds – and, therefore, ring fencing would be contrary to the policy intent.

We have also considered whether it would be preferable to repeal the MUA rules instead of, or as well as, the RLR rules. Overall, those rules serve a different purpose – being, in the context of housing, to prevent holders of rental properties from being tax advantaged by being able to claim deductions for the portion of time when an asset was unused. While MUAs may be substitutable for residential housing, they are by definition not currently used as long-term residential housing. If the MUA rules were to be abolished, property investors could be incentivised to provide short term accommodation over long term accommodation in order to take advantage of additional deductibility of non-interest costs. Therefore, on balance, we believe the MUA rules should be retained in conjunction with the interest limitation rules. However, the interaction between the two regimes must be made as simple as possible.

Notwithstanding the above, we have made comment on some of the specific points raised in the Discussion Document. These are below.

General interface issues

We agree that the interest limitation rules should apply first to determine whether interest is deductible, then the RLR rules should apply. (Paragraphs 12.14 and 12.15)

Portfolio approach vs a property-by-property approach

The interest limitation rule should apply only on a property-by-property basis, regardless of whether the taxpayer has elected to apply the portfolio basis for the purposes of the RLR rules. Anything else would be too complex.

Exemptions

If the RLR rules are to be retained in their current form, it is not logical to say that they should not apply if one of the exemptions for interest limitation applies. Either the two regimes are to apply together, or they are not.

Development exemption

The development exemption proposed in the Discussion Document is different from the development exemption in the RLR rules. The exemption in the RLR rules requires that the property be held on revenue account, whereas the exemption in the interest limitation rules could still apply to property held on capital account.

From a wider policy perspective, it would not make sense to align the two exemptions. If the RLR rules were to continue, the exemption should apply only to those properties held on revenue account. This is because the RLR rules were introduced to match any losses against any gains made on the property. If the property is on capital account, the timing and nature of any gains are uncertain. Therefore, the development exemption should be limited to property held on revenue account. However, for the purpose of the interest deduction rules, the development exemption should be drafted widely in order to encourage property development.

We acknowledge that having two development exemptions brings significant complexity. We have considered whether it may be preferable to streamline the exemptions to reduce compliance costs, despite it not being good policy. We believe the better solution would be to get rid of the RLR rules altogether, as above.

New build exemption

The question of whether the RLR rules should include a new build exemption will depend on how widely the Government wishes to encourage new builds. This is a political decision rather than a question of tax policy.

Implications for the rental loss ring-fencing rules		
Alignment	How should the interest limitation rules be aligned with the loss ring-fencing rules?	The RLR rules should be repealed
Ordering	Is the proposed approach of applying the interest limitation rules to establish deductible expenditure and then applying the RLR rules to this deductible expenditure an effective means of addressing this?	Yes, it is an effective method, but not the best method (see above)
Integration	How should we integrate interest limitation, ring-fencing, and bright-line anti-arbitrage rules?	As a first step, the RLR rules should be repealed

Chapter 13 - Interest limitation and mixed-use residential property

Overview/summary

CA ANZ view is that the MUA rules should be retained and the current tracing rules should continue to apply.

Overall comments

There is less overlap between the MUA rules and the proposed changes than there is between the RLR rules and the proposed changes – both in terms of the subject matter of the rules and in terms of the policy intent.

If the MUA rules are retained, the interest rules in the MUA regime will be of most concern. These may need major rework to enable the two regimes to work together. We would be happy to discuss this further with officials.

In theory, as with the RLR rules, the interest limitation rules should apply before the MUA rules. If the interest is not deductible, then there will be no need to apportion under the MUA rules. However, we agree that the overlap between the two sets of tracing rules means this pure approach will not work in practice. Our views are discussed below.

Proposals

Determining what interest relates to mixed-use residential property

We agree with the proposed ordering rule for property that is a MUA held by a person that is not a close company (paragraphs 13.9-13.11). In essence, the rule would require the interest limitation rules to apply first and then the MUA rules.

We agree that it would not make sense to apply the tracing rules to residential property that is a MUA held by a close company (paragraph 13.12). There is already a rule for this in current section DG 11.

Where a close company is holding a MUA and a non-MUA residential property, allocation on a pro-rata basis may be the most simple method.

You have asked how likely it is that a company would hold both MUA and non-MUA residential property. Whilst it is reasonably common for non-corporate taxpayers to hold MUA and non-MUA residential property, it would be less common for these to be held in a corporate structure. Use of a corporate structure is typically limited to situations where the taxpayer's commercial drivers offer no alternative.

Where residential property is a MUA owned by a close company, we agree that it would be sensible to apply sections DG 12 to DG 14 rather than the proposed interposed entity rules (paragraph 13.19)

Questions

Mixed-use assets	
How commonly are residential property MUAs held in close companies?	We understand that this is not common
How commonly are residential property and other MUAs held in the same close company?	We understand that this is not common

Chapter 14 – Administration

Overview/summary

Further work should be undertaken to determine how to maximise the functions in START as a means of providing and keeping record of information on interest denied and new builds electronically.

Current forms (e.g. IR3R and IR833) could be modified to gather the information required regarding interest denied and new builds.

Information could be provided by a third party (e.g. local Council).

Proposals

Inland Revenue is considering adding new fields to income tax return forms for total interest incurred in relation to land used for income-earning purposes and the amount of the interest that has been deducted.

With respect to new builds, Inland Revenue is working on whether any additional information will be required from taxpayers who apply the new build exemption from the interest limitation rules or the new build bright-line test. If additional information is sought it could be requested in the tax return or by some other means.

No specific record keeping requirements are proposed for the interest limitation rules.

Information gathering

While we understand the rationale to gather information on the interest incurred and deducted in relation to land used for income-earning purposes, it is not clear how this would inform Government about the effectiveness of the changes and whether they are appropriately targeted. Furthermore, this information would not assist with determining whether or not the changes are having the desired effect on residential property prices, housing supply and the effects on first home buyers. The deductibility of interest is likely to be one of a multiple number of factors that affects residential property prices.

Notwithstanding, the above it would be appropriate to track the amount of interest denied under the proposed interest limitation rule. Efficiency would be enhanced if the interest information could be filed electronically in START and a memorandum account created in the taxpayer's myIR account. The memorandum account created should be statute barred so that taxpayers have certainty regarding the length of time that it would be open to the Commissioner to review the interest information provided. It would not be appropriate for the Commissioner to be able to look back, say, 10 or 20 years and challenge the information/interest deducted. Alternatively, the IR3R form could be modified and made compulsory or, as suggested in the discussion document, more boxes could be added to the tax return form.

With respect to the new build exemption and the new build bright-line test, Inland Revenue already has access to property information from third parties such as LINZ. This information would assist with monitoring compliance.

If a taxpayer sells residential land that is subject to the bright-line test, the taxpayer is required to complete and file Form IR833, Bright-line residential property sale information. As an alternative to adding boxes to the tax return, this form could be modified for the new rules in relation to new builds.

We recommend officials investigate further the data analytics and other functions in START that could be used in conjunction with the Commissioner's information gathering powers to monitor/enforce compliance. Officials should also consult with the assurance and property compliance teams in this regard. This would minimise compliance and administration costs, and maximise the benefits delivered under Business Transformation.

Another aspect that could be investigated is whether a copy of the CCC or other building certification could be lodged electronically with Inland Revenue by the local Council when it is issued to verify that a property is a new build.

Record keeping

We support the proposal not to introduce specific record-keeping rules regarding the new interest limitation rules. However, we recommend that Inland Revenue remind taxpayers of the record keeping requirements under section 22 of the Tax Administration Act 1994 and how the seven-year period may be affected by the 10 year bright-line period and the length of time of the new build interest exemption.

It would also be helpful if Inland Revenue published guidance on the records that the Commissioner expects the taxpayer to retain in relation to the 10 year bright-line period, interest limitation rule, new build exemption and new build bright-line test (e.g. copy of the sale and purchase agreement, copy of the title, copy of the deposited plan, copy of the resource/building consent, copy of the CCC, bank statements in relation to the loan). This guidance could also help inform subsequent purchasers of the information they could use to confirm their eligibility for the new build exemption.

Additional record keeping requirements have also been imposed on taxpayers with the legislative amendments to the bright-line rules enacted in March 2021. Under these amendments taxpayers (home owners and investment property owners) will be required to keep records of capital improvements made to their residential properties for the bright-line period (five or 10 years). Records of capital improvements will also be required in relation to a new build. Furthermore, if a taxpayer expects that their property will not be used as their main home for a continuous period exceeding more than 365 days within the bright-line period, they will need to keep records of the relevant dates when this occurs. Inland Revenue should also publish guidance on these aspects of record keeping.

Questions

Adding new fields to tax return	Are there any issues with adding new fields to income tax return forms for total interest incurred in relation to land used for income-earning purposes and the amount of	Could amend current forms IR3R and IR833; IR could create statute barred memorandum account in myIR

	this interest that has been deducted?	
Records for new build	What records should taxpayers have to provide or keep in order to show that they are eligible for the new build rules?	Copies of sale and purchase agreement, deposited plan, CCC/certificate of acceptance
CCCs as verification	Are there issues with relying on CCCs to determine whether a property is a new build? Are there integrity issues the Government needs to consider?	A CCC may not be the only documentation available, e.g. a certificate of acceptance may be issued before a CCC
Alternative to CCCs	If there are problems with relying on CCCs, what else could be used to verify that a property is a new build?	Certificate of acceptance or other form of verification/confirmation; resource/building consent

Subsequent purchasers	What information could subsequent purchasers use to determine that a property they have acquired is eligible for the exemption for new builds from the proposed interest limitation rules?	Copy of CCC/certificate of acceptance, deposited plan, resource/building consent.

From: s9(2)(a)
To: Policy Webmaster
Subject: Design of the interest limitation rule and additional bright-line rules
Date: Monday, 12 July 2021 4:42:17 PM
Attachments: Westpac Economics taxation of residential property.pdf

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Good afternoon – please see our submission attached.

Regards,

s9(2)(a)

s9(2)(a)

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Classification: PROTECTED

Submission on changes to taxation of residential property

Westpac Economics
12 July 2021

Contact:
s9(2)(a) [redacted]

Thank you for the opportunity to comment on the proposed changes to the taxation of residential property. Our submission focuses on three high-level recommendations:

- The interest deductibility exemption for new builds should be applied for a fixed period after the CCC is issued, for both early owners and subsequent purchasers. Granting an exemption in perpetuity for early owners could encourage them to hold back new homes from the market in order to maximise the tax benefits.
- The definition of new builds for exemption purposes should be limited to high-quality housing solutions. Policy needs to be robust to future circumstances, and with housing shortages likely to narrow over the coming years, there are some housing options that we may not want to be encouraging in the future.
- The bright-line test should be removed altogether. This was a compromise measure that has effectively been superseded by the interest deductibility changes. Removing the bright-line test would simplify the administration of the tax rules, and further reduce the risk that homes are held back from the market for tax purposes.

These are covered in more detail below.

1. Fixed period for interest deductibility on new builds

Ideally, the value of the interest deductibility exemption should accrue to the investor that enables the new build. In practice this is what will likely happen – even if the early owner sells to another investor within the exemption period, the price that they receive will reflect the value of the remaining exemption.

However, there may be undesirable consequences if the length of the exemption differs between early owners and subsequent purchasers. If the exemption is limited to just the early owner, or is made perpetual for them, then the early owner will always value a property more highly than any potential buyer. This would create an incentive for the early owner to hold on to the property for as long as possible to maximise the tax benefits, which would restrict the supply of new homes to the market and reduce homebuyers' options.

A more neutral approach would allow interest deductibility for a fixed period after the new build is completed. This would leave early owners indifferent between holding or selling within the exemption period, and would avoid unnecessarily restricting the supply of newly-built homes to the market.

2. Narrow definition of new builds

The discussion document proposes a range of examples that could qualify as 'new builds' for interest deductibility purposes. The focus here appears to be on encouraging as many 'new' dwellings as possible, in order to address the current shortage of housing. However, policy settings need to be robust to the range of possible future outcomes, not just the current situation.

New Zealand is already building enough houses to meet population growth and erode the housing shortage that had built up over previous years. This fact does not depend on assumptions about the reopening of the border, or the outcomes of the Government's immigration policy reset. Indeed, the pace of homebuilding was already outstripping population growth in 2019, and the number of dwellings being consented has risen further since then.

We estimate that on current trends, Auckland could effectively eliminate its housing shortage in as little as three years, although the rest of the country will take longer. Nonetheless, the point remains that the current rate of homebuilding is not sustainable over the long term – at some point in the future there will be a scaling back of building activity, or the risk of an oversupply.

This means that in future years, we will need to be careful about encouraging investors to provide low-quality housing solutions, where they are cheaper than high-quality ones. For this reason, we suggest that the exemption should not be applied when:

- Splitting an existing dwelling into multiple dwellings.
- Adding a new dwelling to an existing site without separate title being issued (alternatively, there may need to be a minimum size requirement).
- Renovation of a previously uninhabitable dwelling. While it can be argued that this increases the effective housing stock, it is difficult to determine whether the dwelling was truly uninhabitable (and may create an incentive to allow properties to fall into disrepair in order to qualify for the exemption). In addition, renovating the existing property rather than removing it will, in many cases, be a missed opportunity for densification.

In principle, it would be preferable to limit the exemption only to situations where there has clearly been a net increase in the housing stock. However, we acknowledge that it may be difficult to determine whether this has happened, as building consents may not contain information about what was on the land previously. (Another example of this is that the previous dwelling may not have been demolished but relocated.)

3. Removal of bright-line test

The Government has sought views on whether interest deductibility should be allowed if a property is sold within the bright-line test period, correctly noting that denying deductibility would mean that investment properties would be over-taxed relative to other forms of investment. If the Government wishes to avoid over-taxation, we propose that it should take a step further and eliminate the bright-line test altogether.

Our modelling of house prices suggests that removing interest deductibility has a broadly similar impact to a capital gains tax at the top income tax rate, in terms of investors' willingness to pay (if not in terms of cashflows). This means that if the Government allows interest deductibility within the bright-line period, the impact on the 'investor value' of housing will be similar both before and after the bright-line period. In turn, this suggests that the tax rules could be simplified by removing the bright-line test, and denying deductibility at all times for purchasers of existing properties.

Bear in mind that the bright-line test was introduced as a compromise measure, as a comprehensive capital gains tax was considered to be politically unfeasible. Since removing interest deductibility is broadly equivalent to a capital gains tax, it renders the bright-line test redundant.

The five-year test for new builds should also be removed. The aim of the bright-line test was to discourage speculative trading that could drive up prices in the existing housing stock. Investments that increased the size of the housing stock were not seen as a problem, and in that respect new builds could justifiably been exempted from the test from the start.

The experience of the bright-line test since 2015 suggests that it does little to dampen investor demand, as they are willing to hold on to properties for several years in order to gain a more favourable tax treatment. Retaining the test means that new builds are likely to be held back from the market for several years, which would not serve any policy purpose.

PUB-0411

From: s9(2)(a)
To: Policy Webmaster
Subject: Design of the interest limitation rule and additional bright- line rules
Date: Monday, 12 July 2021 4:48:01 PM

I disagree with the propose interest limitation rules

- Capital account property holders who are caught with the taxable sale should be able to deduct interest for the whole period of ownership in the year of sale. Date of commencement for new build should be the earliest date possible in the process of developing, and I suggest from date the existing tenant moves out.

- Rollover relief should be included and should be broadened to include LTC elections and all related party transfers, including share transfers. This should also be back dated to 29/3/18

OVERALL – I disagree with the proposed interest limitation rules. It does nothing to help with the supply of housing, and does nothing to achieve one of the governments key housing objectives, which is to ensure “affordable home to call their own”. I believe rents will increase over time as more existing rentals are sold to personal house owners.

CAPITAL ACCOUNT PROPERTY HOLDERS – If a long term hold rental property is sold, and is caught by the brightline rules or other taxing provisions, then interest should be fully deductible in the year of sale. The long term hold investor is already paying a large amount of tax if the sale is taxable, and if interest was not an allowable deduction, tax would then be at an unreasonable level and would severely penalize the property owner. If interest was not deductible for a taxable sale, it could see an owner paying more tax then the gain they made.

DATE OF COMMENCEMENT FOR NEW BUILDS– Interest deductions should be allowed from when the tenant moves out from the old property. This should be the first stage in an older rental property becoming a new build. Or the interest should be allowable from when the older property is demolished.

ROLLOVER RELIEF I agree that there needs to be rollover relief now that Brightline has been extended to 5 and then 10 years. This should cover all related party transactions, and the following should receive rollover relief

- Becoming an LTC should also be excluded from a brightline sale, as becoming an LTC can simplify ownership for a Company and reduce unnecessary compliance costs.

- Sole trader or partnership to LTC, Trust, Company or LP

- LTC share changes, between related parties, including to Trusts and between individuals

Roll over relief should also be back dated to 29/3/18 as there are a lot of rental property owners who unintentional have been caught by these very complicated rules

MAKE IT SIMPLE – 143 page of discussion document, shows that these rules are already too complicated and will be an unfair burden on taxpayers to comply with the rules. The new rules need to be simple and easy for all to follow.

s9(2)(a)

Submission on 'Design of the interest limitation rule and additional bright-line rules'

By s9(2)(a) [redacted]
12 July 2021
s9(2)(a) [redacted]

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Part 1A - Submission feedback
Part 1B - The reasons interest deductibility must be removed for rentals
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Part 3 - Feedback according to Discussion document chapters

Executive summary

Many of the policy considerations within the Inland Revenue discussion document cover rules that will undermine the Governments stated policy objectives. This will therefore damage the NZ economy and the provision of quality affordable housing to New Zealand's population. Most options/ considerations in this Inland Revenue discussion document should not have been included for consultation.

By including options/considerations that undermine the policy intent the document will stimulate feedback from those special interest groups most impacted. Thus providing support for options that undermine the policy and consequentially allow the existing affordability and supply problems within the housing market to persist.

With a stripped down simple to understand approach as I suggest (Part 2) most of the policy and administrative compliance considerations raised in the discussion become irrelevant. Red tape is significantly reduced. Variations on my suggestion are of course possible.

The need to make hard interest deductibility rules is driven by the excellent financial returns available through holding the non-productive asset, residential property. By comparison other investments do not seem as secure; interest rates for term deposits are low, the sharemarket is unstable compared to property, retail is struggling with low demand and higher costs, but rental income from high rents is giving great value, and no capital gain tax. All these factors are skewing investment decisions in favour of holding residential property. This is taking investment capital away from the productive innovative, export driven economy. And NZ will never be wealthy just by selling houses between each other.

But not only is the current situation bad for the business economy it is also making housing unaffordable for ordinary New Zealanders. With strong demand for investment in residential houses and the ability to debt leverage for those who already have a property, this has driven up prices and those higher purchase costs translate into higher rental costs, which makes for more renters as house deposits can't be saved. That trapped pool of renters (middle class and working class) becomes a secure income source for investors in rentals. If we want a society where people can build equity in their house and then have the opportunity to use that to build a business or drive innovation, then we must break that cycle.

Removing the deductibility of interest when holding residential rental property is a key step to breaking that cycle. As the property council has said in a recent news articles, removing interest deductibility will end the 'build to rent' business. They will have to switch to being a 'build' business model, which is exactly what the NZ economy and people need. Rental businesses that are not based on being highly debt leveraged will be fine. There will always be a need for some rentals, e.g. when moving to a new city, but if you give the people the choice of renting forever or buying a house - we know what most will choose.

My submission proposal is more focused on the building of residential houses and encourages, but does not require, the sale of those to first home buyers or others.

Part 1A Submission feedback

The 4 main problems in the discussion document:

1. The removal of interest deductibility is stated as not applying to 'property outside NZ' (para 1.14). This will favour the holding of rental properties outside NZ and therefore will draw investment money away from housing being built in NZ. This is especially true as interest rates rise and the benefits of interest deduction compound for overseas investment. Australia would be the main benefactor of such a scope restriction. I suggest people who declare overseas rentals, short or long term, should not be able to claim interest deductions thus making a level playing field for investment in NZ versus overseas.
2. Chapter 5 considers a series of options for an interest deduction on disposal of the residential property if it is held on revenue account. This will simply perpetuate the problems that arise from deductibility of interest as it is just a deferral (see my Part 1B for why this is a problem). If a

deferral was allowed complicated anti-arbitrage rules would have to be developed, including for risks of multiple sales to gain yearly interest deductibility. This is likely to require specialised accounting and experience skills to monitor compliance, administration costs would rise.

- Contrary to what is suggested (para 5.14) there is no question around fairness or coherence.

  - Within the Inland Revenue discussion document the concept of fairness is discussed in relation to a property investment being subjected to more tax than other investments. But the bright line test already exposes property investment to more tax; but not a higher rate of tax. In the same way the removal of the deductibility of interest will expose more income from the investment to tax, but not to a higher rate of tax. Yes, that exposure is permanent compared to the Bright line rules. But just as the rules for Thin capitalisation restrict the amount of interest that can be claimed, so do these rules. There is nothing unfair about that, it is done to correct behaviour and tax impacts in the wider economy, which is exactly what is intended for rental properties.

  - Coherence only applies if you view the 'normal principles of taxation' like a machine that is only capable of working in one way. Part 1B says why this view is not working for the NZ economy. The governments limitation on interest deductibility are an adaptation to those normal rules, not an existential threat. But they are a significant change and a vitally important one that will guide economic behaviour, which is one of the purposes of the legislative branch of government that must be respected.

With respect, I suggest this chapter should not have been included for consultation.

There must be no deferred deduction for interest on disposal of a property.

3. The document creates two categories in which an interest deduction is allowed - 'development ' (chap 6) and 'new build' (chap 7 + 8).

- Development (I make comments on this in Part 2), or the actual process of building a new residential dwelling is the needed 'new build' definition that must be supported. See my Part 2 which discusses a simple effective and relatively easy-to-administer option to bring this government policy into effect. My option also avoids a series of problems I have identified but which are not addressed in this discussion document.

- But 'new build' as understood in the discussion document includes several options (see para 8.20) for the 'holding of non-productive assets', residential property. These options largely replicate the existing tax situation with all the associated housing affordability problems.(see Part 1B).

  An effect of these options allowing interest deductibility for holding 'new builds' would be to shift the investors to focus on purchasing new builds to gain the interest deduction. The absurd situation would then arise that First home buyers would then find it hard or almost impossible to buy a new build house and the affordability crisis would continue as few new builds are available for purchase. Over time more new builds would sit within the rental market and lower quality higher maintenance cost older places would be the only options for first-home-buyers to purchase.

  This is not providing safe, warm, dry and affordable homes for purchasers (para 1.2). Or to 'dampen investor demand' (The government qualifies this by talking about 'existing stock' but I believe this is a policy oversight for the reasons given in Part 1B)

The 'new build' permission to have an interest deduction must be about a focus on the verb 'build'. These options don't fully support that 'build' goal. Please see Part 2 for my suggestion to deliver government policy.

I believe <u>most</u> of the issues raised in chapters 10 to 14 result from this approach to allowing some residential dwellings to be held as rentals under the 'new build' exemption. If they can't be held with an interest deduction there is no need for rules on tracking who has had what for how long and who purchased and when. And what the amounts are. The cost of administration for the government and the compliance costs for business are vastly reduced.

(note: if the government under pressure thinks it fair to allow some holding of property as 'new build' with an interest deduction, then I suggest possibly those properties already 'under construction' at the point of 27 March 2021 could be retained till the end of the transitional period. From there it should be a level playing field with no interest deduction. But I worry that this will continue the damage to renters and first home buyers, (see Part 1B), and the impact of administration and compliance costs).

4. There is no necessary link between the ring fencing regime and interest deducibility.

The link to the loss ringing rules in chapter 12 is unnecessary and looks as if it could undermine the governments policy intent by allowing interest deductions.

This chapter should not have been submitted for consultation.

IR document options

Much of the complexity in the IR document is a result of a desire to preserve the 'normal principles of taxation' (see para 1.5). These are seen as providing efficiency and coherence to the tax system and are largely based on case law (judge law) developed over many years. These are the principles that currently allow billionaires to pay minimal tax.

Bt stepping out of that assumption we can make simpler more effective tax law that delivers for the NZ economy.

Part 1B - The reasons interest deductibility must be removed for rentals

ON TV one 6pm News Friday 9 July there was a sympathetic feature article about property rental companies coming forward with a petition to parliament and saying the Government's proposed changes to remove interest deductibility is a bad thing that will kill their 'build and rent' business. The implication being that less rentals will be built and the housing crisis will not be helped. There was no pushback on this point of view.

But the Governments proposal will do no such thing. It does **not**:

- prohibit any person or rental company from renting to others.
- prevent them from 'building' properties that can be rented.

However, the proposed removal of the ability to deduct interest will impact their business model and the rates of return they expected. This is a good thing for the following reasons.

The NZ situation sits along with a trend in the United States where large corporations, e.g. the Koch brothers, have been investing in new rental properties because the returns on rentals are so strong. This is because house prices in the US, like in NZ, are high. This shuts out most young middle/working class buyers. These people then become a captive market of renters as they are wealthy enough to pay high rents. And the high rents in turn make it almost impossible for renters to save a deposit to buy a home and the captivity continues. The returns and prospects are great for business.

The problem of affordability (for people to purchase a home) is not helped by these 'build to rent' businesses because business marketing now demands prices are set not by cost structures within the business but by how much the business can extract in consumer surplus. This means rents are likely to remain high regardless of supply because pricing is not as linked to supply. Some houses can be left empty as interest and costs can continue to be deducted. High rents means less chance to save a deposit.

High rents means these rental businesses can pay high prices to accumulate new builds which are generally lower maintenance. Those people who are able to be a first home buyer will find it hard to be able to buy a new home because a company that can heavily debt leverage will be able to outbid them. Property prices will therefore be encouraged by these firms to stay high which will allow them to continue to heavily debt leverage.

So with the removal of interest deductibility when a person or company is holding a non-productive asset, rental property, this business model will become less attractive to those who have business models based on highly leveraging the property. That is the change that will impact these companies. A rental business will be fine for those companies not based on being highly debt leveraged.

Even when rentals are made to beneficiaries the rents are paid direct to the landlord by the government. If there is an overloaded or not properly funded bureaucracy any complaints about the quality of the rental may be slow for the government to follow up on, but the rent goes through. Business favours this, embracing it as a very secure income. And it was strongly anecdotally reported that with the Governments first budget, where the accomodation allowance was raised by $50 per person, rents rose correspondingly. This showed rental businesses raising rents not based on costs but on the ability to extract more revenue that government had declared as available for renters, who sometime have to pay extra from their own pocket. This shows the govt therefore will become trapped in a cycle of paying for high rents by leaving so much of the rental market in this growing private sector business model.

The government proposals to allow interest to still be deducted for the building of new builds (excellent) means construction of housing by building firms will not be financially impacted. Therefore the change by removing interest deductibility might just be in who funds the builders. e.g. purchasers who will live in the homes, govt; rather than firms who want to hold rentals.

So if, as the news segment suggests, the 'build to rent firms' will go out of business then this will free up New Zealand's limited building resources and tradespeople to work on building houses that will go to the supply of the market for houses to purchase. This will improve housing affordability because the rental investment market demand will be reduced. Dampening rental investor demand is exactly what the govt has said it wants to do (see para 1.2).

Also removing interest deductibility may take some demand out of the short term/holiday home rental market. If it does then building resources and tradespeople could be freed up to build and supply houses for sale in locations where there is a need for permanent residences. We need to fix that long term housing demand first. Also with central government moving to take charge of the 4 waters from Local government (as i understand it) then there is an incentive not to encourage too much sprawl which would cost central government.

Most importantly, removing the ability to deduct interest, is an important shift in the economy from a tax system that incentivises the holding of property as the means to wealth gain, into one that gives a slight preference to get back to investing in the productive economy where items are produced for export. New Zealand will never get to be a wealth economy while so much of our investment capital goes into holding non-productive assets, residential property.

No business people in the productive sectors of the New Zealand economy should be complaining about a policy that redirects/encourages New Zealand investment back into producing and making things. The New Zealand economy is currently being starved of investment capital by a tax system that favours holding non productive capital assets, residential property, in a highly leveraged rental business. By implementing exclusions to removing the ability to deduct interest, the Inland Revenue discussion document perpetuates this weakness in the New Zealand economy.

Remove interest deductibility from the rental sector.

Will rental prices go up? In the short term, most likely yes. But if rentals are no longer held by highly leveraged companies as the TV One news segment suggests, the opportunities to purchase should magnify for a short period. Groups could purchase houses and correspondingly the demand for rentals should decrease.

Additionally the government could purchase and make houses available in rent to buy arrangements. Ordinary New Zealanders would go back to accumulating some wealth through property ownership.

For those who have previously benefited from having rental properties based on these assets being highly debt leveraged; you've had a very good run.

Part 2 - Solution - Delayed interest claim of up to 4yrs as a one off

What follows is an approach to identifying what a 'new build' is that removes all the problems I identified above in the Inland Revenue discussion document. And it also deals with further problems I have identified below that aren't in the discussion document.

It will improve housing affordability by:
- providing an incentive to dispose of houses quickly rather than holding them as rentals. Though it does not remove that option.
- increasing the supply of residential housing as it provides an incentive to move onto new projects in order to obtain the tax advantages.
- helping to focus the limited building skills and resources into projects where residential housing is needed by removing an incentive to build houses elsewhere.
- making 'build-to-rent' businesses that are highly debt leveraged shift to a low debt model or just to being a build business for 'new builds' (according to their publicity the existing 'build-to-rent' model can't survive)

This proposal removes the need for a separate category of 'development' as outlined in Chapter 6. But a few elements of that topic remain.

The definition of 'new build'

The proposal/policy intent is therefore to define ‘new builds’ to make sure interest can be deducted for these builds, to encourage new builds.

Problems to avoid that could undermine the legislative policy intent:
1. Land banking, with the intention to ‘one day’ make a new build. This isn’t helping new builds now, but they may claim interest and no new houses are built. The policy is not to support speculative profit taking by supporting land banking. Land banking slows housing/commercial development as agents who could develop the property must look elsewhere for opportunities. And once banked there is no great hurry for the owner/developer to use the resource as it is a leverage asset and still has a high value to them even though under developed (They normally have some business activity on it to sustain it). The policy has to support new builds actually being made. The ability to deduct must sit with the existence of an actual build not the intent to build; or the intent of the legislation will not be met,
2. Slow builds. Sites could be cleared with an intent to new build or construction can begin but then stop, e.g. due to finance or builder availability. Interest is being claimed but there is no urgency in the market forces to build new houses as interest deductions etc are being claimed. The policy intent is not being supported by a slow build which could go on for years and in effect be a land bank.
3. Change of use. If interest deductibility is allowed to be deducted when incurred - a business could go bust or close before a new build is made but deductions for interest have been allowed and received. A new purchaser of a site that was intended for a new build may change the use of this site to another commercial purpose and therefore the allowance of interest deductibility has <u>not</u> gone towards the provision of new builds. (A new purchaser/developer who proceeds with a new build project can only claim for the interest they have incurred)
4. Luxury builds, which are replacing more residences than they create. Developers/builders who wish to build these types of residences should not get the advantages of a ‘new build’ where interest is allowed to be deducted because they are not adding to the legislative intent of creating more housing. (In the discussion document)
5. Holding a new build, eg a developer builds new houses but holds them as rentals or short term rentals (e.g. Airbnb, or a hotel apartment) expecting the ability to be able to continue to deduct interest because it is a new build, and if they are allowed to get an interest deduction they would get an advantage over other rental owners who are not able to get an interest deduction. (In the discussion document but not dealt with effectively).

6. Destruction of heritage buildings to create 'new builds'. New Zealand society would be damaged by having a loss of historical continuity. Heritage buildings are of a finite number and cover only a small space in New Zealand cities as much has already been lost. Opportunity to increase residential housing supply is not diminished by protecting heritage as there is plenty of semi industrial space in central cities to intensify. The issue is land banking by those not financially able to develop their land.

The above problem examples assume no other business activity is occurring on the site where a new build is about to occur because in theory that other business activity can allow a claim for UOMI in its own right. (I raise issues with this later).

To avoid the above problems and therefore to deliver the policy intent of encouraging investment away from purchasing existing properties and into the building of new housing; the following is proposed.

Proposal

That a *'new build'* should be understood as:

- the process of building a new domestic residence (apartment, semi detached, stand alone), that was not previously available on that site, to a finished state, and sold, or occupied.

(note: earthworks to get a subdivision or site ready for a build would also be interest deductible under the normal principles of taxation not the proposal suggested here).

That a new build will cease to be new build when the later of both the following are met:

- the build is sold, and
- the build is in a finished state able to be occupied by a natural person. (a 'natural person' can include a trust if the beneficiary of the trust is to reside full time within that residence. I see these as family trusts).

or

- in the case where the developer or builder (if they are the developer) is putting the houses into the long term rental market without a sale:
  - the build is in a finished state, and
  - rented, at market rent to a natural person who will occupy it as a domestic residence.

(If the developer is putting the new residential dwellings into the short term rental market they would be subject to this proposal. There are compliance issues otherwise).

A new build permission to deduct interest should also include the following:

- a pre 1930's house during and when it is completely refurbished to an excellent/luxury standard from a poor or dilapidated state. There could be a process for an independent panel to pre-determine if such a standard is met. e.g. with local council and Heritage New Zealand.

- a residential dwelling built by Kainga Ora funding for social housing or a social purpose they set. This could be for housing in rural areas, like East Cape or Northland, where new quality housing is needed.

What is the amount of interest that can be claimed?
This would be supported by the following 1st clarification:

- The interest able to be deducted on a new build, is the interest that has been incurred on that particular dwelling within a maximum of the 4 years immediately prior to the ability to occupy the residence in a finished state.
- The interest deduction can then occur in the tax year when the ability to occupy the residence in a finished state arises.
- In the case of a new build apartment building it would be the portion of the total interest that would apply to that particular dwelling. determined by square metres and a related portion of any public areas.

Also the following 2nd clarification
- A 'new build' does not include a luxury build. A luxury build is where a primary dwelling replaces more than one other dwelling that was previously on that site (demolished prior to purchase or not), or where more than one dwelling existed on sites that are now part of the luxury build site area.

Also the following 3rd clarification
- A 'new build' does not include a replacement build.
  - A replacement build is where an existing single residence is demolished and a single residence is built to replace it. Unless the residence demolished is not a pre 1930 residential and was deemed uninhabitable. (This can be slightly expanded)

A 4th clarification
In the case of a new build that goes into a long term rental business on completion and is not 'sold'.
- The period of 4 years for interest incurred that can be deducted ends on the date the 'new build' begins to be occupied in a finished state.

The rational for the proposal
The effect of this definition and the 1st clarification is to delay allowing the deduction of interest until the ability to occupy the new build is clearly established. That is the proof that a new build is in existence and interest deduction is only being allowed for the purpose of encouraging the building of new houses.

This approach removes the risks/problems identified above from, land banking, slow builds and changes in use.

It means the deduction for interest is a roll up of 4 years of interest most recently incurred into a one-off deduction in the developers or builders* tax year, that year is the later of finalisation of the build into a finished state, or sale of the new build. A one off is easy to calculate and track.
* (Builders - if they were the funding developer of the project the interest restriction applies but not if just a sub-contractor - the business of building has full interest deductibility for their business, as interest is incurred. More consultation may be needed for this).

4 year push
If a build takes more than 4 years to build and sell, then the early periods of interest liability will progressively become not deductible. It is a 4 year limit to push residential housing to completion and also being made available to the market. It is not an aggressive period of time and quite generous.

Many new builds are sold prior to completion so the push is to finish the build and get supply up quicker.

The land banking period often has a separate taxable activity, e.g. car parking so interest claims at the moment can be made under that activity. The push comes when construction begins because interest deductibility is delayed until the build is in a finished state (and sold or occupied).

Apartments are often sold prior to completion and once in a finished state to occupy the deduction can be made and a portion of the public area costs can be claimed. A build of 10 apartments and one is sold and occupied can have the interest for that apartment claimed and 1/10 interest cost for funding the public areas.

Why the reference to a sale and not just a finished state?

Interest is paid on money borrowed. This proposal removes interest deductibility at the point the property is sold, and able to be inhabited. Many places are sold off plans or early in the building process so it is only when the place is finished and able to be occupied that the proof is there of a new build coming into existence (e.g. sunset clauses can stop sale). At that point the loan taken out to facilitate the building of a residential dwelling has served its purpose in terms of government policy - to encourage building and therefore increase housing supply.

The need then shifts to getting the builder and/or developer onto new projects. With no further interest deduction advantage to them in having the loan, the developer or builder must find another 'new build' project. This gives a real push to supply the market.

The sale concept means the loan should be able to be repaid and capital is available for a new project. And it is the entrepreneurs risk if the loan is not able to be repaid.

Renting out of a new build?
This definition still allows the new builds to be rented if that is the business model the company wishes to follow. But they will only get the interest deductibility for the period the residential dwelling is built. As soon as it becomes a rental where a person can live in it, interest deductibility no longer applies. This puts all residential rental business on a level playing field of no deduction for mortgage interest.

The IR proposed 'noun' understanding of 'new build' creates a positive incentive to retain 'new builds' as rentals because interest deductibility is retained. So its proposed model was not equitable between different investments.

UOMI expenditure at the point incurred
The normal rule of taxation is that expenditure can be deducted at the point it is incurred. This would bring forward the timing of the deduction to when the interest is being paid by the developer.

To follow this normal rule would undermine the legislative policy intent of promoting a shift in investment into new builds. The normal tax principles will do nothing to stop the risks identified above of land banking, slow builds, and changes in use.

The normal rules of taxation must be modified so there is a clear link from the supply of new builds and the allowance of a deduction for interest.

To not make the link to the outcome of house sales will only encourage land banking or slow building because it does not dissuade these. There must be some market pressure to move the new builds into the market. This may help bring prices down and get developers focused onto new jobs.

Land banking will persist
There are many anecdotal examples of land being held 'under-utilised' for years because the 'business' of land banking is currently profitable. e.g. in Wellington Te Aro.

However, land banking is often done by having a business activity on the site that underutilise's the land but allows deductions for expenses such as interest. The 'normal principles of taxation' support that practise.

Dealing with land banking is a separate issue. However, it could be possible to squeeze the start of the 4 year period for permitted deduction of interest by only allowing a deduction from the point a builder commences construction. This may restrict the 4 year window and lessen the ability to claim interest when 'new builds' are not actually being built but land is just being held.

It would be appropriate for government policy effectiveness to stop land banking as a type of business by removing interest deducibility where land is banked. This would be hard to define and identify but a worthy area to research and investigate options on as solutions would help facilitate intensification rather than the existing urban sprawl which land banking encourages.

Entrepreneurial risk
In the situation of land being purchased and held for too long, or a slow build, or change of use, so some interest is not able to be claimed as the 4 year window has moved, that is the risk the entrepreneur takes. They have the knowledge, and they are aware of the risks they take with the gaps in that knowledge.

To allow the early deduction for interest is to risk a reward for poor performance on new builds. Early deduction and claiming of UOMI does not guarantee the intent of the policy is being met; to encourage an adequate supply of new builds.

And if problems do arise, the allowing of an early deduction is to socialise the cost onto the taxpayer by a reduced tax take, when it is the risk taken by the entrepreneur who has the better supply of knowledge. The taxpayer had no choice in taking that risk. Remedies for problems lies with the entrepreneur and the banking/finance community, not the taxpayer.

The policy here is to encourage new builds to actually happen. Not to pander to those with different intents.

Luxury builds
A purpose of the proposal is not to allow luxury buildings to replace multiple residential dwellings. No interest deduction should be allowed for this purpose. i.e. a developer could have land in a central city and decide that they wish to build a luxury dwelling across two sections where there was a dwelling on each, and it would be a new build with a resident being the ultimate user.

If they wish to do this they can if the local by-laws allow it. But a deduction for interest should not be allowed as that new build is not increasing the housing supply which is the purpose of the ability to deduct.

The inclusion of the phrase ‘primary dwelling’ is to avoid a claim by a developer that a guest house on the site could be seen as a second residence, or the son or daughter lives there. It would be hard to argue a guest house as a full time residence, the inclusion of ‘primary’ is just intended to remove any consideration of the possibility.

Tracking Compliance with this Part 2 proposal.

This a one-off claim made when the residential property is finished and sold or occupied. The claim could be in the tax return accounts but must be supported by the form and subject to audit change. Or by the form giving prior approval and then it is included in the tax accounts - either by filing the return or having it reassessed.

The Government administration system to support this - could be a simple spreadsheet, identifying each residential property with an identifier (address?) and a link to those who are claiming interest deductibility for that address. The business would apply for the interest claim by 31 March each year or shortly after, on an Inland Revenue form giving the basic information and the lending institution and the amounts for each of the year applied for. The claim would be processed in a single amount in the current year. Auditing could be a simple check of the property existing, that the amounts claimed are backed up by bank accounts, and there are not multiple people claiming for the same property (or if they are that it is legitimate). Need to be able to track people to a property. This is a simple overview of a potential approach and would need more substantive work.

Part 3 - Feedback according to discussion document chapters

Chapter 2 of the discussion document

Para 2.60 Questions box

- An apportionment should only occur for the business purpose, and that should be based on general tax principles. But you don't have data on volumes for impact on taxpayers. These is nothing about compliance risks by apportioning.
- business premises should be defined widely. If a bedroom is actually being used as storage for old business junk then it is still business.

Para 2.74 Questions box

- Yes there should be a carve out for temporary employee accomodation. Max of six months give some semblance of integrity. e.g. fruit pickers, Shearers, fishing boats etc,

Para 2.79 Questions in box

- Yes, there should be a carve out for student accomodation. But only if it is a hostel run or contracted to an educational institution to only provide that accomodation to students if they are in formal education with that or a related credible govt affiliated education institution.

Para 2.80 Questions in box

- There should be no carve out for short term stay accomodation. A boarder in a home should be treated without the owner making claims for interest. The boarder charge should reflect the costs whatever they are. I can't remember all the rules.
- This is a very unclear item as it is an intellectual exercise rather than that practical with examples.

Para 2.96 Questions in box

- Yes, a carve out for papakainga is appropriate. I would stress there has to be a link to Kainga Ora giving approval and some monitoring within a time frame to ensure it does come to fruition.

Chapter 3

Para 3.15 Questions in box

- I support a hard rule that minimises the administration effort for determining compliance and delivery of the governments policy objectives.

Para 3.20 Questions in box

- I'm not aware of any that need exclusion.

Chapter 4

Para 4.12 Questions in box

- Yes I support using the existing law and approach if used in good faith.

Para 4.16 Questions in box

- I'll leave this to the experts.

Para 4.22 Questions in box

- I'll leave this to the experts but I expect this to be done in good faith that some do not get an advantage over others.

Para 4.40 Questions in box

I'll leave this to the experts.

Chapter 5

Para 5.43 Questions in box

- I support option A with deductions denied
- My submissions give my reasons why I support this option

Chapter 6

Para 6.30 Questions in box

- Land banking is a problem that delays intensification of cities and building development. It holds back local economies. It encourages urban sprawl onto good farm land to escape land closer to the centre that has already been banked. Ideally actions would be taken to minimise it or control it.
- The economy and the governments policy is not supported if exclusions to allow interest deductibility apply to activities that cover land banking. Land dealers are not actively building houses and they should not get interest

deductibility except for the business activity that they have on the land before the build. e.g. car parking.
- However, if there is no activity on the site then there is nothing saying land dealers are not a business so interest is deductible under current law.
- But in my proposal once they commence the build of the building 'interest deductibility is held in abeyance. And if they do not complete the build (finished state and sold or occupied) within the 4 year period then they will start to progressively lose the ability to claim the interest incurred in those earlier period. These must be some push to complete builds quickly.
- 'Building' the new build would not include financing earthworks and landscaping a subdivision on which to build houses. Interest costs on these should be fully deductible.
- I would expect rules would require banks to finance earthworks separately from each house or be able to identify what loan is for what cost.
- The other questions are answered in my submission.

Chapter 7

Para 7.11 Questions in box
- The proposed definition of 'New build' should allow exclusions for heritage and papakainga housing. I discussed these in my submission Part 2.
- I suggested a panel of local council and Heritage NZ to make simple quick decisions on heritage buildings (pre 1930), being updated from a 'poor' state to an excellent state. I see these as quite permissive panels included to allow improvements to modern standards that don't damage heritage. And the panel could check at the end when the interest deduction is claimed that a claim can be made. If they have completely destroyed the heritage and not done as originally stated then no interest deduction.
- There is a desperate need for papakainga housing. This should be supported.

Chapter 8

Para 8.29 Questions in box
- My submission has already dealt in Part 1A and 1B why these options do not deliver Government policy. They perpetuate existing affordability problems for buyers and renters.

Chapter 9

Para 9.13 Questions in box
- My proposal will encourage sales of new builds rather than being held for rental. The bright line issues will therefore drop away in significance. I see no reason not to keep the bright line rule for new builds.

- There is no need at this point to weaken the bright line test to encourage new builds for rentals. It just creates more rules and red tape to administer and/or comply with.
- A heritage building built from a poor state to an excellent state should not be subject to the bright line rule. This will be a positive encouragement for preservation of heritage which is a finite resource that is dwindling over time. It is largely in small defined areas.

Chapter 10

Para 10.82 Questions in box

- My proposal removes the need to consider rollover as interest deductibility will only apply during the 'building process' of the new build.
- And my proposal encourages sales, these people will often buy in the format/legal entity they wish.
- Switching between types of entities (e.g. Individual to trust or company) will only arise as a problem if the property is a rental but as interest is non deductible in my proposal there is no issue.
- You are bringing changes to the bright line rule only because you came up with options that allowed for the 'holding of rental properties with interest deductibility' and these options undermine the govt policy intention.
- You are making huge amounts of complexity and red tape because you are choosing to. Compliance nightmares from your own dreams.

Chapter 11

Para 11.30 Questions in box

- The risks here are minimised in my proposal by having a single one off deduction claim for interest.
- I think these rules will still apply and are needed in case of changes in funding for a development during the build period.
- I accept your suggestions on how this should be done as I'm not familiar enough with how it could work, and I'm running out of time to get this in.

Chapter 12

Para12.34 Questions in box

- There is no link between these two regimes and I do not support any of what is suggested.
- The loss and ring fencing rules should not be aligned. They should both exist independently. They are separate and only connect if you have a

machine concept of the principles of taxation. That concept does not actually help build the New Zealand economy.

Chapter 13

Para 13.24 Questions in box

- I'll leave this to those with experience

Chapter 14

Para 14.15

- My submission in part 2 provides guidance on how the scheme could work.

From: s9(2)(a)
To: Policy Webmaster
Cc: s9(2)(a)
Subject: [WARNING MESSAGE ENCRYPTED]Design of the interest limitation rule and additional bright-line rules - [redacted] s9(2)(b)(ii)
Date: Monday, 12 July 2021 4:52:05 PM
Attachments: image001.png
image002.png
image003.png
image004.png
image005.png
image006.png
s9(2)(b)(ii) - Property Taxation Discussion Document Submission.pdf

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Hi

We attach a submission on the Government's discission document: *Design of the interest limitation rule and additional bright-line rules* made on behalf of s9(2)(b)(ii).

If you have any questions in respect of the submission please let us know.

Kind regards

s9(2)(a)

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12 July 2021

Design of the interest limitation rule and additional bright-line rules
C/- David Carrigan
Deputy Commissioner, Policy and Regulatory Stewardship
Inland Revenue
PO Box 2198
WELLINGTON

Dear David

DESIGN OF THE INTEREST LIMITATION RULE AND ADDITIONAL BRIGHT-LINE RULES: A GOVERNMENT DISCUSSION DOCUMENT.

The following submission on the Government Discussion Document "Design of the interest limitation rule and additional bright-line rules" ('**the discussion document**') has been written on behalf of s9(2)(b)(ii) [redacted] in relation to the following questions asked in the discussion document at chapters three and eleven:

Chapter 3:
Are there other organisations that should not be subject to the interest limitation proposal?

If so, please provide a description of those organisations' activities and explain why an exclusion is appropriate. In particular, please explain why an exclusion should apply to the organisation as a whole, rather than to the type of land held by, or activities undertaken by, that organisation. Exclusions for particular organisations, rather than for types of land or activities, are more likely to be appropriate when the organisation's functions are prescribed or circumscribed by law.

Chapter 11
What do you think of the interposed entity rules?

Background

s9(2)(b)(ii) [redacted] with a third party, which is a registered charity. s9(2)(b)(ii) [redacted]

Market rental is not charged given the partner's desire to further the activities and charitable purposes of s9(2)(b)(ii) [redacted]. Specifically, s9(2)(b)(ii) [redacted] has a stated charitable purpose of:

- Providing affordable, comfortable rental housing and assistance to the elderly and those in need; and
- Providing maintenance assistance at the accommodation for the elderly Sisters and Priests.

s9(2)(b)(ii) [redacted] is a registered Community Housing Provider ('**CHP**') and going forward expects to receive the Income-Related Rent Subsidy ('**IRRS**') from the Ministry of Housing and Urban Development ('**HUD**') in relation to some of its units.

For your reference:

- The structure as described is included in appendix one of this letter; and
- The Community Housing Provider Operational Guidelines for Income Related Rent Subsidy Services Agreements, which provides information on how CHP's operate, can be found here.

s9(2)(b)(ii) exists as the limited partnership between s9(2)(b)(ii) and a third party charity. All parties are committed to providing affordable rental housing in the s9(2)(b)(ii) over the long-term and see opportunity to expand this capability.

s9(2)(b)(ii) is the corporate vehicle that undertakes the various responsibilities and requirements that are associated with the provision of community housing.

The structure and debt funding arrangements incorporated by s9(2)(b)(ii) are not uncommon and have been set up for various commercial reasons.

In their current form, s9(2)(b)(ii) will be significantly impacted by interest limitation proposals, yet the limited partnership only exists to provide residential land for community housing and rest home like care, two types of residential land that have been identified as exceptions to the interest limitation rules.

Submission

Submission 1: Exclusion for the provision of community housing

One of the questions at the end of chapter three of the discussion document asks:

> *Are there other organisations that should not be subject to the interest limitation proposal?*

The discussion document asks if there are any *other* organisations that should not be subject the interest limitation proposal because Kāinga Ora is specifically excluded. The discussion document states that Kāinga Ora is excluded from the interest limitation proposal because it is not a registered charity or community housing provider (that section CB 42B of the Income Tax Act 2007 ('**the Act**') may apply to) however it provides public housing for people in need of assistance.

s9(2)(b)(ii) agrees with this position taken by Ministers in relation to Kāinga Ora. Social housing providers play a very important role in reducing homelessness and general wealth inequality in New Zealand and therefore entities involved in the provision of community housing should not be impacted by the interest limitation proposals.

However, under the current interest limitation proposals as s9(2)(b)(ii) is not a charitable entity or a registered CHP (that section CB 42B would apply to) it would be subject to full interest limitation on the interest cost it incurs to provide the community housing properties to s9(2)(b)(ii). As described above the property owned by s9(2)(b)(ii) is leased at below market rates to s9(2)(b)(ii) (a registered CHP) in order for s9(2)(b)(ii) to undertake all the duties and requirements of a registered CHP.

On this basis s9(2)(b)(ii) submit that the exemption for Kāinga Ora should be widened to other interposed entities that exist to facilitate community housing, but may not be registered as a charitable entity or CHP.

Submission 2: Exclusion for the provision of retirement villages and rest homes

Noted at 2.46 and 2.47 of the discussion document, the Government intends to exclude retirement villages and rest homes from the proposed interest limitation rules. s9(2)(b)(ii) agrees with this position taken by the Government.

As listed above, the charitable purpose of s9(2)(b)(ii) is primarily to "provide affordable, comfortable rental housing and assistance to the *elderly*…". s9(2)(b)(ii) s9(2)(b)(ii) making them analogous to a rest home.

While s9(2)(b)(ii) is not subject to income tax and therefore does not need to apply these rules, for tax purposes s9(2)(b)(ii) is treated as owner of the properties (by virtue of its interest in s9(2)(b)(ii)), so should be able to benefit from any rest home exemption which s9(2)(b)(ii) would have been eligible for if it were subject to income tax.

s9(2)(b)(ii) submit that the exemption for rest homes should be extend to other entities that provide land and buildings that are used in rest home facilities, but are not a registered rest home themselves.

Submission 3: Interposed entity rules and the use of the property

The two submission points made above regarding the provision of community housing and rest homes both follow a similar theme, that is, the underlying use of the land should be considered when applying the interest limitation to interest incurred by the legal owner of the land.

In circumstances like these, (to continue the example of s9(2)(b)(ii) from above) the party that is the registered CHP or rest home provider will not likely incur any interest expenditure in relation to land, and the lessor of the land who is not a registered CHP or rest home provider will incur interest expenditure. In this example, s9(2)(b)(ii) , is an “interposed entity”, as described in Chapter 11 of the discussion document. The current tenor of the interposed entity chapter of the discussion document is in relation to ‘avoidance’ activities whereby an entity has been interposed in order to bypass the interest limitation rules; s9(2)(b)(ii) submit that in a similar fashion, the interposed entity rules should operate to ensure interposed entities continue to benefit from interest deductions if the underlying property use (or entity) is not subject to the interest limitation rules.

That is, there should be no differences in outcomes between a landowner who leases land to another party to be used in the provision of community housing or a rest home and a landowner who decides to operate the community housing or rest home directly.

If you have any questions please do not hesitate to contact s9(2)(a) [redacted]

We would like to request that some information within this submission is withheld in the event of an Official Information Act 1982 request. We ask that you contact us in the event of such a request.

Yours sincerely

s9(2)(a)

for Deloitte Limited *(as trustee for the Deloitte Trading Trust)*

APPENDIX ONE

s 9(2)(b)(ii)

[redacted]