From:	s9(2)(a)
To:	Policy Webmaster
Subject:	Design of the interest limitation rule and additional bright-line rules
Date:	Monday, 12 July 2021 4:52:59 PM
Attachments:	HCA - Submission re bright line rule changes (12 July 2021).pdf

Please see **attached**.

s9(2)(a)
[redacted]

Submission on bright-line rule changes and definition of "hotel"

12 July 2021

HOTEL COUNCIL AOTEAROA

Contents

Introduction

1. Hotel Council Aotearoa (**HCA**) is New Zealand's dedicated industry body for hotels and hoteliers. We represent over 140 New Zealand hotels (15,600 guest rooms).

2. We refer to the discussion document "Design of the interest limitation rule and additional bright line rules" (the **Discussion Document**).

Summary

3. "Hotels" should be broadly-defined and excluded from the bright-line rules.

4. An inclusive, multi-part test should be devised so that all common hotel real estate ownership structures are captured within the definition. Crude "percentage-use" formulas are not suitable since mixed-use and strata title hotel buildings are already common in the hotel sector. More sophistication is needed.

5. The test should consider ownership/control of the hotel components of the building. It should also consider how (and by whom) the hotel components are operated and the ultimate guest perspective of the relevant accommodation offering. Finally, the definition should be sensitive to the fact that individually owned hotel "units" might be withdrawn from hotel use and returned to private apartment usage.

6. HCA is happy to work alongside Government, including government departments already familiar with tourism-related issues such as MBIE, to help devise a broad and inclusive definition of "hotel" for the purposes of the amended bright-line rules.

"Hotels" should be broadly defined and excluded from the bright line rules

7. It is in New Zealand's best interests that "hotels" are broadly defined in connection with any exemptions from the bright-line rules.

8. Absent of COVID and related border closures, tourism is our country's largest export earner. Highest-spending international business and leisure travellers gravitate towards hotels, as opposed to staying with friends/relatives, at campsites, backpackers, youth hostels or in alternative accommodation such as Air BnB and other home-share platforms. Hotels create more full-time employment than other forms of overnight accommodation on a per-room night basis.

9. Hotels are typically centrally-located near public transport, built vertically and comprise of relatively small "private" guest rooms augmented by shared public areas. They are a more environmentally sensitive and sustainable option that many other transient accommodation types. Hotels provide centre-city amenity and help create a "sense of place".

10. New Zealand's low capital base has negative consequences for our tourism sector. As recently as 2017, a severe shortfall in hotel rooms supply was anticipated, leading to a multi-million dollar government-led campaign to attract new international and domestic investment into the New Zealand hotel sector ("Project Palace"). Generally speaking, New Zealand has historically suffered from a shortage of investment capital for hotel projects, leading to repeated "boom and bust" cycles in hotel development.

11. Future investment into hotels should be actively encouraged if New Zealand aspires to be and remain a premier international tourist destination. The bright line rules should not work against the overall goal of facilitating investment into hotel real estate.

There is no simple definition of "hotel"

12. There is no simple definition of "hotel".

13. As is the case around the world, New Zealand's hotels are owned and operated under different business models. The most common business models are (1) independent/owner-operated; (2) franchised; (3) managed; (4) leased; (5) strata title; and (6) brand-owned.

14. Different business models have arisen in response to commercial decisions made by hotel investors and hotel management companies around the following issues:

    14.1. Who owns the hotel site/building/guest rooms?

    14.2. Is the hotel part of a larger chain of hotels operating under the same brand, or is it independently branded?

    14.3. Who sets and enforces brand standards?

    14.4. Who accepts the majority of the risk/reward from operating a hotel business at this location?

    14.5. Who makes day-to-day operating decisions at the hotel (including selecting and training employees)?

    All of these factors could be relevant in formulating an appropriate definition of "hotel".

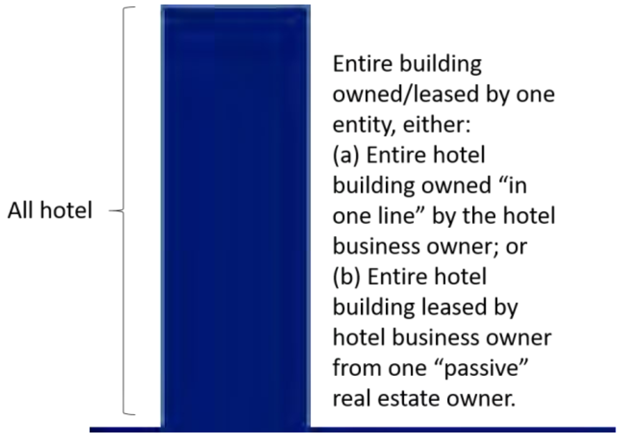
15. Since the bright line rules apply in respect of capital gains generated from the ownership of real estate, it is important that policymakers are particularly mindful of the different real estate *ownership* structures that exist in the hotel sector (paragraph 14.1 above). Policymakers should not impose a definition or test that unfairly excludes any of the commonly employed hotel ownership structure or falls down on the basis of a crude "percentage-use" measure.

16. More sophistication is needed, hence HCA's recommendation of a multi-part test. In a multi-part test, the different *operating* criteria (paragraphs 14.2 to 14.5) might help further inform the assessment of whether particular real estate is part of a "hotel" for the purposes of the legislation.

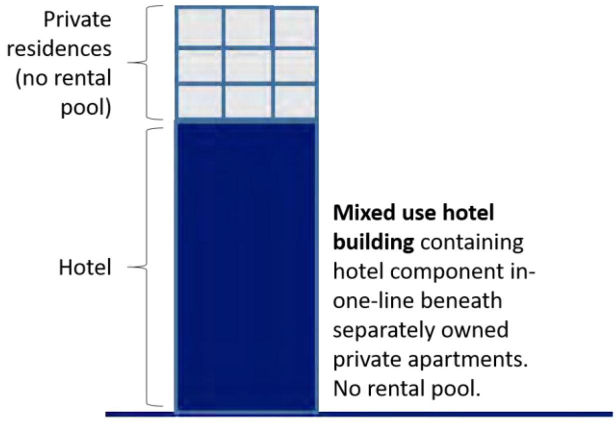
Common hotel land/building ownership structures

17. Set out below are common ways for a hotel real estate to be owned. "In-one-line" means the entirely of the hotel component of the building is owned under one legal title. "Strata title" means that separate components of the hotel are owned under separate legal titles, with the hotel business owner holding a long-term lease of any necessary hotel components it does not directly own.

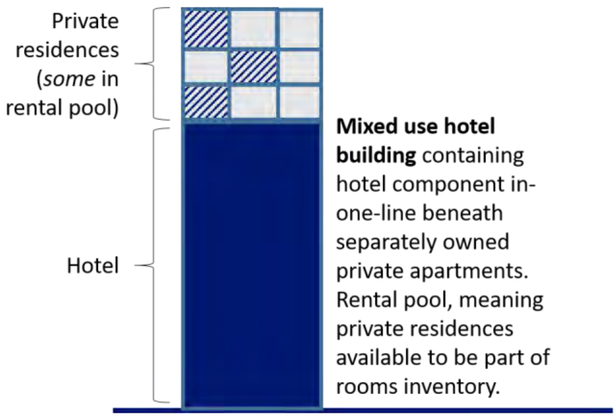
17.1. Hotel building owned "in-one-line":



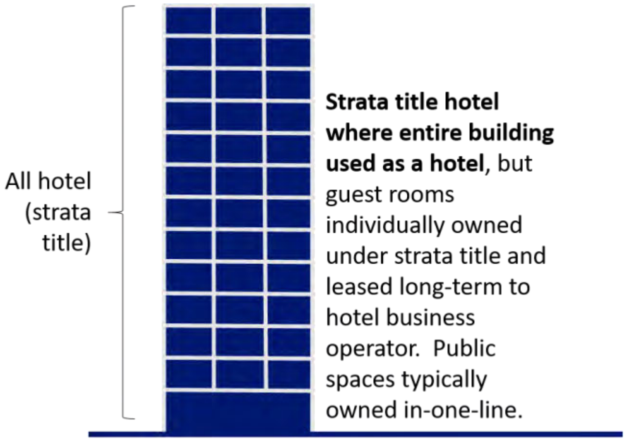
17.2. Basic mixed use hotel (hotel/residential, no rental pool):



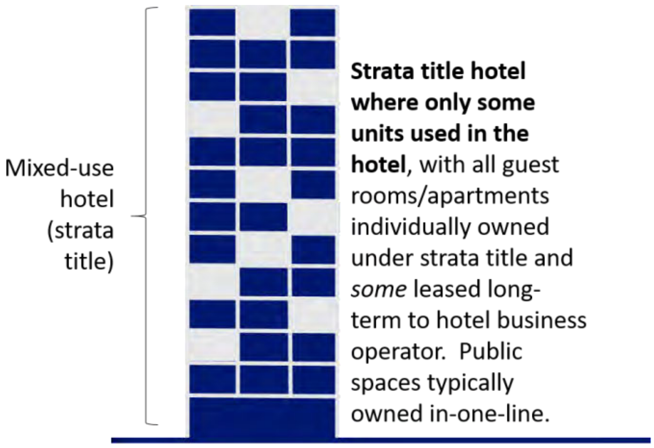
17.3. Mixed use hotel (hotel/residential, with rental pool):



17.4. Basic strata title hotel:



17.5. Mixed use strata title hotel:



18. In each of the above examples, parts of the hotel building might also be separately titled and owned by (or leased to) third parties for retail use. This means the issues identified in paragraphs 2.64 to 2.69 of the Discussion Document could affect application of the bright-line rules to hotels, as well. While additional retail components within a hotel building might be geared towards guest needs (such as jewellery shops, boutiques, convenience stores or additional F&B outlets), they are not strictly part of the hotel's profit and loss accounts (although rental income for the premises *might* flow to hotel P&L, depending on the operating and real estate ownership structure in place).

19. Note that from the guest perspective, all of the hotels described in paragraphs 17.1 to 17.5 might *seem* to be one contiguous property under single ownership and control. Hotel owners and operators make conscious design, management and ownership structuring decisions to "protect" the guest journey and "hide" the underlying real estate ownership structures from guest view.

20. Certain service offerings or amenities might be persuasive in indicating that a property is being managed as a hotel (or is perceived as such by guests). These could include the property having:

20.1. communal guest spaces (such as lobby, gym, pool, meeting spaces);

20.2. in-house food and beverage offerings; and/or

20.3. a liquor license.

There is no simple definition of "serviced apartment", either

21. Just as there is no simple definition of "hotel", there is also no simple definition of "serviced apartments". Nevertheless, there should *definitely* be a carveout for "serviced apartments that more closely resemble hotels" (paragraph 2.86 of the Discussion Document).

22. Many international and regional hotel chains offer guest room product that looks and feels like an apartment rather than a typical hotel guest room. Such properties offer larger guest rooms/suites that may include kitchenettes, or even full-sized kitchens and private laundry facilities. There are numerous such brands in New Zealand and around the world, including Quest, Ramada, Fraser Suites, Ascot Residences, Meriton Serviced Apartments, Marriott Executive Apartments, Residence Inn and Mantra.

23. Branded serviced apartments of the kind referred to above tend to sell a portion of their rooms/suites to "long-stay" guests, being visitors intending to stay at a location for longer than the typical hotel stay, but not long enough to justify the admin of setting up "permanent" residence, such as creating utilities accounts, etc. Many branded serviced apartments will also operate as "transient hotels" as well, selling at higher daily rates during peak times to transient guests who simply want more space than offered by a traditional hotel guest room. These types of properties tend to have the amenities listed in paragraph 20, but perhaps on a smaller scale than found at "ordinary" hotels.

24. Branded serviced apartments should definitely be included within the definition of "hotel", and thereby exempted from the bright-line rules. Ultimately, how best to do this will depend on the general definition of "hotel" used in the legislation. Branding could be an important component of any definition in this context. We note that Smith Travel Research maintains a list of international and regional hotel and serviced apartments brands: https://str.com/sites/default/files/2019-10/STR-Chain%20-Scales-20191025_0.pdf

25. Serviced apartments, particularly strata title serviced apartments, are the category of hotel real estate that is most susceptible to "switching" between hotel use and private residential use (or private landlording). For this reason, a "use" test may be required as part of the relevant definition to ensure the overall definition of hotel/serviced apartment works as intended.

Conclusion – offer of further assistance

26. HCA is happy to work alongside Government, including departments already familiar with tourism-related issues such as MBIE, to help devise a broad and inclusive definition of hotel real estate for the purposes of the amended bright-line rules.

27. We strongly endorse the broadest-possible definition of "hotel", which should capture "serviced apartments that more closely resemble hotels".

About Hotel Council Aotearoa

Hotel Council Aotearoa (**HCA**) is an advocacy-focused organisation with a mission to educate and influence key decision-makers on matters of importance to the New Zealand hotel industry. HCA's target membership encompasses hotel owners, general managers, operators/brand companies, consultants, academics, advisors and other organisations and individuals having a close professional connection with the hotel industry. HCA currently represents over 140 New Zealand hotels, comprising over 15,600 guest rooms or 5.6 million available room-nights per annum.

To learn more about HCA or to become a member, please visit www.hotelcouncilaotearoa.com or email admin@hotelcouncilaotearoa.com.

HCA
HOTEL COUNCIL AOTEAROA

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 4:59:53 PM
Attachments:	Submission.pdf

To whom it may concern,
Please find attached my submission.
Regards,
s9(2)(a)

Summary

1. I am a residential landlord with a small portfolio of properties let to long-term occupants. I am fully self-managing and "hands on".

2. I do not support *any* of the proposed changes, but limit this submission to the issue of interest deductibility on existing portfolios.

3. I leave the complex technical arguments to others: My submission summarises the key faults and proposes solutions. I explain the implications on the real people who make my houses *their* home to **plead** with you not to implement these proposals. If you must, make the small adjustments that will make a significant difference to the real living human beings affected by this plan: This is not about money; it is about people.

My situation

4. I purchased my last property in 2011. Ill health forced me to review my professional career so I switched track and purchased run-down properties. I purchased and renovated properties no one else would "touch" doing all the physical labour myself. s9(2)(a) [redacted] My small portfolio allows me to live a frugal life and any spare time is given to community work using professional qualification to help those with lesser skills.

5. My properties are rented to long-term occupants who applied for them because I am a long-term landlord. Their life circumstances mean they do not wish to own their own home.

6. Behind the thoroughly de-humanising label of "tenant" they are solid New Zealand workers with children and grandchildren and extended family and pets. They contribute to the community, celebrate university graduations, grieve the loss of older relatives, take pride in neatly trimmed lawns, and home-baking and plan small holidays with family. We "got through" covid-19 and job loss and worse, and swapped updates from a safe distance whenever we crossed paths walking our dogs.

7. Their rent is affordable. It is also all they can afford.

8. I have absorbed lower rents because I use every tool available to legally reduce costs. One tool is interest deductibility. The financial benefit does not land in my pocket: It is deliberately passed to my tenants to reduce the amount of rent I must charge to cover the costs of the properties, plus the little extra needed to provide for my dog and me.

Key issues

Dealing with the parties as tax revenue "numbers" denies their humanity:

9. Only a small group of landlords are solely motivated by money. If any exist at all: After 26 years in this industry I don't know a single one. Those who make this a sustainable life-plan fully understand a tenancy relationship being legally a *personal* contract. It is not only about the money.

Please *treat those who call my houses their home with the dignity they deserve*

New Zealand does not subscribe to the unfairness of retroactive changes

10. The overwhelming majority of residential rental property owners have tiny portfolios structured around the age-old certainty of interest deductibility. Neither their portfolio or their personal circumstances are large or flexible enough to absorb changes like this. That cannot be criticised because interest deductibility has never been a consideration. Nor is it affected by a stepped introduction because that does not change the outcome.

11. In my case I will be forced to give selling a very serious consideration. That is solely because my occupants simply cannot afford the increases that would be required. I understand that in your position $40-50/week is piffling: My occupants are s9(2)(a) They live dignified and respectable lives by carefully managing a minimum wage, very few are even on the "living wage". A piffling amount to you is the difference between dignity and bankruptcy for them. As addressed next, I represent the large number of landlords whose commitment to affordable rents means we are not positioned to absorb any more costs before we (literally) lose the ability to put food on our own tables.

12. This should not be a choice between who eats. And had I been aware this was intended I would have made different decisions twenty, ten, five or two years ago. I would not have accepted occupants looking for long term homes. The occupants of my houses should not be punished for past decisions that were sound when they were made.

The stepped introduction does not change the outcome, it only delays it for a short time. And the outcome is to retroactively punish decisions that were sound when they were made.

Not everyone is fat

13. The calculations are based on assumptions about the rents being charged. But the available data is based on properties being advertised for rent, or bonds lodged: The money-wasting, money costing, community disrupting and therefore more expensive "churn".

14. That makes long-term tenancies invisible. I do not know a single residential landlord who has not recently discovered their rents are substantially below market rent. That arises because of the lower costs of long-term occupants, but also irrelevant externalities.

15. For example, rents sky-rocketed in the s9(2)(a) after an enthusiastic group clubbed together to purchase a large run-down heritage property. They worked their weekends to convert it to high spec apartments and attracted young professionals willing to pay for the quality and quirkiness of an historic building. A vacant lot was sympathetically in-filled with high-spec stand-alones. Social or community housing providers rented properties from owners after out-bidding other renters to get them: The result is that the *on paper* the "market rent" for the suburb has sky-rocketed.

16. That is not reality and I represent the huge number of landlords who refused to use skewed figures to justify rent increases. Some of my properties are approaching $200.00/week below the rents I am supposedly pocketing. When I am not. Worse, we also face 10% increases in local rates, a 78% percent in regional rates.

Changes based on presumed income creating financial "fat" will place those who deliberately chose to not to become "fat" dangerously close to the financial edge. If not over it.

What do my occupants deserve being discriminated against – and where do they go?

17. There is inadequate evidence these changes will free up houses for first home buyers, or reduce house prices. But if I make the intended drastic change and sell, where do the occupants go?

18. They cannot afford current market rents. Which means the reality is homelessness: Solid, reliable salt-of-the earth Kiwi's facing homelessness. Because their status as long-term renters means they are now considered to deserve a home less than youthful first-home buyers who are apparently "entitled" to se them booted out so they can have the houses instead. That is *not* who we are.

I have sleepless nights wondering where my tenants will go if I must sell. I constantly ask exactly what they did wrong to be the target of such a discriminatory plan

We did not create the current problem

19. I purchased my last house in 2011. Impending "retirement" age means I will not purchase any more properties. I did not contribute to the current housing problem and I will not make the current situation worse. Nor did the occupants of my houses.

But both of us will pay with a complete fracturing of our lives if these proposals are implemented.

Solutions

20. Do not implement the proposals. If you must then it must be limited for reasons of natural justice, social fairness and sound common sense:

- Only apply it only prospectively so it does not affect decisions made in the past.
- Only apply it to portfolios of a certain size
- Only apply it to portfolios that *on* actual figures are earning an amount to absorb the cost

From:	s9(2)(a)
To:	Policy Webmaster
Subject:	Design of interest limitation rules - submission.docx
Date:	Monday, 12 July 2021 5:08:26 PM
Attachments:	Design of interest limitation rules - submission.docx

Dear sir and madam. Attached is a submission for the proposal 'Design of the interest limitation rule and additional bright-line rules'
I am happy to be contacted in relation to this submission
Thank you.
s9(2)(a)

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

Dear Sir or Madam, I would like to submit a response to the document "Design of the interest limitation rule and additional bright-line rules".

Firstly I am very supportive of the governments efforts to address the NZ housing market. As someone who has recently bought their first home after 25 years of saving and after 2 years of failed attempts to secure a property I have been frustrated by the dominance of investors in property sales so these measures are very much welcomed. I have paid particular attention to the policy objectives and note the Government's objective is to 'tilt the playing field away from property investors and towards first home buyers' when reviewing the proposals

Nevertheless there is one aspect of the proposals that risk impacting the very people you are hoping to sway the market towards specifically the subsection 'Income derived from a main home' paragraphs 2.48 – 2.55.

This subsection rightly permits '*interest deductions to be taken when a homeowner rents out a room or rooms in their main home to flatmates, boarders or as short stay accommodation. Some first home buyers may rent out a room in their main home to help with servicing their mortgage. Denying interest in these situations would not further the policy objective of making home ownership more affordable. Allowing interest deductions in these situations may assist in mitigating under-utilisation of owner-occupied property, as it would not discourage homeowners from taking on flatmates*' (paragraph 2.52).

I was dismayed to find however that '*the proposed interest limitation rules would apply where a property owner rents out a separate dwelling that is not part of their home but is on the same land as their main home (for example, a self-contained flat or a cottage) (*paragraph 2.54).

Many first home buyers have specifically looked for such properties with separate rentable spaces (such as a garage conversion, sleep-out, cottage or small garden property) in order to support mortgage serviceability, myself included, so this specific inclusion will significantly impact ability to repay debt or even to get on the property ladder in the first place! Certainly, these measures have a worrying impact on my own ability to repay my home loan.

In addition, in some areas of the country, such as where I live, tourism is the driver of the economy and short term rental properties for hospitality staff are in extremely short supply. These measures will likely impact the availability of such rental stock and will have a detrimental impact on the local economy.

Finally these types of property are rarely '*property that is commonly and foreseeably used to provide residential accommodation on a long-term basis'*. I note that '*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'.* Sleep outs/cottages such as the one on my own property is not somewhere that can be used for long term accommodation and certainly could not be sold in its own right. It is very close to my own property and is accessed through the garden. Moreover, under resource consent it is covenanted to only be used as short-term accommodation! On that basis my rates are impacted by the APTR which effectively doubles the rates I pay! The interest limitation rule would be yet another impact on the income I receive and seriously makes me doubt whether the returns I get are worth the hassle of rental.

Ultimately paragraph 2.54 has the potential to have a huge and detrimental impact on first home buyers who are likely to be more open to renting a small self-contained unit on the same property as their only home, and many other whose one and only residential property is a source of a small income that nevertheless supports mortgage serviceability. Such people cannot seriously be called investors for the purposes of this legislation and such properties cannot seriously be defined as ones that are suitable for long term owner occupation.

I suggest that the proposal in 2.54 is reconsidered so interest limitation rules are excluded for those who rent out a **<u>single separate dwelling on the same land as their only home</u>**. Therefore this should apply when the homeowner has another property or is renting out more than one dwelling on the property.

Thank you for your consideration

s9(2)(a)

From:	s9(2)(a) [redacted]
To:	Policy Webmaster
Subject:	Design of the interest limitation rule and additional bright- line rules
Date:	Monday, 12 July 2021 5:09:11 PM

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

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.

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s9(2)(a) [redacted]

s9(2)(a)

From:	s9(2)(a)
To:	Policy Webmaster
Cc:	s9(2)(a)
Subject:	[WARNING MESSAGE ENCRYPTED]PwC submission on "Design of the interest limitation rule and additional bright-line rules: A Government discussion document"
Date:	Monday, 12 July 2021 5:10:51 PM
Attachments:	PwC submission - discussion document on interest limitation for residential properties - 12.7.21.pdf

Dear Deputy Commissioner

Thank you for the opportunity to comment on the Government discussion document on the proposed interest limitation rules for residential property.   Please see our submission attached.

Please let us know if you have any questions in relation to our submission.

Kind regards
s9(2)(a)

s9(2)(a)

[redacted]

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15 Customs Street West, Auckland 1010
Private Bag 92162, Auckland 1142
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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

Subject: 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)
[redacted]

s9(2)(a)
[redacted]

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". Further, the discussion document states the following objectives:

- 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 challenge the proposals in the context of established principles of tax policy design, we acknowledge the effort that has gone into the articulation of the desired objectives of the proposals, and the recognition that the design of the rules is intended to reflect those objectives. Therefore, we have also 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 alignment with existing concepts and definitions (e.g. the existing definitions of "residential land", "dwelling", and "business premises" contained in the Act), as appropriate within the context of the objectives of the proposals. We further note our support of the approach to exclude particular categories of properties which do not fall within the desired objectives of the proposals.

A new de minimis threshold in relation to the business premises exclusion

Proposal

The Government has solicited feedback on whether an apportionment calculation would be appropriate instead of the existing "all or nothing" application of the business premises exclusion.

Comment

The Government considers that a business premises exclusion would be appropriate for the proposed interest limitation rule, particularly given the prevalence of dual-purpose buildings around New Zealand. However, the Government considers the existing "all-or-nothing" approach used for the bright-line test may not be appropriate for interest limitation.

We strongly support the general premise that interest deductions should be available for business premises. To the extent where the business use is only for a portion of the building, 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 could apply to a specific transaction (i.e. 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 for taxpayers that are already in the GST net.

Submission

That an apportionment approach is adopted in relation to determining the amount of interest deduction available for dual-purpose buildings, and that the GST apportionment methodology is applied.

Student accommodation

Proposal

The rules are not intended to apply in relation to student accommodation. The discussion document notes that most kinds of student accommodation are likely to be categorised as a “hostel” and therefore excluded from the definition of “dwelling”. However, to provide additional certainty it is suggested that an additional definition of “student accommodation” linked to requirements contained in sections 5(1)(h) and 5B of the Residential Tenancies Act 1986 be introduced.

Comment

We support the introduction of a new definition as proposed in the discussion document. We note for completeness that many universities may own residential properties as part of their investment portfolios, and it would not be appropriate to exclude such properties from the rules. The requirements of section 5B of the Residential Tenancies Act 1986 appear to be an appropriate safeguard against such concerns, as well as any concern that regular residential rental properties could be converted into student accommodation.

Submission

We support the inclusion of a definition of “student accommodation” linked to existing definitions and requirements under the Residential Tenancies Act 1986 to provide greater certainty.

Commercial accommodation

Proposal

Properties that are used to provide commercial accommodation are to be excluded from the scope of the interest limitation rules.

Comment

We agree that commercial accommodation should be excluded. However, we note that it is common that commercial accommodation operators (i.e. hotel operators) may not necessarily own the properties. Rather, the operator will lease those properties from investors.

In the above circumstances, interest deductions should continue to be available to those investors. To the extent that the resulting legislation adopts the current carve-outs to the definition of “dwelling”, we envisage that the investors leasing the property to the commercial accommodation operators would fall within the scope of the exemption.

Submission

We support clarity to be provided in the resulting legislation and guidance to ensure it is clear that taxpayers, who are the lessor, are able to claim a deduction for the interest expense incurred to in relation to the property which is used to provide commercial accommodation by the operator (i.e. lessee).

Chapter 3 - Entities affected by interest limitation

Social housing providers

Proposal

There are no specific exclusions from the proposed rules contemplated for social housing providers. This was based on the assumption that social housing providers are likely to be either registered charities or “community housing entities” (as defined in the Act) and therefore exempt from income tax. A specific exclusion is however proposed for Kāinga Ora and its subsidiaries.

Comment

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 families in need, that do not fall within the community housing entity tax exemption under section CW 42B of the Act. 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 – 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 a general residential rental. This could help alleviate the current issues faced by the Government due to the lack of social housing available.

Submission

We submit that properties which are being used to provide social housing are excluded from the scope of the proposed interest limitation rules. Our preference is for the exclusion to apply on a property-by-property basis and not on an entities approach on the basis that a business can hold a range of investments, including those that are used to provide social housing.

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

Availability of both apportionment and stacking

Proposal

The general approach proposed to determine whether interest limitation applies is to trace the use of amounts borrowed to the use of the funds. For pre-27 March loans (i.e. loans for which interest deductions will be phased out over time), the discussion document proposes two options: apportionment and stacking.

Comment

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.

Submission

Both the apportionment and stacking methods should be available as options and in relation to all pre-27 March loans (i.e. not just those where tracing is not possible). To the extent where only one option is made available, our preference is for the stacking approach to be adopted.

Application of s BG 1 to restructured arrangements / refinanced loans

Proposal

The discussion document states that a taxpayer who restructures their borrowings so that it is traced to non-residential business assets should be allowed full interest deductions, subject to possible application of the general anti-avoidance rule in section BG 1 of the Act.

Comment

The discussion document is explicit that, under a tracing approach, tax deductibility is based on the use of the funds, not on the security or collateral for the loan.

Therefore, we would not expect the general anti-avoidance provision in section BG 1 to apply (that is, we would not expect a finding of artificiality) in relation to restructured arrangements which are consistent with black letter tax law and existing Inland Revenue publications on the application of section BG 1.

Submission

Further clarification should be provided as to when the general anti-avoidance provision would apply in the case of restructures of funding arrangements, including clarifying that the restructure would not be subject to the general anti-avoidance provision provided it is consistent with black letter tax law and existing Inland Revenue publications.

Evergreen loans (revolving credit facilities)

Proposal

Interest on amounts borrowed on or after 27 March 2021 in relation to existing residential property will be non-deductible immediately.

Comment

The discussion document proposes a “high water mark” approach to address the potentially complex tax outcomes arising from the interest limitation rules on loans drawn down under a revolving credit facility.

An “evergreen” facility is similar to a revolving credit facility in that the principal borrowed fluctuates. The terms may need to be renewed periodically. For these types of loans, there is ambiguity as to what extent a renegotiation of terms will constitute “new lending” under the Government's proposals.

Submission

Further clarity is required in the determining when “new lending” arises under an “evergreen” facility.

Interest rate swaps

Proposal

The current proposal does not provide for symmetrical tax treatment of interest rate swaps in relation to taxable residential property.

Comment

We support the current proposal in relation to foreign currency hedges, which would ensure symmetrical tax treatment by removing gains or losses on a hedge of a foreign currency loan that is covered by the interest limitation proposals.

However, the financial arrangement rules also impact interest rate swaps, which do not appear to be contemplated in the discussion document. Gains or losses on interest rate swaps should not be assessable or deductible if the interest in relation to the loan is also nonassessable or non-deductible.

This approach would be consistent with Inland Revenue's views contained in the limited consultation on the fair dividend rate foreign exchange hedging rules in October 2020.

Submission

That the gains or losses on interest rate swaps in relation to affected loans be non-assessable or non-deductible as applicable.

Chapter 5 - Disposal of property subject to interest limitation

Proposal

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

Comment

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 the point of sale by not carrying them forward under the proposed anti-arbitrage proposals.

Submission

We support options D and F but with the acceptance that taxpayers can choose to "forfeit" any interest deductions that they do not wish to carry-forward under the anti-arbitrage mechanism.

Chapter 6 - Development and related activities

Exemption for developers

Proposal

The current proposal will mean that certain land developers who subdivide land (and are therefore not the target of the Government's policy to increase housing supply through the tax system) may nevertheless be subject to the rules. The development exemption is proposed to cover:

- land being developed by persons in the business of developing or dealing land or erecting buildings (captured under section CB 7 of the Act); and
- other developments which may not be covered under section CB 7 but contribute to the creation of a new build.

Comment

The Government is seeking to ensure that the proposed rules do not discourage further residential property development (as the objective of the proposed rules is to increase housing supply). However, applying the development exemption based on the activity and not the entity presents practical issues given the way in which many property developers operate.

We are aware of land developers who buy significant parcels of land over time using debt financing with the strategy of subdividing the land for residential housing in the future. Often, the land has an existing residential dwelling (for example, a lifestyle property in a rural area). As a matter of commercial practice, development activities do not necessarily begin immediately after acquisition. Further, the land may be acquired by a special purpose acquisition entity which has not carried out any development activities.

There may be significant periods of time that land acquired for future development is being rented out as residential property (sometimes exceeding ten years). Given the Government's stated intention to encourage residential land development, it would be inconsistent with Government's policy objectives (and may discourage residential property development) for the land developer to be subject to the interest limitation during this period when the property is being rented out. The amount of interest denied could be significant because of the length of time involved in planning a subdivision.

Further consideration should be given to ensuring that the development exemption will still apply in these circumstances. Although the land is acquired for the ultimate purpose of development, there could be some technical uncertainty as to whether the land is subject to section CB 7 (and therefore the development exemption applies).

Furthermore, we consider a broader general exemption should apply to cover development activities that are captured by other land sale tax provisions – i.e. 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 (i.e. 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 (i.e. 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.

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.

Submission

We submit that the development exemption would need to apply in circumstances where land is acquired by an acquisition entity which holds and rents out the property for an extended period of time before development activities commence.

We further submit that a broader general exemption should apply to cover development activities that are captured by other land sale tax provisions – i.e. the activity is not captured by section CB 7.

Definition of remediation activities

Proposal

Remediation work could be treated as a development activity where the work makes a building habitable or extends the life of a building.

Comment

We support the inclusion of remediation work to make a building habitable (e.g. including conversions from commercial to residential use) or to extend the life of a building, on the basis that it leads to an increase in the housing supply as well as improving the quality of housing stock. Certain kinds of remediation activities are required by law - for example, earthquake strengthening (under the Building Act 2004), insulation, ventilation, drainage, guttering, and draught-stopping (under the Residential Tenancies (Healthy Homes Standards) Regulations 2019 ("**the Healthy Homes regulations**"). In our view, these should be explicitly confirmed as qualifying remediation activities that result in interest deductions (either under the legislative definition or through guidance) as they are activities that the Government wishes to incentivise.

Submission

We submit that interest expenses incurred to carry out earthquake strengthening and remediation performed to meet the Healthy Homes regulations be deductible.

Chapter 8 - New build exemption from interest limitation

Build to rent

Proposal

The general rule is that the exemption should only apply in relation to new builds with a code compliance certificate ("**CCC**") issued on or after 27 March 2021. This is subject to transitional rules which allow the new build exemption to apply in relation to properties which received a CCC before 27 March 2021 but the land was acquired on or after 27 March (up to 12 months after the CCC was issued).

Comment

As a general comment, we note that the position of build-to-rent ("**BTR**") developments has not been considered in great detail in the discussion document. Specifically, we submit that consideration should be given to providing transitional relief to BTR developments which have recently been completed, similar to the transitional rule set out in this chapter.

BTR developments help increase housing supply (and contribute towards greater variety and choice in the overall housing stock). We would expect that new BTR developments would be able to obtain relief from the proposed rules through a combination of the development and new build exemptions. However, relatively new BTR developments which are now being rented out may not be able to access this same relief, effectively being penalised for being early movers in this space.

A form of the transitional rule described in this chapter could apply to larger BTR developments which were issued CCCs up to four years before 27 March 2021. This transitional rule could be narrowly targeted towards larger BTR developments by including requirements as to the size of the project.

Submission

An extended transitional rule should be considered for larger BTR developments so as not to penalise early movers.

Commercial to residential conversions

Proposal

Conversions from commercial to residential will be considered as a "new build" and therefore excluded from interest limitation. However, this is based upon the issuance of a CCC.

Comment

It is 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 in 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 – i.e. 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.

Submission

We submit that a supplementary test based on the GST change-in-use rules is included in the definition of a "new build" for commercial to residential conversions which do not require an issuance of a CCC.

Early and subsequent purchasers

Proposal

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.

Comment

On balance, we consider that providing a new build exemption in perpetuity for early owners and a fixed period for subsequent purchasers strikes the right balance between reducing demand for residential property investment while managing the supply of new builds by supporting the resale value of the property.

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

We do not support the proposed continued investment rule. New builds should be treated in the same way regardless of whether an early owner lives in the property, to support the increase of new housing supply. It is unclear to us what the proposed continued investment rule is trying to achieve. Furthermore, the rule would impose additional compliance costs due to the requirement to check whether previous owners have lived in the property and would cause uncertainty.

Submission

We support the availability of the new build exemption in perpetuity for early owners and a fixed period for subsequent purchasers. We do not support the proposed continued investment rule.

Chapter 10 - Rollover relief

Proposal

Rollover relief is proposed in certain circumstances, including involuntary dispositions (e.g. transfers upon death or relationship property transfers) and where there has been no change in economic ownership.

Comment

We support rollover relief in the circumstances provided in the discussion document, based on tax principles of equity and efficiency.

We do not support a time limit on rollover relief for the new build exemption upon death (such as allowing the rollover relief for transfers on death only once). The same rationale for providing rollover relief on the first transfer on death should apply equally to subsequent transfers on death.

Submission

We support the availability of rollover relief, without a time limitation.

Chapter 11 - Interposed entities

Frequency of apportionment calculation

Proposal

Where residential land subject to the rules is held in an interposed entity, an apportionment calculation is to be performed to determine the amount of interest expenditure subject to interest limitation. Performing the calculation more frequently gives the most accurate result whereas an annual calculation could give rise to integrity concerns.

Comment

While we appreciate that a daily calculation would give rise to the most accurate outcome, in our view there should be a tradeoff between accuracy and simplicity. This is particularly the case given the overall increase in complexity as it relates to the tax rules for residential property. We support an annual calculation (with a specific anti-avoidance rule if it were considered necessary), or a quarterly calculation.

Submission

We do not support a daily or monthly apportionment calculation due to the increased complexity involved. We submit that a quarterly or yearly calculation should be used.

Chapter 12 - Implications for the rental loss ring-fencing (RLR) rules

Interaction between the development exemption and the RLR rules

Proposal

The discussion document proposes that properties subject to the development exemption from the interest limitation rules should be exempt from RLR under the existing carveout for property developers, property dealers, and builders who fall under section CB 7 of the Act.

Comment

In our view, the existing exemption from RLR may not be sufficient to exclude one-off remediation, including work such as earthquake strengthening (which was contemplated in chapter 6 and which our submission supports). In order to achieve the objectives of the interest limitation rules, we submit that an additional specific exclusion for properties subject to the interest limitation development exemption be excluded from the RLR rules.

Submission

A specific exemption to the RLR rules should be included for properties subject to the development exemption under the interest limitation rules.

From:	s9(2)(a)
To:	Policy Webmaster
Subject:	INTEREST LIMITATION AND ADDITONAL BRIGHT-LINE RULES: GROUND LEASE STRATA LEASEHOLD STRUCTURES
Date:	Monday, 12 July 2021 5:14:46 PM
Attachments:	image001.png P0564_18805_007.pdf

Please see our attached submissions for your consideration.

Ngā mihi | regards

s9(2)(a) [redacted]

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12 July 2021

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

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

Dear Deputy Commissioner

INTEREST LIMITATION AND ADDITONAL BRIGHT- LINE RULES

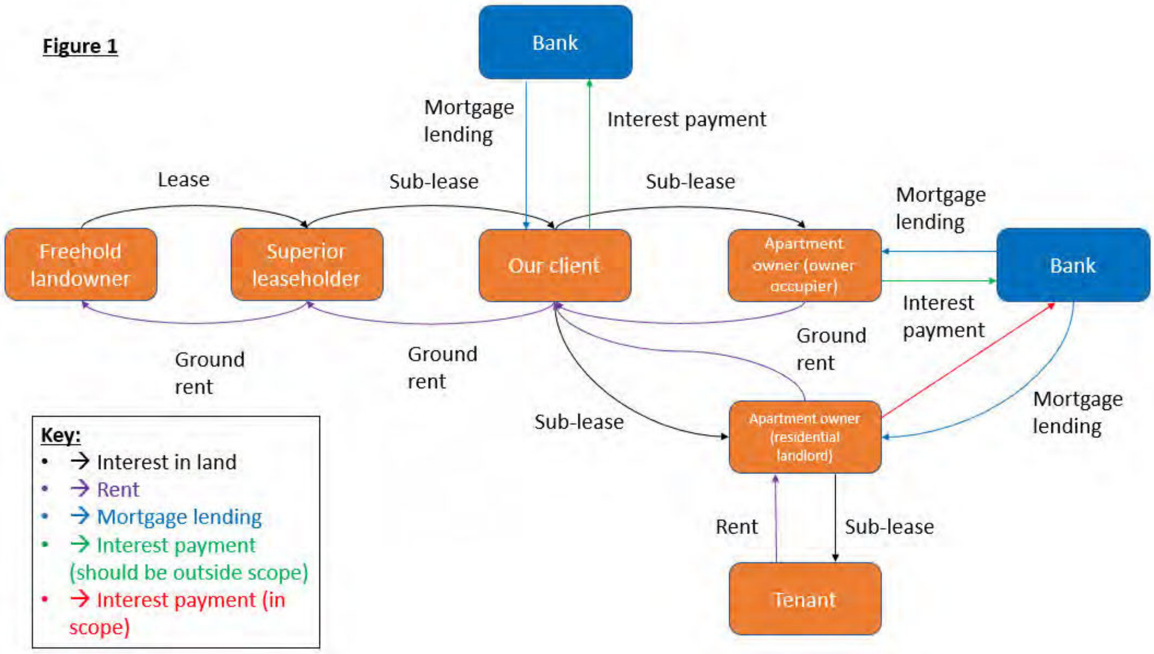
Thank you for the opportunity to comment on the Government discussion document: Design of the interest limitation rule and additional bright-line rules.

Background

Our client (through its subsidiaries) holds intermediary leasehold interests in relation to s9(2)(b)(ii) [redacted] The freehold of the land is owned by a an unrelated party, who leases it to a superior leaseholder, who subleases to our client, who subleases to the ultimate lessees. s9(2)(b)(ii) [redacted] These ultimate lessees own an interest in the buildings and improvements built on the land by the original developer including apartment buildings s9(2)(b)(ii) [redacted] as well as some mixed use / commercial. Our client's ground lease interest is on a separate certificate of title (with lending secured against its separate title) from the individual apartment owners' title and security. Our client derives ground lease rents from the ultimate lessee/apartment owners.

We set out the arrangement in the diagram pictured below (**Figure 1**):

Figure 1



s9(2)(b)(ii) [redacted] this is a common type of commercial arrangement and we consider that the issues raised in our submission below are of wider application. Ground lease arrangements are common all over New Zealand and lease strata s9(2)(b)(ii) [redacted] comprise around 1000 apartments in Auckland alone (of which we are aware).

Our client's tax position under the proposals

The discussion document proposes that the new interest limitation rules should apply to interest expenses relating to "residential land". The current legislative definition of "residential land" includes land that has a dwelling on it or bare land that can be used for erecting a dwelling. "Land" is defined for tax purposes as including an interest in land.

Based on these existing definitions, we would expect that it is arguable that the leasehold interest held by our client is residential land for the purposes of the proposed interest limitation rules. As such, interest expenses incurred by our client in relation to its leasehold interest would be phased out over time and eventually be non-deductible.

Submission

The discussion document states that the proposals are intended to reduce the tax advantages associated with residential property investment. This is intended to lower investor demand, which should reduce the upward pressure on housing prices. Further, the goal is to make the purchase of residential properties more affordable for potential owner-occupiers.

In our view, the tax outcome for our client if the proposed rules were to apply would represent an unintended overreach, contrary to the Government's housing policy objectives.

Our client's leasehold interest is a s9(2)(b)(ii) . It is merely a legal interest which is one step removed from the kind of residential property which we consider to be the intended target of the proposed rules. We submit that removing interest deductions in relation to this kind of indirect legal interest would not support the Government's desired impact on the housing market and may give rise to unintended consequences. We elaborate further below.

Housing market impacts

We submit that reducing investor demand in the kind of legal interest held by our client would not necessarily make housing more affordable for potential owner-occupiers. Our client's leasehold interest is a s9(2)(b)(ii) .

Our client's leasehold interest is separate to ownership of the apartment. Rather, it merely gives our client the right to derive ground rent from the sub-lessees (i.e. the apartment owners). The leasehold structure does not give our client a right to live in the apartment, or to build a dwelling on the land. Reducing demand in this type of investment would therefore not be expected to have an impact on the demand for residential housing that potential owner-occupiers could purchase to live in.

We note that a number of exclusions are proposed from the definition of "residential land" for the purposes of the interest limitation rules. In our view, this indirect legal interest in land shares many of the characteristics of other kinds of property proposed to be excluded:

- **Physical structure and configuration**: the physical occupation, the entitlement to rent for such occupation and the associated right to sale proceeds in relation to a sale of the physical structure for such residential use is not part of our client's interest. The leasehold interest is separate to the ultimate right to the physical structure (i.e. the apartment) on the land.

- **Unconditional occupation**: the leasehold interest does not provide any right to occupation of a dwelling since it gives exclusive occupation to the ultimate owner occupier/residential landlord for s9(2)(b)(ii) Rather, the right to occupy the apartment is derived from ownership of the apartment title (which our client does not own).

Under the terms of our client's lease agreement with its lessees (i.e. the individual apartment owners), it is not possible for our client to increase the ground rent to pass on the cost of its denied interest deductions as the ground rent has already been set contractually. However, even if our client was able to do so, in principle we submit that such an outcome would be inconsistent with the Government's policy objectives. Increasing the ground rent would increase the overall cost of owning the property (when factoring in the higher ground rent payable during the time that they own the apartment). This would make the apartments more expensive for prospective purchasers who intend to live in the apartment as their main home. We note that the Government has firmly stated that the proposed changes will not apply to the family or main home. For potential purchasers who intend to rent out the property, any interest expenses in relation to that investment (i.e. purchase of the apartment building itself) would still be subject to the proposed rules (i.e. refer to the red arrow in Figure 1 above).

Conclusion

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

Yours faithfully

s9(2)(a)

[redacted]

From: s9(2)(a)
To: Policy Webmaster
Subject: Design of the interest limitation rule and additional bright- line rules
Date: Monday, 12 July 2021 5:19:20 PM

Good afternoon,

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. This seems like blame shifting from the government onto people who are operating under rules set by previous governments.

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.

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

s9(2)(a)

PUB-0421

From:	s9(2)(a)
To:	Policy Webmaster
Subject:	Design of the interest limitation rule and additional bright-line rules
Date:	Monday, 12 July 2021 5:21:30 PM
Attachments:	Interest limitation and bright line submission.docx

Submission attached

Design of the interest limitation rule and additional bright-line tests
C/- Deputy Commissioner
Policy and Regulatory Stewardship Inland Revenue Department

policy.webmaster@ird.govt.nz

Design of the interest limitation rule and additional bright-line tests submission

The announced of the Interest limitation rule and bright line test without consultation was unfair. More notice should have been given and discussion entered into.

Interest limitation for residential landlords is discriminatory. If landlords have obtained loans to purchase a residential rental property, and they derive revenue from this property they should be entitled to deduct the interest on the loans from the revenue, just like businesses are entitled to do. Who else is penalised in this manner?

The legislation is going to severely impact middle NZ landlords. People who decided to plan for the future by having rental properties so they have money for their retirement or to help a family get on the property ladder. Many will have purchased the properties sometime ago and will be locked into loans and mortgages and will now have to struggle to hold onto these plans. The government is playing god with people's lives and, of course, gaining a substantial amount of revenue in the process.

The Government's "objective to tilt the playing field away from property investors and towards first home buyers" is very one sided. The term 'property investors' is very broad and includes many mum and dad investors trying to get a nest egg for their retirement and people who have bought a house to get on the property ladder and are renting it out while living with parents or renting themselves. These people are not speculators but are trying to plan for the future.

The bright line test impacts people who may have brought a rental property in another city to get on the property ladder and subsequently want to sell to buy a property for themselves. It also takes no account of situations where a property may need to be sold for financial reasons or a relationship split.

Rental properties are required for people who may not want to or ever be able to afford to buy a property. By attempting to reduce the rental stock it is going to make it more difficult for these people to find accommodation which will effectively drive rents up.

Ordinary New Zealanders should be allowed to have one, if not two, rental properties before the interest limitation and bright line rules apply. This means that ordinary hardworking people can still continue with their personal plans.

Having different rules for new builds is not fair. Most people who want to have a rental property cannot afford to fund a new build without income. The only people this benefits is developers.

When investors sell they should be entitled to claim real estate agent fees as a deduction. Why should they have to pay tax on the proceeds of a property without any allowance for these fees.

The government should place restrictions on the exorbitant fees that real estate agents charge. Reducing these fees would have to have a positive impact on housing prices. What other industry gets a pay increase, with no additional effort, when property market values increase? The government has restricted pay increases for public servants yet real estate agents are allowed to continue to earn huge amounts of money.

The document states that the objective is to introduce the changes as fairly and simply as possible. There is nothing fair about it.

While I agree with most of the Healthy Homes principles, landlords are being forced to spend money on one hand and are being penalised with the new rules on the other. Not all landlords can afford to pay the tax on rental income without the offset of the interest. They have already experienced tax restrictions and ring-fencing of losses and now this.

We became landlords by circumstance rather than a plan to own rental property. Once we had a property we saw it as an opportunity to use this for our retirement rather than contribute to superannuation schemes. We have worked hard all our lives. We have one rental property. The rent just covers the costs. Now we are going to be penalised for trying to get ahead. We have struggled over the years to be able retain the property often having to make top up payments and feel that losing the ability to claim the interest and having to pay tax on the income is totally and utterly unfair.

s9(2)(a)

PUB-0422

From: s9(2)(a)
To: Policy Webmaster
Subject: Design of the interest limitation rule and additional bright-line rules
Date: Monday, 12 July 2021 5:21:33 PM
Attachments: Interest deductibility submission.pdf

Kia ora,

I would like to submit the attached document in response to the Government's discussion document on *Design of the interest limitation rule and additional bright-line rules*.

Thank you very much for your consideration and I wish your team the best as they work through this process.

Best regards

s9(2)(a)

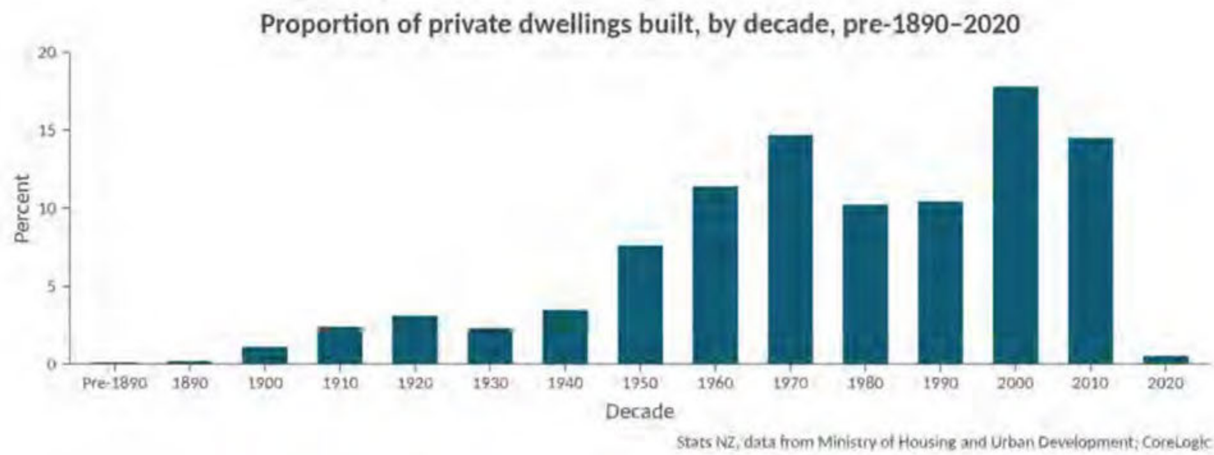
Submission in response to the government discussion document on *Design of the interest limitation rule and additional bright-line rules*

s9(2)(a)

[redacted]

1. **Summary:** This submission advocates that interest deductibility should apply for a **fixed period of 20 years for both early owners and subsequent purchasers** and that a property should **not cease to qualify for the new build exemption once it has been lived in by an owner-occupier.** Under these rules, the interest deductibility limitation would **apply to around two-thirds of all homes**, while the limitation exemption would apply to one-third of all homes. The deductibility limitation would be **predictable**, **easily enforceable**, and would **avoid undesirable market outcomes**. Other options may inadvertently **disincentivizing new builds.**
2. My name is s9(2)(a) and I write in my capacity as a private citizen. s9(2)(a) concerned about the housing crisis. I have worked in the property sector for a little over the year as a data scientist and have an understanding of the industry from a birds' eye view.
3. I have recently become a first-home buyer and have experienced the stress of a constrained market first-hand. I plan to enter the market as an investor myself when I have the money available. Due to the proposed law on interest deductibility I intend only to purchase a new home. The new law does restrict my options somewhat. But overall, I support the law. I have experienced the stress of watching skyrocketing house prices while trying to pay the rent and I don't wish that on any of my friends or family who are still renting.
4. This submission addresses the question, "Who should the exemption apply to and for how long?" in Chapter 8 of the discussion document, *Design of the interest limitation rule and additional bright-line rules*.
5. Section 8.20 of the discussion document lays out three possible answers to the question, "Who should the exemption apply to and for how long?", and I advocate for the third possible answer given, "For a fixed period for both early owners and subsequent purchasers". I also advocate that the example given in Section 8.20 for the fixed period, is a sensible length of time.
6. **A long fixed period of 20 years interest deductibility will still be effective because it would leave around two thirds of all private dwellings covered.** The discussion document asks if "a longer exemption will dampen house prices by less than a shorter

exemption". Even with a fixed period of 20 years, the ban will still be highly effective because most houses in New Zealand are much older than 20 years. Consider Statistics New Zealand's recent report, *Housing in Aotearoa 2020*. The report contains the following data credited to Statistics New Zealand/CoreLogic.



The data shows 18% and 15% of private dwellings were built in the decades beginning 2000 and 2010, respectively. This amounts to 33% of private dwellings in total. **A fixed period of 20 years interest deductibility for new houses in 2021 would therefore still leave 67% of private dwellings where the interest deductibility limitation applies.**

7. **Twenty years** is an appropriate fixed period of interest deductibility because 20 years is the modal term of a mortgage in New Zealand. Arguably, paying off the initial build costs of a house is an expense related to the original build of the house. Even if the investor later sells the home, in a sense the cost of having built the home is 'built in' to the loan the next owner takes out to buy the house.
8. **A fixed period of interest deductibility limitation exemption would be predictable**. Each local body council records the age of dwellings in their area. Thus, the number of dwellings coming out of the limitation exemption each year would be easily predictable from an inventory of the number of houses 'ageing out' of a the fixed period.
9. **A fixed period of interest deductibility limitation exemption would be easily enforceable**. Because it is simple to test the age of a house, it would be straightforward to enforce the limitation exemption because it would be very clear when the exemption applies and ceases to apply.
10. The discussion document's Section 8.22 says "*The Government invites your views on whether a property should cease to qualify for the new build exemption once it has been lived in by an owner-occupier ('continued investment rule')*". I am of the view that the property should **not** cease to qualify for the new build exemption once it has been lived in by an owner-occupier.

11. The solution proposed in this submission, for **interest deductibility to apply for a fixed period to any owner regardless of any owner-occupiers**, is the only solution that avoids undesirable market distortions. Problems with each of the alternatives are described below.
12. **Owner-occupiers should not remove an exemption because this risks disincentivizing new builds:** Consider the proposal for the property to cease to qualify for new build exemptions once it has been lived in by an owner-occupier. Some investors may wish to build a new property to live in it with the intent of later renting the property out. That proposal would incentivize them against this course of action. Instead, those investors might choose to buy an existing house instead (which may involve less risk than a new build). Alternatively, they may choose not to move into their new house for any period of time, even if that means leaving their new build empty. In that case they would presumably rent or hold another house to live in. Either way, housing supply will be threatened.
13. **Owners should be able to pass on the exemption to new owners; not being able to weakens the incentive to invest in new builds**. An investor may choose to build a new home with the intention of renting it out and later selling it. If the investor cannot 'pass on' the exemption to the next buyer, they could respond in two ways. First, they might choose to not build the new home at all. Thus, losing the ability to pass on the exemption could weaken the incentive to build new houses. Second, an investor might choose to hold the home themselves. This would remove the house from the secondary market where First Home Buyers could otherwise benefit from. Thus, **losing the ability to pass on the exemption could restrict choices available to first home buyers**.
14. **Why the exemption should applying the exemption to a fixed period only**. **If an exemption instead applies to an owner past the fixed period**, then the house becomes much more valuable to that investor than to any other investor and **this could introduce various market distortions**. Consider an early investor A, who has purchased a house. They hold the house for 25 years, passed a fixed period of 20 years. Although Investor A continues to benefit from the interest mortgage deductibility past the initial 20 year period, Investor B would not benefit from that exemption. This would incentivize investors to hold properties even when it would be otherwise in their interest to sell them. This seems like an undesirable market friction that will make the market less efficient and should be avoided.

PUB-0423

From:	s9(2)(a)
To:	Policy Webmaster
Subject:	Design of the interest limitation rule and additional bright-line rules
Date:	Monday, 12 July 2021 5:24:18 PM

Dear IRD and Treasury team,
Thank you for the invitation to comment on this important policy proposal. I have reviewed the materials and consider the policy in general to be relevant and well-designed to achieve its goals. It is clear that a lot of careful thought has gone into this.
I will focus my comments on two specific areas where I think I have the best chance of adding value to the discussion. Please note that I am submitting my own thoughts as an urban development professional and my comments do not reflect the position of PwC. Nothing I say here is to be taken as a PwC product or message in any way.

- **On whether remediation work undertaken by someone who does not have a property development business should also qualify for the development exemption, particularly for work that makes a building habitable or extends its life:** Remediation work that extends a building's life has two types of effect: first, it can be said to increase housing supply by adding "dwelling-years" to the overall housing market. Second and more importantly, it may increase the opportunity cost of more substantial redevelopment of a plot (e.g replacing a dwelling with multiple dwellings), thereby delaying the addition of more supply and preventing more "dwelling-years" than it adds. This is especially true in high-demand urban areas included under the upzoning rules introduced by the NPS-UD. To focus the incentives of the policy on greatest possible increases to housing supply, I suggest the development exemption for someone who does not have a property development business should only extend to activities that increase the total number of dwellings on the property.
- **On the potential extension of the new-build exemption to purchasers who acquire the new build more than 12 months after the CCC is issued:** I assume that the aim of this exemption is to indirectly encourage new builds by increasing their commercial viability, since investor demand for them will take future tax exemptions into account in their ROI calculations. On one hand, the government wishes to encourage as much new supply as possible, while on the other, the purpose of the policy is to depress investor demand to improve the purchasing power of would-be owner-occupiers, and this exemption mitigates that latter goal.
  I argue that the concern for incentivising additional supply is the more important factor for long-run housing affordability, but that the effectiveness of an exemption diminishes as time passes from the moment of the first purchase. The government should frame the question of how long the exemption is available as follows:
    - The exemption is only relevant as a supply stimulus to the extent that it influences the first sale of the finished house and by extension the developer's NPV and decision on whether to build at all.
    - This implies that there will be a point some number of years after the first purchase when continued exemption would no longer materially influence investor demand at the moment of the first purchase decision. At this point, the exemption is no longer appropriate.
    - This might be expressed quantitatively as a comparison between the exemption's impact on the early buyer's ROI (and thus indirectly on overall demand for new builds, noting this is mitigated to the extent that demanders are owner-occupants rather than investors) and the overall uncertainty faced by developers when forecasting margins to inform the build/no build decision. If the impact of the exemption is small compared to, for example, the risk of a delayed and costly consent process, it may not be worthwhile to dull the

policy's intent of advantaging owner-occupiers for what would be an immaterial boost to supply.

I am happy to be contacted by IRD or Treasury to discuss these comments further. All the best in your ongoing work on this.

Best regards,

--

s9(2)(a)

[redacted]

From:	s9(2)(a)
To:	Policy Webmaster
Subject:	Design of the interest limitation rule and additional bright-line rules
Date:	Monday, 12 July 2021 5:47:58 PM
Attachments:	submission.pdf

To whom it may concern, Please find attached my submission.

s9(2)(a)

Sir/ Madam,

Letting rental properties is a commercial activity. With any other business when that entity incurs interest costs it is able to claim for that loss.

If we look at the mortgage costs, rates and insurance associated with homeownership versus rental income in most scenarios without being able to claim the interest costs it can make for an unviable proposition. The downside of this is that people who already own investment property won't be in the position to maintain the property to an appropriate level and tenants will be negatively impacted. The overall quality of the housing stock of the nation will drop. Whilst properties will be Healthy Homes compliant their general quality will likely be very poor and I outline the numbers below as to why.

Investors will not have the ability also to provide further rentals for the market that is already in crisis due to these high expenses. This will cause more tenants to go into temporary accommodation and raise families in motels which is not good for them, the state or investors.

There is an idea that this tax law change will be offset by new homes. Currently there isn't enough land, compliance costs associated with council are hugely expensive and material costs are through the roof making in unviable for most people to invest in new housing stock due to the negative cash flow.

It is anticipated that at some point in a thirty-year period an investor would have to replace the carpet, paint the exterior and interior at least three times, replace the hot water cylinder, bathroom vanity, kitchen cabinetry and appliances, clean gutters and drains plus numerous other expenses that go with owning a home.

In Auckland or Wellington where the lion share of kiwis live these are suitable numbers:

Purchase price $800,000

Deposit $240,000

Total borrowings $560,000

$560,000 P&I on a 30 year loan at 2.99 fixed for three years = $2,357.96 per month

Monthly council rates at $2300 p.a. = $191.67 per month

Monthly insurance at $2333 p.a. = $194.42 per month

Monthly rental income at $530pw = $2,120 per month

Total expenses **before** vacancies, management fees and maintenance is $2,7440.05, less the rental income is a deficit of $624.05 per month.

Optimistically if you could maintain the property (as mentioned in a previous paragraph) over a thirty-year period for $75,000 that would be an additional cost of $208.33 per month.

So the investor is not able to claim the interest loss on that $832.38 and this is in an optimistic scenario. At present investors borrow to maintain and do-up property but it won't be economically viable if tax law is changed.

Inclosing I am for keeping the interest deductibility so investors can maintain the homes to a standard that renters would expect s9(2)(a) [redacted]

s9(2)(a)

[redacted]

From:	s9(2)(a)
To:	Policy Webmaster
Subject:	DESIGN OF INTEREST LIMITATION RULE
Date:	Monday, 12 July 2021 6:15:41 PM
Attachments:	12072021181141-0001.pdf

Please see attached.

Regards

s9(2)(a) | Gilligan Rowe + Associates LP
A: Level 6, 135 Broadway **P**: PO Box 9918, Newmarket, Auckland 1149
s9(2)(a) **W**: www.gra.co.nz

We would love feedback on how we are doing. Please click here to tell us

From 1 October 2018 new Anti-Money Laundering (AML) legislation requires that we seek more information from our clients to prove their identity, address and source of funds. Please don't be offended when we ask you for this information.

GRA GILLIGAN ROWE + ASSOCIATES

GILLIGAN ROWE & ASSOCIATES LP
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12 July 2021

Design of the interest limitation rule
C/- Deputy Commissioner, Policy and Regulatory Stewardship
Inland Revenue
Via - policy.webmaster@ird.govt.nz

Dear Sir

DESIGN OF INTEREST LIMITATION RULE

We thank you for your opportunity to submit on the discussion document issued in relation to the design of the interest limitation rule and additional bright-line rules. We specifically wish to submit on the definition of the term "new build". As noted at paragraph 7.3 in the discussion document the intention is that the only property that should qualify as a new build is where the residential housing supply has clearly increased. Subsequently at paragraphs 7.9 and 7.10 a view is proffered that renovating an uninhabitable dwelling so that it becomes habitable is not to be regarded as falling within the new build definition due to difficulty in differentiating between a renovation which increases housing supply and that which does not. It is our view that it is not appropriate to exclude remediations which make an uninhabitable dwelling, habitable, from the definition of new build. Our view is that such a renovation clearly increases housing supply.

Extension of Definition of New Build

In summary our submission is as follows.

a) That the new build definition should include properties that are currently uninhabitable and uninsurable, and subsequently remediated to the point that they become habitable and insurable.

b) Essential to this is having a definition of a "pre-remediated property", which is one which is currently uninhabitable and uninsurable.

c) There could be specification to focus on "as is" earthquake damaged property in Christchurch. This could further be extended to include property in other regions effected by natural disasters.

d) Interest incurred on money borrowed to acquire such property, and interest incurred on money borrowed to remediate such property, should be deductible initially under the developer exemptions and subsequently under the new build exemption.

Example

One example which we are particularly concerned about is remediation of "as is" properties in Christchurch. In our experience there are clearly grounds for including the remediation of such properties within the definition of new build. As the Government will be well aware, there is a plethora of "as is" property in Christchurch that could be remediated to increase housing supply there. For the large part these properties are currently not only uninhabitable, but also uninsurable. It is our view that a definition of a pre-remediated property could be crafted to include properties that are earthquake damaged and as a result of that uninhabitable and uninsurable.

Following this, we consider that interest incurred in buying and then remediating such properties so that they become both insurable and habitable, be included in the new build definition and therefore excluded from the interest deduction limitations.

Multi-tenancy Properties

On a secondary note, we also wish to submit on the exemptions to the definition of residential land and consider that an exemption should be added for multi-tenancy properties that sit on the same title and under the ownership of the same legal entity. We reach this conclusion on the basis that such properties are not substitutable for owner occupied homes. Given the tenet of paragraphs 2.11 and 2.12 of the discussion document, noting that the focus of the rules is to deny interest deductions for investors who acquire housing stock which otherwise could be available to owner occupiers, this rationale should not extend to deny interest deductions in relation to properties such as multiple flats that sit on one title. These are not properties that are readily available on the market to owner occupier purchasers. They are not easily converted to being properties that would be available to owner occupier purchasers and keeping the incentive of interest deductions in relation to these properties would mean that they remain available for tenant occupiers, thus maintaining housing supply that would otherwise then potentially be converted into other non-residential use where there may be a tax incentive to do so.

We thank you for the opportunity to submit on these rules and would welcome any queries you may have in reply.

Yours faithfully
For Gilligan Rowe & Associates LP
s9(2)(a)
[redacted]

From: s9(2)(a)
To: Policy Webmaster
Subject: Design of the interest limitation rule and additional bright- line rules
Date: Monday, 12 July 2021 6:30:26 PM

Hi,
My name is s9(2)(a) and I have owned rental properties for 36 years, and I have the below comments on the proposal;

- The rules are far too complicated, MAKE IT SIMPLE the 143 page discussion document, shows that these rules are too complicated and will be an unfair burden on taxpayers to comply with.. The new rules need to be simple and easy for all to follow.

- I really disagree with the proposed interest limitation rules. The governments housing objectives are to ensure affordable homes. I believe this policy will push rents higher as investors react to the implementation of these rules by selling existing rental properties. Less rentals upsets the supply / demand balance and will push rents higher.

- Property owners who are deemed to have a taxable sale under the brightline rule should be able to deduct interest for the whole period of ownership in the year of sale. The investor is already paying a large amount of tax on the sale as all tax from the sale will be at the highest tax rate.

- Rollover relief should be included and should also include LTC elections and all related party transfers, including share transfers. This should also be back dated to 29/3/18 as many property owners will be unintentionally caught by these complicated rules.

Cheers
s9(2)(a)

[redacted]

Hydro & General Engineering Ltd
s9(2)(a)

s9(2)(a)

From:	s9(2) [redacted]
To:	Policy Webmaster
Subject:	REINZ Submissions: Design of the interest limitation rule and additional bright-line rules
Date:	Monday, 12 July 2021 6:34:29 PM
Attachments:	image002.png image003.png image004.png image005.png REINZ Submissions on interest limitation and extension of the Brightline test 120721.pdf
Importance:	High

Good evening

Please see attached submissions.

Thank you for the opportunity to make submissions on behalf of our members.

Kind regards

s9(2)(a) [redacted]

12 July 2021

Ministers of Finance & Revenue
Parliament Buildings
Wellington

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

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

Introduction

Thank you for the opportunity to submit on behalf of members on the proposal to phase out mortgage interest deductibility for residential property investors and to extend the bright-line test from 5 years to 10 years (**the Proposals**). The Real Estate Institute of New Zealand (**REINZ**) is grateful for this opportunity.

REINZ is a membership organisation with more than 16,000 members (representing approximately 90% of the real estate profession). Our members span the breadth of real estate services, including residential sales, rural/lifestyle, auctioneering, business broking, commercial & industrial sales & leasing and property management.

General Comments

Broadly speaking, REINZ supports the Government's *objectives* behind the consultation in that it is aiming to:

- ensure that every New Zealander has a safe, warm, dry, and affordable home to call their own – whether they are renters or owners
- support more sustainable house prices
- create a housing market that responds to population growth and changing housing preferences, that is competitive and affordable for renters and homeowners, and is well-planned and well-regulated.

We are also mindful of the Government's comments that it must 'balance several housing, economic and tax policy objectives'.

However, REINZ cautions against proceeding with the Proposals. REINZ believes the consequences (both intended and unintended) will outweigh the potential benefits. Additionally, we do not believe that the Proposals will achieve the objective of improving affordability for renters or first home buyers.

All initial feedback from members on the Proposals has been negative.

Residential property subject to interest limitation

While the proposals are designed to 'tilt the playing field away from property investors and towards first home buyers' (paragraph 2.4), REINZ's view is that this objective is unlikely to be achieved. What is likely to happen, is that investors will raise rental prices in order to offset losses as the level of mortgage interest claimable as an expense against income reduces to 0%.

Residential property investors have already had to cope with significant legislative changes in recent years, including the Residential Tenancies Act change removing 90 day no cause terminations, and incurred extensive costs in order to meet some of the changes, for instance the Healthy Homes Standards.

Raised rental prices will mean that it will take first home buyers even longer to save the required 20% deposit for a home (as is required under the LVR rules) and keep these buyers out of the market for even longer.

Alternatively, some investors will likely look to exit the market entirely, or look towards other investment opportunities, thereby further reducing the pool of rentals and pushing up the price of existing rentals as demand continues to exceed supply. At a time when there is a shortage of rental properties, we need to be encouraging the supply side of the equation, not diminishing it.

The discussion document also suggests the Proposals should cover a house or apartment, regardless of whether it is used to provide long-term or short-stay accommodation (paragraph 2.6). REINZ disagrees. REINZ does support statements made by other industry experts who have recommended that landlords who provide long term tenancies – say for 10 years – should be exempt from the interest limitation rules.

Exclusions to residential property interest limitation

The discussion document has outlined that a number of exclusions are proposed, including land outside New Zealand, employee accommodation, farmland, care facilities such as hospitals, convalescent homes, nursing homes, and hospices, commercial accommodation such as hotels, motels, and boarding houses, retirement villages and rest homes, employee accommodation and student accommodation.

REINZ questions why private investors who invest in these particular asset classes (e.g. student accommodation or retirement homes) should be exempt from the interest limitation rules. Our concern is that by excluding these properties, it will proactively cause investors to move away from the provision of tenanted rental property and towards investment in other property types (e.g. student accommodation) due to the tax breaks available. This could tilt the supply side in an area where an uplift in supply is not needed and reduce the supply where it is desperately needed.

The discussion document also proposes excluding property outside of New Zealand 'on the basis that investments in properties outside New Zealand have no direct impact on New Zealand housing' (paragraph 2.5). REINZ disagrees with this and believes this will act as a 'push' factor, encouraging investors to exit their investment holdings in New Zealand residential property and look to instead invest in offshore properties. Whilst this might increase the pool of properties available for first home buyers, an unintended consequence is that it is likely to further reduce the overall supply of rental properties available for tenants. As demand further exceeds the supply of rental properties, this is likely to place upwards pressure on rental prices.

Development exemption to interest limitation

The discussion document recommends 'in principle that property developers should be provided an exemption from the interest limitation rule' (paragraph 6.1). Should the proposals proceed, REINZ would be supportive of this initiative as the development of additional residential homes is extremely important in order to increase supply for both renters and purchasers.

REINZ would also be supportive of the proposed exemption for remediation work (paragraph 6.19) as anything that improves the overall level of New Zealand's housing stock and provides warm, dry homes is to be welcomed.

New build exemption

Should the proposals proceed, REINZ is broadly supportive of the suggestion that owners of new builds will be subject to a five year bright-line test and exempt from the proposed interest limitation rules (paragraph 7.1). REINZ is also supportive of the definition of new builds as outlined in paragraph 7.3 and that exemptions should apply where the build adds to the supply of housing.

However, REINZ cautions that this may create an unintended consequence in that investors will only purchase new builds in order to take advantage of the exemption available to them. Whilst in principle, having new, warm, dry homes for tenants to live in is to be applauded, there is the potential for this to price some tenants out of the market.

Rollover relief from interest limitation

Assuming the proposals go ahead, REINZ is supportive of rollover relief for transfers upon the death of the owner (paragraph 10.42) and for family trusts (paragraph 10.55).

Conclusion

In conclusion, REINZ believes that whilst well-intended, the Proposals will have material unintended consequences including:

- Reducing rather than increasing affordability of residential properties
- Reducing supply, which, coupled with increased rental prices, will not help first home buyers get on the property ladder
- Disincentivising ordinary New Zealanders from investing their life savings in a rental property in New Zealand or a family bach
- Removing the ability of ordinary New Zealanders to spend more than a year away from their main family home within a 10 year period without attracting additional income tax liability by virtue of the extended bright-line test
- Reducing the pool of rental properties available, increasing the price of rentals as increased costs are passed on to tenants, and impacting vulnerable tenants by contributing to overcrowding and sub-standard conditions.

Thank you for the opportunity to make a submission on behalf of our members. If the Committee has any questions, please direct them to mbeight@reinz.co.nz.

Yours faithfully

s9(2)(a)

[redacted]

From:	s9(2)(a)
To:	Policy Webmaster
Cc:	s9(2)(a)
Subject:	Ockham Residential - Interest Deductibility & Bright Line Submission
Date:	Monday, 12 July 2021 6:52:35 PM
Attachments:	image002.png image003.png 210712 Ockham ID Submission1.pdf

Thank you for the opportunity to provide feedback on this particular area of Government policy. Please see attached the Ockham Residential submission in response to the design of the interest limitation rule and additional bright-line rules discussion document.

While Ockham broadly supports the intention of the proposed legislation our submission seeks to further refine the interest deductibility rules to ensure that the business case for quality developers to participate within this area of the affordable housing market is fully supported. Further to this, that those who have previously proactively provided a quality build to rent product prior to March 2021 are also recognised.

We would be pleased to participate further in this discourse as the opportunity arises.

Kind regards

s9(2)(a)

OCKHAM RESIDENTIAL

Ockham Residential

s9(2)(a)

ockham.co.nz

Ockham Group Limited
PO Box 78-007
Grey Lynn
Auckland 1245

12 July 2021

Ockham Residential submission on the design of the interest limitation rule and additional bright-line rules.

Thank you for the opportunity to submit on the design of the interest limitation rule and additional bright-line rules.

About Ockham

Ockham Residential is one of Auckland's leading apartment development firms and a partner in the Government Build Programme. We are committed to high quality, sustainable urban living, building beautiful homes that people love. We call ourselves 'urban regenerators' – we want to play our part in making the new Auckland work, without losing the charm of the old. We look long-term: we see housing as infrastructure – the building blocks of community. We have completed 12 apartment projects (over 700 units) in the past 12 years, s9(2)(b)(ii) [redacted] We are also active proponents of the Build to Rent/Purpose Built Rental concept, and have built and own a number of properties in this category.

General comments

We support the intent of these policy changes and, particularly, the intent to create a tax differential between people 'investing' by buying existing homes, which does not increase supply in any direct sense, and those investing in housing development, which creates additional supply.

If people want to invest in housing, they should build houses.

These changes are an opportunity to encourage a shift in housing investment towards development. To achieve this, however, it is crucial that the changes do not undermine the business case for new developments.

To achieve this, we see a requirement for the mortgage interest deduction rules to have three main features:

- New builds to be eligible for mortgage interest deductions for 50 years after completion, or until they become owner-occupied.
- Mortgage interest deductibility for new builds to be carried across to successive owners for the period the new build is eligible.
- A new category to be created for Build to Rent/Purpose Built Rentals (including existing ones), akin to the separate treatment for student accommodation and retirement villages, that

excludes them from the proposals and permanently treats mortgage interest as a deductible expense.

We lay out the reasoning and some possible design details for each of these three requirements in more detail below. Following that, we address some of the specific questions in the discussion document that are relevant to Ockham Residential's area of expertise.

1. New build interest limitation exemption eligibility period – 50 years

We agree that some point, a new build should an existing home and no longer be eligible for mortgage interest deductions. A perpetual exemption for new builds would, over the long-term, undermine the tax differential that is meant to direct investment to increasing housing supply because a large number of decades-old houses would exist that would still be able to realise interest deductions. However, it is important that the endpoint for interest deduction is far enough away when a developer is making the decision to build that the end of mortgage interest deductibility does not undermine the business case for the development.

The mechanism by which the removal of mortgage interest deductions affects whether a development goes ahead isn't so much any effect it will have on house prices in the short-term but on the net present value of the future income stream that can be generated from the development. While the point in time will be many years off when a development decision is made, in a low inflation world changes in net returns many years out have a significant impact on the net present value of making an investment now.

An investor, whether as developer/owner or early owner would, therefore, have to discount that they are prepared to pay against this future reduction in net returns. This would decrease what they can pay, and what banks and financiers will be prepared to lend them. This may see them not invest in a new build development at all, reducing the supply of new housing.

Our view is that a 10-year exemption, for example, would be too short. If a property purchase is mortgaged over a typical 25-year period, then 60% of that time would not be eligible for mortgage interest deductions, with the risk that real interest rates may rise in the future, as well. The net present value of mortgage interest deductions is still significant after 10 years, and their loss would have a chilling effect on investment in new housing.

Our view is that a 50-year exemption, will be long enough that investing in a new build will not be disincentivised. While the net present value of continued mortgage interest deductions becomes trivial beyond 25 years, as the end of that period approaches – say from about year 15 – the valuation will be impacted and will affect funding decisions.

We propose that, after the period of new build exemption expires, the new build would be treated as an existing home for these purposes, and the incentive would swing to investing in another new build.

Please note, our view is that this exemption should only persist while the home is a rental. If at any point, if the property transfers to an owner occupier, the interest deductibility drops away, the home reverts to 'normal stock'. This should not have a chilling effect on development decisions because those decisions would be made on the basis of the potential mortgage interest deductions – if the future owner chooses to forgo them by being an owner-occupier, or by selling the property to owner occupiers, it will not affect the original investment decision.

2. Carry new build interest limitation exemption to subsequent purchasers, while home remains a rental.

An investor buying a new home off the plans may not intend to sell it for the foreseeable future, but they must account for the risk that they will need to sell. If mortgage deductibility were not allowed to transfer to a new owner, the home would be worth less to any second buyer of the property intending to use it as a rental because they would not be able to realise the income stream from mortgage interest deductions. This would reduce how much they would be willing to pay.

The developer-owner/early buyer would, therefore, have to allow for the fact that, if they sell, they would be selling an asset with a reduced income stream compared to the one they paid for. They would have to discount this risk in their investment decision-making by a meaningful percentage, meaning they would not be willing to pay as much for the new build or may not be able to invest at all, reducing in decreased supply of new builds.

The solution to this is simple – allow the exemption to carry on to successive buyers through the period it is allowed after completion, as long as the dwelling remains a rental. If it becomes an owner-occupied dwelling, the exemption should end permanently.

As the discussion document notes, this would support resale. This would, therefore, support initial value, supporting development decisions, in turn.

We do not think that this will noticeably dampen house prices by less than if the exemption cannot be passed on. Certainly, that is not the mechanism that will affect development decisions. As noted above, the impact is through the revenue stream that can be realised from the development, whether the developer retains ownership or sells them to investor early buyers, and how that affects the economics of going ahead with the development, not macro market impacts.

We note that, for the period when mortgage interest deductions are available, a later purchaser who buys a property to rent it will have the same tax advantage over a home-buyer than such an investor enjoys when buying any home currently – but this would be limited to only new houses within the selected exemption period after completion, which have always been rentals.

We note that the value of new stock is strongly determined by the secondary market – both for the purchaser, who needs to know they have an exit strategy – and funders, who need to know that an asset they are financing can be realised for its security value. If the exemption does not transfer to a subsequent purchaser, the value of the asset will be severely impacted by the reduced cashflow. Valuers are obliged to recognise the impact of a non-transferable right in valuing assets. Accordingly, not allowing deducibility to transfer will severely impact on the ability to finance these developments.

3. Carveout for Build to Rent/Purpose-built Rentals sector from interest limitation

As the discussion document notes, the Government has two main objectives from these changes:

- *Housing affordability* - The Government wishes to reduce the incentive for non-owner-occupiers to invest in existing residential properties. This will reduce the upward pressure on housing prices. The goal is to make the purchase of residential properties more affordable for potential owner-occupiers.
- *Housing supply* - The interest limitation and bright-line extension should not discourage new additions to the stock of housing.

Therefore, these changes should not negatively affect categories of accommodation providers that are not creating competition for home-buyers and pushing up prices for existing housing. Nor should they negatively affect the increase in the supply of accommodation.

A number of such categories of accommodation providers are identified to be carved out of these changes – student accommodation and retirement villages, for example. The Build to Rent/Purpose-Built Rentals sector should also be added to this list.

The Build to Rent/Purpose-Built Rentals sector does not compete with home-buyers for existing housing. Instead, it creates new housing supply and provides people wanting to invest in housing a productive way to make that investment. The Government has expressed strong support for the sector, which is actually helping to achieve the Government's goal of turning property investors away existing property and direct their resources towards easing the housing shortage.

We do not believe that the Government intends to negatively impact the Build to Rent/Purpose-Built Rentals sector yet, without a carveout, these changes risk killing the sector off in its infancy. While the new build exemption would apply to new projects in the sector, they would not protect the developments that the sector has invested in in recent years. The economics of these investments would be substantially hurt by the loss of mortgage interest deductibility, reducing the value of the assets. This, in turn, would negatively affect the appetite among developers, banks, and financiers to take on the risk of future investments in the sector, and reduce the capitalisation of companies in the sector.

It may seem at first glance that a carveout that includes existing purpose-built rentals simply protects an existing asset and doesn't encourage new supply. This is not the case. The balance-sheets of Build to Rent/Purpose-Built Rentals investment entities, their ability to raise debt, and the confidence in the sector from investors would all be severely reduced, which would mean fewer new projects progress and ultimately, fewer new homes.

Ockham Residential s 9(2)(b)(ii) [redacted]. Losing the mortgage interest deductibility from them would have a significant negative impact on our balance-sheet and put us off building more purpose-built rental developments. The immediate devaluation of our existing rental stock may result in us being obliged to sell down some of our current rentals in order to remain within bank funding requirements. This would dislodge tenants who have been under the impression that they have a stable and secure rental for the foreseeable future.

A company in the business of developing purpose-built rentals is very different from a 'mum and dad' investor buying up existing homes. The returns on existing developments are used to help finance new developments and make the business case to lenders to support new developments. The revenue from continued interest deductions on existing purpose-built rental developments will go into creating additional supply, not into competing with home-buyers (and would not be eligible for interest deductions if it was invested in existing houses, anyway).

Just as the student accommodation and retirement village definitions carry with them certain conditions above and beyond that of a landlord, we propose a carveout for the Build to Rent/Purpose-Built Rentals sector that would bring with it requirements around scale (e.g. 10+ dwellings), quality (at least up to the current Building Code), security of tenure for tenants, and continuous purpose as a rental.

This carveout should be applicable to existing developments as well as new ones, bearing in mind that older developments are unlikely to be able to meet one or more of these requirements.

The applicability of the carveout could expire for individual developments at a certain time after receiving CCC, aligned with the new build exemption or when the purpose of the dwelling's changes (e.g. they become owner-occupied) but it is crucial that it extends backwards to capture purpose-built rentals that have **already been completed**.

<u>Responses to specific questions</u>

Chapter 4

- **Do you agree with the proposed approach to generally rely on the existing law on tracing, except where it would cause transition issues? (Transition issues are discussed at paragraphs 4.17 to 4.40.)**
- **Are there 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.**

  We agree with the proposal to generally rely on the existing law of tracing, while noting in passing that this does introduce significant complexity to a tax system which has in the past been notable for its clarity. We would strongly urge the Government to adopt an implementation date of 1 April 2022 to avoid the inevitable complexity and challenges of a significant change in tax treatments mid-year.

- **Do you agree that a new loan to refinance a pre-27 March loan would benefit from a specific provision?**

  Yes. The intention of the Government's intention is to allow a phase-out of interest deductions for pre-27 March loans and continued interest deductions for loans subject to exemptions or carveouts. That should not be curtailed by the need to finance a loan.

- **Which of the proposed approaches do you prefer?**

- *Option 1: Apportionment*. Under this option, taxpayers may apportion their pre-27 March loans across their assets based on their original acquisition cost, including any improvements. Apportioning based on original cost (including improvements) instead of, for example, market value makes sense because the aim of apportionment in this context is to provide some basis to work out how funds are deemed to have been applied. Taxpayers should also be able to work out their original cost relatively easily, whereas market value can be costly to work out (for example, if a taxpayer owns unlisted shares). We propose that apportioning should be done based on loan balances as at 26 March 2021, with repayments of any apportioned loans after that date allocated to assets in the same proportions. Increases in debt balances on or after 27 March 2021 would represent new drawdowns (not pre-27 March loans), for which tracing should be applied.
- *Option 2: Stacking*. Under this option, taxpayers would allocate their pre-27 March loans, excluding any loans traced to private purposes, first to assets that are not residential investment properties. The rationale for this approach is that well-advised taxpayers would be able to restructure to achieve the same tax outcome under tracing anyway. Allowing this tax outcome without requiring a restructure would therefore reduce compliance costs and help taxpayers who do not have professional advice. For this option, stacking will be based on the market value of assets as at 26 March 2021.

We prefer the apportionment method when determining the tax treatment of dual-purpose properties. Apportionment is a fairer, more accurate way of determining usage, and mitigates against incentivising strained definitions to avoid certain types of tax treatment. We also note that the current rules regarding apportionment, which generally focus on time and space, should be used over developing new and potentially more complex and burdensome definitions.

Chapter 5

- **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 A. The other options create more complexity and undermine the intent of the policy, lessening the tax differential between investing in new housing vs buying existing houses. The paper points out this may make investment in rentals high for some investors – but that is the point: to disincentivise the investment in existing housing and encourage them to shift their investment to new builds.

Chapter 6 – developer's exemption

- **Are there other types of developments or activity which should be covered under this exemption?**

  The scope is sufficient in our view.
- **Should land dealers (who are included under section CB 7) be carved out from the proposed section CB 7 safe harbour?**

  Yes.
- **Do you agree with the proposed criteria for the development exemption to apply?**

  Yes.
- **When should interest begin to be deductible when property is not acquired for the purpose of development, but that intention is formed later?**

When the intention is formalised through action such as commissioning design work.

- 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 sometime later?

  Any additional debt for development and acquisition debt from when intention to develop is formalised, as proposed.

Chapter 7 – new builds

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

  We agree with the proposed definition. Property should only qualify as a new build where residential housing supply has clearly increased. This can cover anything from a commercial to residential conversion, adding a new dwelling to a site with an existing house, to a greenfields/brownfields development of entirely new dwellings.

Chapter 8 – new build exemption

- Should the new build exemption apply only to early owners, or to both early owners and subsequent purchasers?

  As discussed above the exemption should apply to both early owners and subsequent purchasers. If it does not, it will reduce the value of the property to the early owner, reducing the return on the development, resulting in fewer homes being built.

- 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.

  As discussed above, we do not see the end for a perpetual exemption and this would, over the long-term, undermine the policy objectives by giving investors an avenue to claim interest deductions while not contributing to the housing supply.

  However, too short an exemption period would undermine the investment proposition for developers because it would cut into the net present value of the future revenue stream obtainable from the development.

  We don't see any value in a perpetual period for early owners and a fixed one for subsequent owners – the above objections to a perpetual exemption still apply.

  Therefore, we recommend a fixed period that covers both early owners and subsequent purchasers. This period should be sufficiently long that the impact on the net present value is minimal for the developer making the decision whether to build. 10 years is too short to meet this test. We recommend a 50-year period.

- Are there any issues that specifically relate to the new build exemption and:
  - papakāinga housing?
  - heritage buildings?
  - the purpose-built rentals sector?

As discussed above, we believe that the purpose-built rentals sector should be carved out of the interest limitations policy altogether because the loss of deductions on existing developments in the sector would undermine the companies involved, make it harder for them to raise debt, reduce confidence, and, ultimately, result in the sector delivering fewer new homes.

The applicability of the carveout could expire for individual developments at a certain time after receiving CCC, aligned with the new build exemption or when the purpose of the dwellings changes (eg they become owner-occupied) but it is crucial that it extends backwards to capture purpose-built rentals that have already been completed.

- **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?**

  BIC code at registration

- **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 Government needs to consider?**

  CCC is an appropriate and robust verification method and could be crossed referenced with the BIC code.

- **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?**

  The agreement with the developer, and paperwork showing the deposit the person has made, would be sufficient.

- **How practicable is the continued investment rule (described from paragraphs 8.22 to 8.26)? Do you think the rule is a good idea (considering the criteria mentioned in paragraph 8.26)?**

  We support the continued investment rule. Once the property has ceased to be used as an investment, e.g. becoming owner-occupied, the new build exemption should permanently expire. Knowing whether this is the case may be difficult for a subsequent owner but it may be possible to put a note on LIMs when this has occurred.

Chapter 12

- **How should the interest limitation rules be aligned with the loss ring-fencing rules?**

  We support extending the loss ring-fencing exemption to new builds. This would further increase the tax differential between investing in building more houses and buying up existing ones and, thus, help to achieve the Government's goals of reducing investor competition for existing houses while directing more investment towards increasing the housing supply.

Yours faithfully,

s9(2)(a)

[redacted]

From: s9(2) [redacted]
To: Policy Webmaster
Subject: Design of the interest limitation rule and additional bright-line rules
Date: Monday, 12 July 2021 6:56:37 PM

Hi
I am opposed to an aspect of the interest limitation rule. I believe the exemption date for new builds needs to be moved from 2021 to 1 December 2016.
I am accepting of the proposed bright-line rules relating to new builds.

My wife and I are on a low income and our employer requires us to live in its house to ensure we are more easily relocatable as our employer's needs change. So we have embarked on residential property investment using new property for three reasons:

1. To ensure we have a house to live in upon retirement.
2. To increase quality and quantity of NZ housing stock by providing new, warm, dry and quality accommodation for others.
3. To model good landlord practices

The above ensures we do not fritter away what little income we have and ensure we will be less of a burden to others in our latter years. It also helps lift the standard and quantity of housing, helps lower the housing stock deficit and ensures tenants get a fair go.

It appears to me that if the proposed changes go ahead, while doing our part to meet the above needs in our society, we will be penalised. My understanding is that other businesses and investments can claim against their tax the costs of running their business or investment. For example, they can claim interest deductibility and building depreciation on commercial property investment, borrowing for equity investment, borrowing to own an Uber car or corner Diary. It therefore makes me wonder whether this planned move to limit interest deductibility for residential property investors has been sufficiently considered.

Please:
1. Change the effective date for the new build exemption to something earlier like 1 January 2016 without a phase out, as people need time to adjust including that of fixed term loans. (Isn't this what we did when we changed vehicles from 6 month WOF to 12 month WOF?)
2. Note that the effect of the proposed change will force Mum and Dad property owners like us to increase rent to cover costs, making it even tougher on rent affordability.

Thank you for considering my views.

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

From: s9(2)(a)
To: Policy Webmaster
Subject: Design of the interest limitation rule and additional bright- line rules
Date: Monday, 12 July 2021 7:28:21 PM
Attachments: image001.png

I am s9(2)(a) an accountant and also own and manage short term accommodation and rental properties

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.
- 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. Those with a second property may also look at removing it from the short and long rental market as the compliance and taxation costs are just to great. The overall result will be even more of a housing shortage.

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

SHORT TERM ACCOMMODATION – The proposed new build rules will allow people to build new properties and use these for short term accommodation. They will also be allowed to claim interest deductions and have a bright line rule of 5 years which will give them an unfair competitive advantage over those that have been operating a short term accommodation before the changes. It also will not help the overall objective of increasing the housing stock and affordable housing.

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

Kind Regards
s9(2)(a)
[redacted]
Paradise Consultancy
www.paradiseconsultancy.co.nz
s9(2)(a)

s9(2)(a)

From:	s9(2)(a)
To:	Policy Webmaster
Cc:	Paul Fulton; Claire McLellan; NZ Corporate Taxpayers Group
Subject:	Design of the interest limitation rule and additional bright-line rules - Corporate Taxpayers Group
Date:	Monday, 12 July 2021 7:30:30 PM
Attachments:	image001.png image002.png image003.png image004.png image005.png image006.png CTG - Submission on the interest limitation discussion document (Final).pdf

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Hi

Attached is a submission on the Government's discussion document: *Design of the interest limitation rule and additional bright-line rules* made on behalf of the Corporate Taxpayers Group

If you have any questions in respect of the submission please let us know.

Kind regards

s9(2)(a)

s9(2)(a)

Deloitte
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Corporate Taxpayers Group

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.

Introduction

The Corporate Taxpayers Group ("**the Group**") is writing to comment on the Government discussion document "Design of the interest limitation rule and additional bright-line rules" ("**the discussion document**").

The Group would first like to acknowledge the significant effort of the Officials employed by Inland Revenue to prepare the discussion document for public consultation within such a short time frame. The Group has been involved in an external reference group assembled by Officials to aid in identifying all the relevant issues related to the introduction of the new interest limitation and additional bright-line rules (**"the new rules"**) and therefore is acutely aware of the amount of work that was required to prepare the discussion document, particularly given the breadth of potential issues arising from the proposals.

The Group also acknowledges the intention of the Government in introducing the new rules proposed in the discussion document and understands that the Government may choose to introduce any tax laws they deem necessary. However, the Group submits the following general comments in respect of the Government's discussion document:

i. By introducing tax policy that contravenes one of the core principles underpinning the tax system in New Zealand (that a taxpayer is able to claim tax deductions for costs incurred in deriving their income), and within such a short timeframe, there is a risk New Zealand will begin to lose its important reputation for predictable, stable and rational tax settings which has been important in attracting investment into New Zealand.

ii. The proposed interest limitation rule, while sounding simple in nature, is in fact incredibly complex. This can be verified by the size of the discussion document, the amount of consultation questions, and number of variables for the various issues in the document. Many of the taxpayers, for whom these rules are proposed to impact, will not have the skills required to identify there is a tax issue let alone interpret and follow the law.

iii. The timeframe committed to by the Government, to have the new rules in draft legislation before Parliament within 6 months of the first public announcement and within 11 weeks of receiving submissions on the discussion document:

Contact the CTG:
s9(2)(a) [redacted]
s9(2)(a) [redacted]

We note the views in this document are a reflection of the views of the Corporate Taxpayers Group and do not necessarily reflect the views of individual members.

a. Will still result in the law being retrospective given that it is proposed to come into effect from 1 October 2021 which still being draft law, and noting the law applies to most acquisitions after 27 March 2021.
b. Even then it is too short a timeframe to ensure the output is of adequate quality and suggests the Government has not appreciated the complexity of the work that is required.

iv. Given the abovementioned short timeframes, the final legislation enacted will likely have numerous issues and will require ongoing remedial action. This required remedial action will add more pressure to the already limited resources available to Inland Revenue.

v. The fiscal impact (and revenue gain) of the new rules has not yet been accounted for by the Government, it was not estimated or included in Budget 2021. Therefore, there is no existing fiscal requirement for the proposals to be enacted by a certain date. As such, to assist Officials in drafting the legislation, the legislative process should be slowed down, and the application date should be extended by at least another 6 months to **1 April 2022**. Ultimately delaying the legislation and the application date will help with getting the legislation closer to being 'right from the start', even if it means the legislation still has retrospective effect.

vi. We also draw Officials' attention to the impact of the new rules on lenders, who will need to take the new rules into account when considering customers' income for loan affordability assessments, and the challenge that retrospective legislation presents to conducting lending assessments prior to legislation being enacted.

With that said, the Group generally agrees with the proposals that will exclude large businesses, employers and properties which are not substitutable for owner-occupied dwellings (for example farms, retirement villages and student accommodation). The Group submits that Officials should be careful not to create additional compliance costs for organisations that are not causing the purported mischief that the new rules seek to mitigate.

Appended to this letter is the Group's responses to some of the specific consultation questions in the discussion document that are relevant to the interests of the Group.

If you have any questions or would like to seek consultation from the Group directly on any matter please do not hesitate to get in contact.

For your information, the members of the Corporate Taxpayers Group are:

1	AIA New Zealand Limited	24	Meridian Energy Limited
2	Air New Zealand Limited	25	Methanex New Zealand Limited
3	Airways Corporation of New Zealand	26	New Zealand Steel Limited
4	AMP Life Limited	27	New Zealand Superannuation Fund
5	ANZ Bank New Zealand Limited	28	Oji Fibre Solutions (NZ) Limited
6	ASB Bank Limited	29	OMV New Zealand Limited
7	Auckland International Airport Limited	30	Pacific Aluminium (New Zealand) Limited
8	Bank of New Zealand	31	Powerco Limited
9	Chorus Limited	32	SkyCity Entertainment Group Limited
10	Contact Energy Limited	33	Sky Network Television Limited
11	Downer New Zealand Limited	34	Spark New Zealand Limited
12	First Gas Limited	35	Summerset Group Holdings Limited
13	Fisher & Paykel Appliances Limited	36	Suncorp New Zealand
14	Fisher & Paykel Healthcare Limited	37	T & G Global Limited
15	Fletcher Building Limited	38	TAB New Zealand
16	Fonterra Cooperative Group Limited	39	The Todd Corporation Limited
17	Genesis Energy Limited	40	Vodafone New Zealand Limited
18	Heartland Bank	41	Watercare Services Limited
19	IAG New Zealand Limited	42	Westpac New Zealand Limited
20	Infratil Limited	43	WSP
21	Kiwibank Limited	44	Xero Limited
22	Lion Pty Limited	45	Z Energy Limited
23	Mercury NZ Limited	46	ZESPRI International Limited

We note the views in this document are a reflection of the views of the Corporate Taxpayers Group and do not necessarily reflect the views of individual members.

Yours sincerely

s9(2)(a)

s9(2)(a)
For the Corporate Taxpayers Group

APPENDIX ONE

Chapter 2 – Residential property subject to interest limitation

- Generally the Group agrees with the principles outlined in paragraphs 2.10 to 2.12, that land and buildings that are not suitable for owner-occupier housing should not captured by the new rules.

- Therefore, the Group **strongly agrees** with the proposed exemptions for **farmland**, **business premises**, **care facilities**, **commercial accommodation**, **retirement villages and rest homes**, **employee accommodation** and **student accommodation**.

- In relation to the abovementioned exemptions, the Group notes that there may be a period prior to the construction of these types of properties where funds have been borrowed but the land is vacant or is being developed into one of these types of properties. It should be made clear that all interest related to these developments is fully deductible (either under the developer exemption or otherwise). For example, a retirement village operator acquires a block of land in April 2021; from 2021 through to 2023 the retirement village undertakes land development, architectural planning and construction of the new retirement village. All interest costs from April 2021 should be fully deductible and outside the scope of these rules.

- The Group submits that in addition to the above, properties that are part of a "build-to-rent" scheme should be entirely excluded from the new rules. Build-to-rent is a segment of the housing market which is in its infancy in New Zealand, but has the potential to positively impact the supply of high-quality, stable residential rental accommodation. Build-to-rent investment is something the Government is considering incentivising[1], and therefore build-to-rent should be excluded from the rules. As it stands, build-to-rent would be excluded under the "developer" or "new build" exemptions, however, if the new build exemption does not apply in perpetuity then the financial metrics of build-to-rent investments may not work. We submit that, "build-to-rent" properties should be entirely excluded from the new rules as a build-to-rent property is not one which is otherwise available for an owner-occupier to acquire.

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?

- The Group submits that if an "all-or-nothing predominant use" approach is taken, taxpayers that are separate to, and in no way part of, the housing issue may be impacted by increased rents. This may arise where a landlord is renting a dual purpose building to residential and commercial tenants, but the residential tenancy makes up more than 50% of the floorspace. The landlord should still be entitled to interest deductions for the part of the property used for commercial tenancy. This should also apply when the land is intended for commercial use and the building is vacant and seeking tenants.

How might "business premises" be defined for the purpose of interest limitation? To what extent is it possible to reuse the definitions outlined above for this purpose? What issues might this cause?

- The Group submits that the definition of business premises for the purposes of the new rules should not be framed with reference to the entertainment regime, as suggested at paragraph 2.69.

- The business premises exemption should begin with the current Tax Counsel Office guidance already published, such as QB 19/13 Income tax – When does the business premises exclusion to the bright-line test apply?

[1] **BRF20/21120827** "Progressing Build-to-Rent" paper to Minister Woods dated 22 December 2020.

Should a carveout for employee accommodation be provided under the interest limitation rules?

- The Group submits that employee accommodation should be excluded, and this should be done in the same manner it is for the residential ring-fencing rules in section EL 13 of the Income Tax Act 2007 ('the Act').

Should a specific carveout for student accommodation be provided? Is it necessary?

- The Group agrees with the conclusion (at paragraphs 2.75 of the discussion document) that student accommodation will in many cases already be excluded on the basis it is a "hostel". The Group also agrees that it would be desirable to put the matter beyond doubt by way of a specific carve out for student accommodation, as proposed.

- Consideration should be given to the impact of a specific exclusion for student accommodation in the context of the interest deductibility reforms for other provisions which depend on a distinction between residential land or buildings and commercial dwellings (for example, depreciation on buildings, residential loss ring-fencing, the bright-line test and GST). It will be important that the use of a specific exclusion for student accommodation in the interest deductibility context is not taken to imply that student accommodation would necessarily be residential in other contexts.

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 carveout?

- The Group agrees that using the existing regulatory framework in sections 5(1)(h) and 5B of the Residential Tenancies Act 1986 would provide a suitable basis for the carve-out.

- In relation to the requirement at section 5B(1)(a) (that the premises are used to provide accommodation "exclusively" to students of one or more tertiary education providers), the Group understands it is common for student accommodation to be used in part for:
  - "casual" or "short stay" accommodation, for example, to host conferences over the summer when the relevant tertiary institution is not operating;
  - retail premises (e.g. a café or dairy) operated on site by third parties to cater for students; and/or
  - employer provided accommodation (e.g. for evening duty managers).

- The drafting of any exclusion for student accommodation should permit such ancillary uses of the land.

Could a carveout encourage the conversion of regular residential rental properties into student accommodation? How could this risk be mitigated?

- The Group agrees with the conclusion (at paragraph 2.79 of the discussion document) that using the existing regulatory definition reduces the risk of conversions. Further, as the discussion document notes, student accommodation would in many cases meet the existing exclusion for a "hostel" in any case. The specific exclusion for student accommodation would therefore provide clarity and reduce compliance cost and risk, rather than providing any form of additional incentive for student accommodation that does not already arise for other commercial dwellings.

Chapter 3 – Entities affected by interest limitation

- Generally the Group agrees with the primary limitation of the new rules to close companies, however the Group submits that this should also be expanded to also exclude widely-held companies as a company can be both close and widely-held at the same time. It is possible for an NZX listed-company to also be a close company, it does not seem conceivable that such a company should be in the rules and subjected to the compliance costs of tracing borrowings to assets.

- The Group understands the Government and Officials may have a concern that landlords might come together and establish widely-held companies that collectively own a portfolio of residential rental properties. This scenario seems unrealistic for all manner of practical reasons (such as individual property owners being able to agree relative property values and ownership percentages). Unless the level of residential property was at such a scale that the company was large enough to have professional management in place (e.g. hundreds, if not thousands of properties) the administrative costs of managing the properties and shareholder relationships would likely exceed any benefits of interest deductions.

- However even if this unrealistic scenario were to take place, it would ultimately benefit New Zealand as:

  i. people who cannot afford to acquire land could acquire a share in a widely-held company that owns land and have exposure to the residential housing market; and

  ii. Current rental properties would generally be better looked after as repairs and maintenance costs would be viewed from a corporate perspective (as opposed to a direct landlord who may not want to/be able to afford regular repairs and maintenance).

- Ultimately there is the general anti-avoidance rule if parties are entering into artificial and contrived arrangements to defeat the rules. These policy design of the rules should not be driven by avoidance concerns as the end result will be unworkable policy.

- As a consequence of the above, the Group does not consider it should be necessary to carve entities back into the rules if they are "residential investment property-rich".

- In summary, the Group sets out below its preferred outcomes in relation to companies:

  i. All widely-held companies are excluded from the rules and do not need to evaluate if they are residential investment property rich.

  ii. Close companies are only subject to the rules if they are residential investment property rich (this reflects the fact that a diversified close-company will be able to restructure debt to avoid interest deductions being denied in any event, so they should be spared the compliance costs).

  iii. In the event the companies need to assess whether they are residential investment property rich, this must be calculated on a group basis, not a company-by-company basis.

Does treating new builds and residential property covered by the development exemption as "residential investment property" for purposes of the "residential investment property-rich" threshold cause issues for any developer companies? If so, what are those issues?

- The Group submits that the requirement for taxpayers to assess whether a company is residential land rich every single day of an income tax year is overly burdensome. Other regimes (e.g. the thin capitalisation regime) allowing testing on a yearly basis with targeted avoidance rules focussing on preventing manipulation so as to meet the year end testing date. In addition, having to undertake this calculation every day on a company-by-company basis (if not part of a tax consolidated group) is not practical. In many instances large businesses will undertake distinct activities through separate legal entities (for a range of reasons), so having to measure on a company-by-company basis will cause issues for businesses who have placed all residential property in a single entity.

- While it is acknowledged that the threshold can be determined at a tax consolidated group level, there are a number of reasons why businesses choose not to use the tax consolidated group regime and/or they exclude certain entities from a tax consolidated group (for example, it is a legal entity which is developing property and the intention is to sell the property owning company at completion). Those businesses should not be punished with additional compliance costs simply because they are not consolidated.

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?

- The Group submits that accounting values should be used. If the measurement requirements are to be kept as simple as possible, the rules will be easier to apply and will result in increased compliance.

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

- The Group supports the existing proposed exclusions and submits that the following entities should also be excluded:
    - Schedule 36 (Government Enterprises). This is because Government Enterprises are not competing with owner-occupiers for residential housing. An exclusion of this nature will ensure these rules have consistency with the exclusions from the residential ring-fencing rules in section EL 11 of the Act.
    - Entities listed in section CX 55(1)(b) to (be) ie:
        - the Crown as owner of the New Zealand Superannuation Fund (NZSF);
        - a fund investment vehicle of the NZSF;
        - a company that is treated as wholly owned by the Crown under section HR 4B;
        - the Crown as owner of the Venture Capital Fund (VCF)
        - a VCF investment vehicle

  This is because the entities listed above are part of the Crown and they are not competing with owner-occupiers for residential housing.

- As noted above, the Group considers the definition of close company should exclude any widely-held company.

Chapter 4 – Interest allocation

- Generally, the Group supports the proposals that allow taxpayers to refinance with different banks (or the same bank but different lending products) without any risk that the refinancing is treated as new borrowing for the purposes of the new rules.

- The Group submits that Inland Revenue should proactively release guidance on the application of section BG 1 to refinancing arrangements to give all parties a clear understanding of what can and cannot be done when refinancing debt. The discussion document implies that it is acceptable for taxpayers to refinance debt so it is allocated first to commercial business operations, with residual borrowing against residential property, however this should be made explicitly clear given the high number of impacted taxpayers.

Chapter 5 – Disposal of property subject to 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?

- The Group does not support Option A (deductions denied).

- The Group strongly supports Option B. Where revenue account property is sold interest deductions should be allowed.

- The Group is wary of introducing complicated anti-arbitrage rules which impacted taxpayers will find too complicated to understand and apply. The anti-arbitrage rules being considered by officials to "discourage the selection sale of residential property to minimise taxable gains and maximise deductible losses." We suspect the commercial costs of undertaking this outweigh any tax advantage given a sale generally requires brokerage costs, legal costs, and banking fees (such as breaking fixed interest mortgages). Taxpayers are unlikely to incur these costs, hence we recommend against these complex anti-arbitrage rules.

Chapter 6 – Development and related activities

Are there other types of developments or activity which should be covered under this exemption?

- The Group disagrees with the comments made in section 6.11 of the discussion document, in particular the comment "*it is anticipated that almost everyone who develops residential property will hold the property on revenue account under section CB 7 because they are in one of the above businesses.*" Many taxpayers developing residential property could be developing the property for their own long-term hold as rental property, they will not hold the property as revenue account property under CB 7 of the Act.

- Such taxpayers (like Aroha in example 22 of the discussion document) should also qualify for the development exemption and this should be made clear to taxpayers.

Should land dealers (who are included under section CB 7) be carved out from the proposed section CB 7 safe harbour?

- Land dealers who are holding land on revenue account should be entitled to interest deductions.

Do you agree with the proposed criteria for the development exemption to apply?

- The Group agrees with the proposed criteria for the development exemption to apply.

- As land developers are assisting in adding to the housing stock of New Zealand they should be entitled to full interest deductions.

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?

- In the absence of providing a list, the Group submits that the remediation work that should be included in the development exemption should be able to be independently verified (such as certain building improvements held on a separate register). This would remove complexity when taxpayers are providing evidence that remediation work qualifies for the exemption.

When should interest begin to be deductible when property is not acquired for the purpose of development, but that intention is formed later?

- The Group submits that this should be from the date the taxpayer has changed their intention for the property.

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?

- The Group submits that all interest should be deductible from the date the taxpayer has changed their intention for the property.

Chapter 7 – Definition of new build

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

- The Group agrees with the principle that anything that adds to the housing stock in New Zealand should be considered as a new build.

- In addition the Group agrees with the proposed pragmatic approach to demolishing old dilapidated houses to rebuild – that this is included as a new build. While not directly addressed by the discussion document the quality of residential rental properties in New Zealand is another issue, and including rebuilds being included in the new build exemption can help with raising standards.

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?

- While the Group notes that converting an uninhabitable building into a habitable one does add to housing supply, there should be consideration given to whether this sends the right signals or could be seen as rewarding bad behaviour in some circumstances. It is questionable whether this change would be coherent with other parts of the Act, such as section EE 39(2) which provides that losses can't be claimed on buildings when the actions or failure to act of the building owner has contributed to its destruction.

- Given New Zealand's building history, the Group is sympathetic to allowing interest deductions in relation to the significant costs faced by taxpayers to deal with seismic strengthening and dealing with weathertightness repairs.

Chapter 8 – New build exemption from interest limitation

Should the new build exemption apply only to early owners, or to both early owners and subsequent purchasers?

- The Group submits that the new build exemption should apply to every owner (early and all subsequent owners).

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.

- The Group submits that the application period should be in perpetuity for everyone, or at a minimum, 30 years.

- In the event our submission to exclude build-to-rent entirely is not accepted, the application period needs to ensure that taxpayers undertaking build-to-rent developments are not disincentivised by the lack of future interest deductions.

Are there any issues that specifically relate to the new build exemption and the purpose-built rentals sector?

- As mentioned above, any limitation of interest at a future point in time will cause institutional investors, planning to undertake large build-to-rent investments, to reconsider such developments. If interest deductions were to cease at a particular point in time that will cause a value shift from future owners to earlier owners of the investment vehicles.

- Once the legislation is finalised, we expect lenders may take some time to understand the scope of the new build exemptions (given their likely complexity) and assess how these rules impact customers and interact with other legislation and regulations that lenders are subject to. Until taxpayers have certainty as to, and understanding of, the definition of "new build", the effectiveness of this policy in encouraging new builds may be impacted.

How practicable is the continued investment rule (described from paragraphs 8.22 to 8.26)? Do you think the rule is a good idea (considering the criteria mentioned in paragraph 8.26)?

- The Group submits that the continued investment rule is completely impracticable and not possible. There would be no way to evidence who did what with a property when they owned it, and it would not be feasible to automate a register of verifiable data to help with this.

- If the continued investment rule were implemented it will lead to disputes around the sales process and increase the need for purchasers to include warranties and indemnities in the sales process as they may be buying a property on the basis that no one has ever lived in it as an owner occupier with the expectation of qualifying for an interest deduction.

- Finally, the introduction of such a continued investment rule could result in two completely identical properties having different tax outcomes all because an owner lived in one of them for a period of time. This does not seem an appropriate outcome.

Chapter 10 – Rollover relief

- Generally, the Group supports the rollover relief principle and agrees that where property has changed legal ownership, but not economic/beneficial ownership, no tax event should be triggered.

- The Group submits that the proposal to only allow rollover relief for zero consideration disposals should be reconsidered. If the rollover relief provisions have reference to the associated persons framework there is very little chance that any integrity issues arise.

- Transferring property for zero consideration seldom happens, especially where the transaction requires consideration to have legally taken place (if not structured as a gift). The rollover relief is not likely to assist many taxpayers if this restriction is included.

- In addition, the discussion document does not provide assistance on what "consideration" would be for the purposes of rollover relief. For example, a taxpayer could gift a house into a family trust for no consideration, but arranging for the beneficiaries to pay for the rates and insurance in return for the right to occupy the house may be treated as consideration.

Chapter 11 – Interposed entities

What do you think of the interposed entity rules proposed above?

- The Group does not support interposed entity rules applying to widely-held entities, and does not support the proposal at paragraph 11.21 that **all** interest deductions will be denied in relation to borrowing to invest into a residential interposed entity (as illustrated by example 44). If the Government wants to support institutional investment into large-scale residential building projects (such as build-to-rent), investors should be able to claim interest deductions.

- From a practical standpoint, a build-to-rent project might be undertaken through a special purpose vehicle, with several large investors separately borrowing funds and using these to finance the construction costs.

- If interposed entity rules are included, then it needs to be ensured that the rules and various definitions are implemented in a way that ensures that interest is not denied in the event that the end use of the residential property is not subject to the rules. For example, a privately owned company (Private Co) has borrowing within a special purposes financing subsidiary (Finance Co). Finance Co borrowed funds to acquire residential property which is held in another legal entity within the group (House Co). The property owned by House Co is then leased to a tax-exempt charity who uses the housing as social housing. In this instance the end use of the housing results in a situation where interest should not be denied. The interposed entity rules should not operate in a manner which would deny interest deductions to Finance Co.

From:	s9(2)(a) [redacted]
To:	Policy Webmaster
Subject:	Design of the interest limitation rule and additional bright-line rules
Date:	Monday, 12 July 2021 7:34:49 PM

Chapter 2 - Residential investment property subject to interest limitations

Brief Summary:

1.We agree with the views expressed by Terry Baucher in his article This Week in Tax (interest.co nz).
2. We think one of the unintended consequences of the proposed legislation is that one group is impacted that are not really the target of the proposed legislation. These are the Mum and Dad investors, who may have one, maybe two investment properties which represent their investment fund. They do not trust investing in shares or managed funds.
3. Mr Baucher notes that "whatever their circumstances, this is a group that's going to face a significant amount of compliance going forward and for very little reward for the Government , either politically or in terms of improving the housing market".
4. Mr Baucher makes a suggestion we are happy to add as our recommendation.

Recommendation:

That the rules do not apply for one investment property held by private individuals provided the gross rental income is not more than $40,000 in Auckland and $30,000 elsewhere in New Zealand.

We would be very happy to be contacted by IRD officials.

Thanks
s9(2)(a) [redacted]

[redacted]

From:	s9(2)(a)
To:	Policy Webmaster
Subject:	Design of the interest limitation rule and additional bright- line rules
Date:	Monday, 12 July 2021 7:49:01 PM

SUMMARY
- I am a rental property owner (landlord) with one rental property which I have owned since 2015.
- I strongly oppose the proposed interest limitation rules. Interest costs are a legitimate business expense.
- This change will ultimately penalise renters (costs go up, prices go up) over time. I charge below market rent (I have discounted the rent $100/week since COVID, and have slowly reduced the discount – currently still discount to $35/week), and have not increased my rent in many years for current good sitting tenants, however over time I will be forced to increase rent to help cover significantly increased costs.
- 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 strongly oppose the proposed interest limitation rules. It does not help the supply of housing, and does nothing towards one of the governments key housing objectives, which is to ensure "affordable home to call their own". There are other, better, fairer ways to dampen demand from investors, or to make it easier for first home buyers to enter the market. I believe rents will increase over time as more existing rentals are sold to personal house owners (less rental supply), and input costs of landlords go up.

CAPITAL ACCOUNT PROPERTY HOLDERS: When a rental property is sold, that was intended as a long term hold, but is caught by the brightline rules or other taxing provisions, then interest should be fully deductible in the year of sale. Such an 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 excessive and unreasonable level that severely penalizes the owner. If interest was not deductible, it could potentially see the owner paying more tax than any gain made.

ROLLOVER RELIEF With the Brightline being extended to 5 and then 10 years there needs to be rollover relief. This should cover all related party transactions. Exemptions should also be allowed to facilitate ownership restructuring that doesn't equate to a true sale (related party transfers).

MAKE IT SIMPLE – 143 pages of discussion shows that these rules are already too complicated and will be an unreasonable burden on taxpayers to comply with the rules. The new rules need to be simple and easy for all to follow.

- At the very very least the start date of new tax laws should coincide with the beginning of a new tax year, not be introduced part way through.

s9(2)(a)

s9(2)(a)

From:	s9(2)(a)
To:	Policy Webmaster
Cc:	Joshua Fowler; NZ National Tax
Subject:	[WARNING MESSAGE ENCRYPTED]Design of the interest limitation rule and additional bright-line rules - Deloitte Submission
Date:	Monday, 12 July 2021 8:04:36 PM
Attachments:	image001.png image002.png image003.png image004.png image005.png image006.png Deloitte Submission on property discussion document.pdf

Hi

Attached is a submission on the Government's discussion document: *Design of the interest limitation rule and additional bright-line rules* made on behalf of Deloitte (note, there are at least 2 other submissions made on Deloitte letterhead on behalf of specific clients).

If you have any questions in respect of the submission, please let me know.

Kind regards

s9(2)(a)

s9(2)(a)

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Deloitte means Deloitte Limited (in its own capacity for assurance services, otherwise as trustee for the Deloitte Trading Trust)

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12 July 2021

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

Dear David,

Deloitte is writing to submit in relation to the Government Discussion Document "Design of the interest limitation rule and additional bright-line rules".

Deloitte does not agree with many of the proposals contained in the discussion document and would have preferred the Government had instead consulted on "demand side" tax solutions to the housing market before concluding that denying interest deductions were the best option to pursue. The denial of interest deductions creates a large number of complex boundary issues, as illustrated by the discussion document and we are concerned that both Inland Revenue, taxpayer and tax advisor resources will be tied up dealing with the complexities of these rules for a number of years rather than being able to focus on more productive uses of time.

We have attached an appendix to this submission which provides brief answers to most of the specific questions posed throughout the discussion document.

If you have questions please contact me at s9(2)(a) [redacted]

Yours sincerely

s9(2)(a) [redacted]

s9(2)(a) [redacted]

for Deloitte Limited (as trustee for the Deloitte Trading Trust)

APPENDIX – ANSWERS TO DISCUSSION DOCUMENT QUESTIONS

Chapter 2 – Residential property subject to interest limitation

- Would an all-or-nothing predominant use approach for business premises used by the bright-line test appropriate for interest limitation, or would an apportionment approach be more suitable?

  Apportionment

- How could an apportionment approach work?
  - Should it follow general tax principles, or is there another approach that might be more appropriate?
  - Are there any apportionment calculations regularly done by landowners for other purposes (for example, insurance and mortgages) that might be useful in this context?

  General tax principles, however, these should be clearly explained and illustrated with lots of examples for taxpayers to follow. Many taxpayers would have never had to consider any sort of apportionment methodology before and therefore many will not be familiar with general tax principles.

- How might "business premises" be defined for the purpose of interest limitation?
  - To what extent is it possible to reuse the definitions outlined above for this purpose? What issues might this cause?

  A new definition should be written rather than using a concept from the entertainment rules.

- Should a carveout for employee accommodation be provided under the interest limitation rules?

  Yes

- Does the employee accommodation carveout in the residential ring-fencing rules provide a useful basis for an interest limitation carveout? Can you see any issues with using these rules?

  Exemptions should be modelled off existing rules were possible.

- What integrity issues might arise from carving out employee accommodation, and how could these be mitigated?

  The existing ring-fencing rules provide integrity measures.

- Should a specific carveout for student accommodation be provided? Is it necessary?

  Student accommodation should be exempted. Whether it is necessary is best left to the industry to determine, however to the extent there is any doubt this should be clarified.

- 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 carveout?

  This legislation seems a reasonable starting point. Officials should ensure that accommodation providers have some flexibility in relation to how the accommodation is used. In particular student accommodation may be made available for rent on a short-term basis outside of educational term time (i.e. over the end of year break), this should not cause the property to become subject to the interest limitation rules.

- Could a carveout encourage the conversion of regular residential rental properties into student accommodation? How could this risk be mitigated?

  The section 5B definition seems difficult for people to artificially satisfy.

- Should short-stay accommodation that is not substitutable for long-term accommodation be carved out from the interest limitation rules and why?

  If the policy objective is to the deny interest deductions for accommodation which is otherwise suitable for owner-occupation, then accommodation which doesn't satisfy that criteria should be exempt. It will be a question of fact for individual property owners to determine. However, to be eligible the property should be one that is not possible to easily adapt to owner-occupation; for example it does not have suitable kitchen or laundry facilities / does not have the facility to add these without materially altering the property.

- How could a carveout be designed to reflect a sense of commercial scale akin to a hotel or motel?

  For consistency, consider adopting the same approach used in the building depreciation rules.

- Would a carveout for papakāinga housing be appropriate to support the aims of papakāinga and the Government's wider housing objectives?

  Yes.

- Should separate consideration be given to a carveout for kaumātua housing?
  - Are there issues that need to be considered in relation to legacy kaumātua housing?
  - Is it common for interest expenses to be incurred in the provision of kaumātua housing?
  - How could the interest limitation rules impact a decision to take out a loan to upgrade existing or construct new kaumātua housing?

  Kaumātua housing is similar in nature of a rest home or care facility and as such should be exempted from the rules.

- Beyond papakāinga and kaumātua housing, what other ways are iwi and hapū supporting whānau through housing, in particular the provision of rental accommodation?
  - What structures are used? (for example, joint ventures)
  - How is such housing financed?

  A variety of structures are used. Many entities will be Māori Authorities, but some will not be. Companies, trusts and partnerships are commonly used also.

Chapter 3 – Entities affected by interest limitation

- Does treating new builds and residential property covered by the development exemption as "residential investment property" for purposes of the "residential investment property-rich" threshold cause issues for any developer companies? If so, what are those issues?

  Yes, it causes a need to trace interest when it shouldn't be necessary.

- 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?

  Accounting should be used in the first instance as the less compliance cost intensive option, with the ability for taxpayers to use more accurate values in the event that the bright-line test is failed.

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

  Yes.

- 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.

  - *Interposed entities where the end use of the property is exempt;*
  - *Māori authorities;*
  - *Government entities (including related entities).*

Chapter 4 – Interest allocation

- Do you agree with the proposed approach to generally rely on the existing law on tracing, except where it would cause transition issues? (Transition issues are discussed at paragraphs 4.17 to 4.40.)

  Yes, however this will need to be thoroughly explain through commentary and examples.

- Do you agree that a new loan to refinance a pre-27 March loan would benefit from a specific provision?

  Yes.

- Are there any commercial reasons a loan that is in New Zealand dollars would be restructured to a loan in a foreign currency?

  If the rules are clear that foreign currency loans cause problems then it is unlikely that a refinance would take place. However if a New Zealand resident were leaving New Zealand then they might otherwise opt to change any borrowing into the currency in which they are earning income.

- Are there other issues with refinancing that we have not considered?

  The options provided are suitable. However, it should also be made clear that a taxpayer making a choice to refinance borrowing in a manner which optimises interest deductions is acceptable from a tax avoidance perspective. That is, taxpayers and leading institutions should not have to seek tax advice each time borrowing is restructured.

- Which of the proposed approaches for pre-27 March loans that cannot be traced do you prefer?

  Stacking.

- Do you have any suggestions on how the proposed approaches can be made simpler?

  Provided it is implemented in the manner described in the discussion document, the stacking approach is already relatively simple.

- Are there alternative approaches you would prefer? If so, how would that alternative approach work?

  Nothing specific.

- Do you agree with the proposed approach to a high water mark?

  This seems a reasonable approach.

Chapter 5 – Disposal of property subject to 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?

  Taxpayers should be entitled to deductions for all costs if they are taxable on sale, therefore Option B is preferred.

- Should the bright-line anti-arbitrage provision be extended to sales taxable under section CB 6 (purchased with the intention of resale)?

  No, these rules will bring excessive amounts of complexity for no good revenue reason. From a market perspective it is a low likelihood that many properties are sold at a loss in the first instance.

- Should some interest deductions be allowed when property is sold on capital account?

  We support Option F as this is consistent with recognising that a taxpayer has not actually made a tax-free capital gain as there was no capital gain when all costs were taken into account.

- What are the trade-offs in considering housing market objectives and tax policy efficiency and equity objectives?

  Tax policy efficiency and equity have been lost as a consequence of the proposals.

- 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?

  As above, anti-arbitrage rules will introduce unnecessary levels of complexity.

Chapter 6 – Development and related activities

- Are there other types of developments or activity which should be covered under this exemption?

  The exemption should not be limited to taxpayers caught by section CB 7. This section does not capture anyone who is developing property for a reason other than resale.

- Should land dealers (who are included under section CB 7) be carved out from the proposed section CB 7 safe harbour?

  No.

- Do you agree with the proposed criteria for the development exemption to apply?

  Yes.

- 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?

  The rules should not act as a disincentive to earthquake strengthening.

- 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 of change of intention.

  Consideration should be given to whether there need to be time incentives put in place to ensure land developers are taking active steps to develop the property (acknowledging that the processes involved in building houses can take a long time to complete).

- 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?

  All interest should be deductible from the point of change of intention, that is interest on original land costs plus additional costs incurred.

Chapter 7 – Definition of new build

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

  We agree that all the categories of simple new builds and complex new builds should qualify for an exemption.

- 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?

  We recommend checking with local councils for details of how buildings are classified.

Chapter 8 – New build exemption from interest limitation

- Should the new build exemption apply only to early owners, or to both early owners and subsequent purchasers?

  Early and subsequent.

- 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.

  The exemption should be in perpetuity for all owners. However, at a minimum the exemption should last 30 years. The rules should not be designed to try to force a property out of the new build exemption based on if the property is sold or how the property has been used. There are enough incentives existing for owners of existing properties to acquire new builds without owners of "new builds" being incentivised to continually buy more new builds.

- Are there any issues that specifically relate to the new build exemption and:
  - papakāinga housing?
  - heritage buildings?
  - the purpose-built rentals sector?

  For the purpose-built rental sector there needs to be a clear and predictable ability to claim interest deductions. The purpose-built rental sector should be encouraged and supported through the ability to claim interest deductions over an extended time period.

- 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 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)? (Refer to paragraphs 8.27 to 8.29 for more information).

  Apportionment would be appropriate.

- 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?

  Taxpayers should hold information, available on request, which verifies when a building was completed.

- 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 Government needs to consider?

  Officials should seek advice from local government on the types of instances when CCC's are not required to be issued. We understand that this can vary by area and also there is less requirement for CCC's in the Christchurch region.

- 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?

  The taxpayer should hold records which are available on request. That said, officials should be providing advice to taxpayers in relation to when interest deductions are available; i.e. at what point is the general permission satisfied to allow interest deductions in the first instance.

- How practicable is the continued investment rule (described from paragraphs 8.22 to 8.26)? Do you think the rule is a good idea (considering the criteria mentioned in paragraph 8.26)?

  The continued investment rule is completely impractical and should not be pursued. This rule will cause many legal disputes if it is implemented.

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

- 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 alternative approach (such as applying a predominant test)?

  An apportionment approach should be followed if properties are on the same title. In most instances taxpayers will be incentivised under these rules to obtain separate titles and keep all property costs segregated between non builds and non-new builds.

- Are there any simple ways to prove that residential land a person owns qualifies for the new build bright-line test?

  Consideration should be given to including the CCC or some other "new build declaration" on the sale transfer forms completed.

- 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?

  If a property has been acquired without an existing CCC then it should not be eligible for a new-build exemption (i.e. the previous owner has undertaken a non-compliance build process which has been completed by the new owner).

Chapter 10 – Rollover relief

- Should rollover relief from interest limitation be provided for transfers on death?

  Yes.

- 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?

  No.

- In your view, are the conditions proposed at paragraph **Error! Reference source not found.** appropriately targeted at the most common family trust situations? Are there any alternative criteria that you would suggest?

  These criteria are a good starting point. However, we do not support the statement at paragraph 10.3 which states that rollover relief would be limited to situations where there is no consideration (for the bright-line test). In many instances property will be transferred with some form of consideration.

- What number of degrees of blood relationship should be permissible to determine whether a beneficiary is associated with the principal settlor?

  The number of situations which are appropriate are unlikely to be defined by a number of degrees of relationship. The test should adopt the same approach used elsewhere, being a test of whether there is "natural love and affection" between the beneficiary and principal settlor. Inland Revenue has guidance on what natural love and affection means in BR/Pub 99/7.

- Would the trust proposal in this chapter be appropriate for Māori authorities that are trustees?
  - Would a connection other than association to a settlor be more appropriate? (For example, being a member of a particular hapū or iwi)
  - How could this work for Treaty settlement land?
  - Are there issues with dilution that need to be considered?

  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.

- Are there any issues that arise under the bright-line test or interest limitation rules where rollover relief may be appropriate? Some potential examples include:
  - Other situations where residential land is transferred to a Māori authority.
  - An election to become or cease to be a Māori authority.

  Currently the bright-line test can inappropriately apply where land is being transferred as part of a Treaty of Waitangi Settlement.

Chapter 11 – Interposed entities

- What do you think of the interposed entity rules proposed above?

  The rules are complicated but probably necessary.

  The interposed entity rules should work in a manner to ensure that interest deductions are not denied where an entity is interposed in a situation where the end use of the property is not subject to the rules (e.g. there is a charitable use, the property is a rest-home, the property is used an employee accommodation etc).

- In your experience, how common are interposed entities in the residential investment property context?

  Where there are commercial property investors, joint ventures or special purpose large scale property investments it will be very common to have an interposed entity.

- 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?

  Accounting values in the first instance with the option to use more precise values if the relevant thresholds are exceeded.

- 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.

Chapter 12 – Implications for the rental loss ring-fencing rules

- How should the interest limitation rules be aligned with the loss ring-fencing rules?

  Where possible the rules should be aligned as much as possible to reduce compliance costs for taxpayers.

- 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?

The proposals in the discussion document are confusing.

- Are there other interface issues between the rules that we have not addressed?

  It is not clear how the interest phase-out rules will apply to the ring-fencing rules (for example if a deduction at 75% is carried forward, does that carried forward deduction automatically get cut to a 50% deduction?).
- How should we integrate interest limitation, ring-fencing, and bright-line anti-arbitrage rules?

  To the extent it is determined at each set of rules requires anti-arbitrage rules then the rules should be kept as consistent as possible between each regime to reduce compliance costs and the chance of errors.

Chapter 14 – Administration

- Are there 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 this interest that has been deducted?

  This is largely an issue for Inland Revenue to resolve at its end.

- What data points might Inland Revenue be able to use to verify that a person qualifies for the new build rules?

  Should just be a self-assessment disclosure by the taxpayer.

- What records should taxpayers have to provide or keep in order to show that they are eligible for the new build rules?

  Full records about the building.

- 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?

  As per comments on Chapter 9.

- If there are problems with relying on CCCs, what else could be used to verify that a property is a new build?

  As per comments on Chapter 9.

- 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?

  Declaration and provision of records by vendor.

From:	s9(2)(a)
To:	Policy Webmaster
Subject:	Design of the interest limitation rule and additional bright- line rules
Date:	Monday, 12 July 2021 8:25:58 PM

IN SUMMARY

- 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 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

- Lack of Interest deductibility for residential property landlords undermines the entire tax system of this country. The IRD itself has said that owning a residential rental property is running a business. To disallow interest deductibility on an asset producing income, undermines the entire tax base of the tax system: the entire New Zealand tax system is now under threat. It shows that this government has complete disregard for how this country assesses taxable income, and that the tax system can be manipulated in any way it wants, so that 'taxable income' is no longer necessarily income less expenses. A number of expenses could potentially be ruled out by the government as being non-tax deductible, and many New Zealand business owners are very concerned about this.

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. The changes to residential property deductions undermine the entire tax base of this country.

BRIGHTLINE TEST INCOME IMPLICATIONS – If a long term hold rental property is sold, and is caught by the brightline rules or other taxing provisions, then the interest incurred over the brightline test taxable time of owning the asset 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, taxing the owner for 'brightline test income' that was not actually produced from the sale of the asset. It's bad enough that in this country, our capital gains tax (ie brightline test income tax) is taxed at our marginal tax rate, as opposed to a flat rate (like most other OECD countries), and that our capital gains tax does not even factor in CPI inflation adjustments. If interest was not deductible for a taxable sale, it could see an owner paying more tax then the gain they actually 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:

1. Becoming an LTC should be excluded from a brightline sale, as becoming an LTC can simplify ownership for a Company and reduce unnecessary compliance costs.

2. Transferring ownership from being a rental sole trader or partnership to an: LTC, Trust, Company or Limited Partnership

3. Share changes in an LTC, transfers of property between related parties (in situations not just relationship property splits which are presently covered) including to Trusts and between individuals

Roll over relief should be back dated to property purchased between 29/3/2018 and prior to 27 March 2021, as there are a lot of rental property owners who unintentionally have been caught by these very complicated rules.

MAKE IT SIMPLE – a 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)

From:	s9(2)(a)
To:	Policy Webmaster
Subject:	Removal of mortgage Interest tax deductibility-Submission
Date:	Monday, 12 July 2021 8:32:18 PM

To whom it may concern.

I am submitting on the proposed removal of mortgage interest tax deductibility from Oct 1st this year.

Firstly, it is important to understand the precedence in NZ of interest deductibility.
Businesses who borrow are able to incur taxable expenses in the course of doing their business in NZ, as they also pay tax against their income- a traditional model for a system that ensures a fair and reasonable profit and loss system.
In order to operate a higher level of investment against their core business, any business who borrows money for the sole purpose of funding investment in capital expenditure, wages, to expand services or provide new opportunities and markets is able to claim their mortgage interest tax deductibility as per IRD NZ rules.
In this way we have seen businesses take on all the risk of providing a sustainable business model a viable form of income and to provide jobs for NZers.

Why then we would like to ask would ONE set of businesses suddenly be penalised for providing quality housing and tenancies for many of NZ renters.
This removal of the ability to operate a loan to procure and fund the exorbitant costs of proving housing in NZ places the future of sustainable supply of rental properties at risk.
The fact is many Mum and Dad Investors take on ALL the risk, of building, renting, maintaining, and securing housing for ordinary NZers.

The work that goes into the venture for becoming a landlord is borne out over many years of financial planning, with the model of expanse on property calculated far in advance of purchasing a property.
We have seen housing costs increase tremendously over the past 10 years, and therefore there are many now who can simply not afford to buy the same property valued at over the median of $1Million now that may have been 500,000k when purchased. Is it the government's intention that these properties will now simply drop in value to reflect selling off of these properties, when first home buyers are not being approved to purchase these types of homes?

Renters will feel the pinch of the increased rents due to the squeezed supply, of inadequate consenting that has NOT been tackled by this government.
The prospect for renters in fact is that due to the higher costs imposed by this government, the rents will, not decrease or stabilise but increase to cover the costs of mortgages as a direct proportional passing on of the costs of the mortgage interest deductibility.

If this government wishes to rule out normal expenses that are claimable against income with the intention of stopping the house price boom, this government is sadly mistaken.
By taxing investors as a class of business owners who undertake risk to provide housing, this risks lowering investment in existing housing stock to cut costs, resulting in poorer quality housing.
At the same time, the discouragement of investors into this private housing provision results in decreased supply of rental housing, and correspondingly raises the demand above supply so the

cost of rents go up.
The right solution is the new ACT Party housing policy which incentivises councils to consent new housing, reinstating the interest tax deductibility and replacing the land use rules for overcrowded, homeless cities like Auckland with removing limits such as Auckland's Rural Urban Boundary (as Labour promised when elected) and replace the Resource Management Act with a development focused law suited to cities.

If you need any further information, feel free to contact me for any queries.

s9(2)(a)

From:	s9(2)
To:	Policy Webmaster
Subject:	Design of the interest limitation rule and additional bright- line rules
Date:	Monday, 12 July 2021 8:33:33 PM

Hi There

SUMMARY
- 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 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 do not agree with the proposed interest limitation rules. It does nothing to help with the housing supply, and does nothing to achieve one of the governments key housing objectives, which is to ensure “affordable homes 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.

Regards
s9(2)(a)

PUB-0438

From:	s9(2)(a)
To:	Policy Webmaster
Subject:	Design of the interest limitation rule and additional bright-line rules
Date:	Monday, 12 July 2021 8:33:41 PM

Good Evening

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.

Kind Regards
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 and are costly to upgrade to modern Building Standards and at the same time, meet various *Heritage* requirements set by Councils. 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

The above definition makes it easy to implement and leaves no doubt for Owners, Council, Government Agencies (IRD, in particular) that a building is permanently exempt from the interest rules.

• 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 and will require future upgrade in relative short order.

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. Yes, we concur

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. Yes, we concur

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 for each title to individually meet the Building Code and will raise a multitude of compliance and cost issues that could stop a development from proceeding. A Predominant test seems reasonable.

From: s9(2)(a)
To: Policy Webmaster
Subject: [SUSPECT SPAM]Design of the interest limitation rule and additional bright- line rules
Date: Monday, 12 July 2021 8:53:53 PM

To whom it may concern,

I write in regards to the recent changes to interest deductibility and brightline rules for investment property.

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

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 government's key housing objectives, which is to ensure “affordable homes to call their own”. I believe rents will increase over time as more existing rentals are sold to personal house owners and landlords increase rent to cover these new additional costs.

WHAT IS A NEW BUILD – The proposed date is unfair. I, personally, settled on a new-build the day the government announced these new rules. Under the proposed legislation, this unit would not be considered a new-build - despite being built early 2021! What constitutes a new build if not that? Also, if the government decides that a new-build can claim interest deductibility for up to 10 years, this should be extended to all rentals under 10 years old. People shouldn't be punished because they bought a house earlier than someone else.

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.

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

Yours sincerely.

s9(2)(a)

s9(2)(a)

To:	Policy Webmaster
Subject:	DESIGN of Interest Limitation Rule and additional bright line rules
Date:	Monday, 12 July 2021 8:56:12 PM

Dear Policy maker,

I would like to make below submission. I am a 'mum and dad' type long term hold investor working hard to be in independent of government support for retirement and wanting to help our children get into owning their own home one day. We only own a few rentals and have just started recently so this interest deductibility removal would heavily impact us and will likely be cut out of property investment.

Please refer to below summary:

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

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
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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.

Best regards,
s9(2)(a)

PUB-0441

s9(2)(a) [redacted]

To: Policy Webmaster
Subject: Design of the interest limitation rule and additional bright-line rules
Date: Monday, 12 July 2021 9:02:39 PM

Hi there,

I strongly oppose the interest deductible tax law change proposal.

Myself and my husband are in our mid 30's. Our household yearly income is $114k after tax.

We are long term property investors (NOT SPECULATORS). We managed to buy [redacted] s9(2)(a) [redacted] and all our properties are negative gearing. We worked so hard and sacrificed so many things (sharing our owner occupied with tenants, not eating outside at all, roaster around our s9(2)(a) [redacted] living with very basic things, etc.) to save money for buying those investment properties. We are still working hard to pay the mortgage and provide best service for our tenants and we are proud to do that.

This new changes to the residential property tax rules are very disappointing as we can't afford to pay the tax on our losses which will be around $24,000 years when new rule kicks in 100%. The only option we have is to sell all our rental properties and look for offshore investment options more likely move to Australia and start building our property portfolio.

These proposed law changes will not solve the housing issue, as the problem is with HOUSING SUPPLY, NOT the INVESTORS.

We are always thought of investing our savings in property and working hard to achieve it to secure our future. Now with not many options available in New Zealand for us to invest. All our savings will be invested offshore.

Thank you for disappointing the hard working investors like us with the new tax law changes and good luck with that.

Regards
s9(2)(a) [redacted]

PUB-0442

s9(2)(a)

To:	Policy Webmaster
Subject:	[SPAM]Design of the interest limitation rule and additional bright-line rules
Date:	Monday, 12 July 2021 9:08:48 PM

I would like to make the following submission regarding proposed upcoming property rules, specifically relating to the extension of bright-line tests to ten years.

Previously the government has proposed introduction of a capital gains tax on sale of properties and the NZ public overwhelmingly voted against this, so this proposal was withdrawn.

Extension of the bright-line test to ten years essentially amounts to a capital gains tax on properties not a main home, as it is extremely difficult and therefore unrealistic to plan ten years ahead when making a decision on a property purchase, as a persons circumstances or needs will likely change significantly over such a long period. The NZ public has already shown they have no appetite for a capital gains tax.

In addition, extending the bright-line period to ten years will likely result in people holding on to 2nd properties for a longer period to avoid being taxed on sale, therefore this will result in less properties coming on to the market, which is counter to the governments intentions of freeing up properties for prospective first home buyers.

For the reasons above the bright-line test should not be extended to ten years, as proposed in the announcements made in March 2021.

If discussion is required I can be emailed at this email address.

Thank you

s9(2)(a)

Wellington

s9(2)(a)

	Policy Webmaster
Subject:	Design of the interest limitation rule and additional bright-line rules
Date:	Monday, 12 July 2021 9:09:14 PM
Importance:	High

Dear Commiss oner

With reference to the consultat on document proposes, I would like to mentioned as below:

• Deductions for interest expenses on residential properties will be restricted from 1 October 2021:

This will impact cash flow of landlords and t results into increase of rental which impact again to house prices. As per the income tax act provision ment oned in BG and DG describes that any business entity/person can claim ts core business related expenses from its business income as taxable deduct ons.

Recommendation:

This decision would refrain from investors from providing further rental accommodat on. Rental accommodation is important as some people do not have capacity or equity to buy even first home. so therefore, it adds to many burdens to the economy.
Landlord should able to claim core expense which is Interest expenses at 100%.

Many inventors were likely to increase their rent over the next few years as they look to offset the costs. Therefore, it results into making rentals houses even more expensive and unaffordable and making t even harder for current renters to save a deposit for their first home.

Let me know if you need any further informat on on t.

Kind regards,

s9(2)(a)

s9(2)(a)

To: Policy Webmaster
Subject: Design of the interest limitation rule and additional bright- line rules
Date: Monday, 12 July 2021 9:14:01 PM

To whom it may concern
In my view this consultation should be about the justification for this blatant tax grab policy and the fact that it is in no way about helping home buyers.But instead is all about penalising legitimate providers of rental property in New Zealand, but as we all know this government doesn't follow logic but only their own ideology- please read below comments-

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

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.

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- 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.

Sent from my iPhone

Regards

s9(2)(a)

s9(2)(a) [redacted]

To: Policy Webmaster
Subject: Design of the interest limitation rule and additional bright-line rules
Date: Monday, 12 July 2021 9:27:27 PM

To whomever it may concern,

Firstly, I'd like to share some information about me. s9(2)(a) [redacted]. We purchased our main home which we occupy with our 3 children in 2018, and purchased a 3-bedroom and a 2-bedroom home in 2019 and 2020 respectively. The incentive to purchase these investment properties was the recognition that s9(2)(b)(ii) [redacted]. We want to ensure our children will be able to own their home one day. In the meantime, I am motivated to provide affordable accommodation and maintain it to the highest standard for tenants. This is because I have witnessed very neglectful landlords during my ten years of renting accommodation and also during the inspection of open homes that were tenanted. As such, I am supportive of the government's introduction of the Healthy Home Standards and changes to the Residential Tenancies Act. I intend to hold the properties long-term/in perpetuity, both properties have been subjected to a lot of maintenance and repairs to ensure their living standard since their acquisition and I intend to pay off the mortgage on them as soon as possible.

New Zealand has an obsession with property resulting from and inequitable treatment of owners and renters. Whilst the government's changes mentioned above have raised the standard and rights of renting, the changes announced on the 23rd of March are going in the opposite direction. The message appears to be that everyone should be aiming and able to purchase their own home, thus effectively rubber stamping that owning is more desirable than renting. Although the discussion document clearly states the intention to continue ensuring affordable housing for renters, it will be difficult to design the rules in a way that this is practicable. By incentivising people to purchase their own home, the government will also ensure that house prices will keep rising at high levels, even if the purchasing and ownership of investment properties is disincentivized.

In Chapter 2, a range of carve-outs from interest limitation rules are discussed. I would view an apportionment of floor space for mixed-use commercial/residential properties as the fairest approach. I don't understand why employee accommodation or student accommodation should be carved out, though. Such a rule would create a market-distortion, which should be avoided. Business would purchase accommodation for employee's, thus privileging them over people who are not in a fortunate situation to be employed by a business that provides accommodation. I would also doubt that such a business will be a suitable entity to provide quality accommodation. Student accommodation providers tied to universities are already making a huge amount of money from questionable services that are primarily sold to the parents and not delivered to the students. These providers should not be further encouraged with a carve out, as allowing them to deduct interest will only result in them raising their cost to increase their own profit at the expense of the taxpayer. They would be increasing their cost because they often compare their fees to what it would cost for a student to set up their own accommodation including the purchases of furniture and whiteware. As the cost of renting will inevitably rise due to the introduction of the interest deductibility limitations, so will student accommodation charges.

In Chapter 4, the proposed ideas to ensure any new lending against existing properties is no longer interest deductible appears too complicated and could be simplified, as only a small percentage of this interest is deductible for a very limited time anyway. I do think that re-financing should be allowed and the original interest still deductible subject to phasing. The stacking approach is the prefereable approach of the ones suggested, and existing laws on tracing sound fine. I also think that the High Water Mark proposal is fair. In my case, s9(2)(b)(ii) [redacted] The cost for more transparency is the higher floating interest rate and the monthly fee for the account. It seems pedantic to not allow the full interest to be phased out, but in my case the High Water Mark is probably resulting in the same outcome as the property is cashflow positive. However, a cashflow negative property would now no longer be deductible at all, resulting in punishing the owner twice (more tax and instant non-deductibility, resulting in even more tax). I would propose to simply allow all loans originally drawn for an investment property to be subject to phasing out, regardless of whether they are fixed or floating. Some people may fund the purchase of a new existing property, a renovation or for personal use via such a loan, but as this lending is still phased out by 2025, the IRD should not bother trying to deny the deduction of interest in this case. It does not influence its aims in a positive way and creates unnecessary bureaucracy, which should be avoided.

Chapter 5 was very strange. Somehow there is an attempt to compare interest payments with capital gain. If the government considers is unfair that capital gain is not taxed (which is correct), then it should introduce a proper capital gains tax that includes all forms of capital gains including the family/main home. Trying to do so by muddling with interest deductibility and brightline tests is bound to be arbitrary. With the examples given her, a $200k capital gain is $200k in hand, but a $300k interest deduction denied is paying $100k in extra tax (assuming 33% tax rate). How then are these two treated the same? From the options presented, D and F sound most reasonable.

The definition of a new build in Chapter 7 appears to be incentivizing the replacement of large dwellings with lots of bedrooms and land to small dwellings with few bedrooms on less land. It seems to discourage the process of updating/renovating existing dwellings. I believe that a house that is being renovated is uninhabitable, so therefore I do not think there is a way of distinguishing the renovation of habitable to uninhabitable buildings. An uninhabitable building should be demolished and the land used more efficiently. However, one consideration could be that if an insurance company refuses to insure a house on purchase and is subsequently renovated to the standard where it can be fully insured, this could be considered a "new build". One of the problems with the "new build" definition is that there is still a large demand from large families to purchase or rent a house with lots of bedrooms and a large backyard for children to play in safely. The supply of these dwellings would become reduced. A consequence will be that children growing up in lower socio-economic households will be confined to increasingly less space, spend more time indoors, are less active and less healthy, mentally and physically. That does not sound desirable.

Chapter 8 asks the really important questions about how this new rule should be applied. I strongly feel that a new build should be treated as a new build regardless of who lives in it (no continued investment rule) and whether and how often it is sold (fixed period for both early owner and subsequent purchasers). A new build should only stay new for a relatively short period of time, 10 years sounds about reasonable. By this time, rents should have increased sufficiently and the loan reduced sufficiently to make the investment stack up without having to rely on interest deductibility. Any other variation creates a lot of bureaucracy and market distortions. These should be minimized. As far as the apportionment rule is concerned, I would purchase a big block of land with an existing house, then add a second dwelling to it. This sounds like what the government would be happy to incentivize. I would be incentivized if I can deduct interest on the cost of erecting the dwelling and the land that goes with it, i.e. 50% of the land value if both dwellings are the same size (match land size % with floorplan %). If I can not deduct the interest of some of the land value, there is no incentive on adding the extra dwelling. Also, purpose-built rental accommodation is a great idea and should definitely be encouraged. These should be interest deductible in perpetuity.

In Chapter 9, the brightline test exemption should apply for the period of time that the building is a new build, i.e. the 10 years suggested above, regardless of who owns the new build (early or subsequent). Interest deductibility and bright line exemptions should be applying as similar as possible.

Chapter 10 is large, and I will have to read the entire section once I have more time available. However, roll over relief is important. This is because the bright-line test was designed to capture trading activity. As it as been extended well beyond its original intention, it now effectively prevents any re-structuring. We currently own our properties in our own name but would like to establish and move them into a trust in the future and benefit our children. This process looks currently very difficult, as it could only be done by 2025 and the property could then not be sold until 2035 without any adverse effects. Ideally, the bright-line test should not apply at all to any transfers that are not genuine sales to unrelated parties.

Thank you for considering my submission. I would welcome being contacted directly by the IRD to discuss this further.

Kind regards,

s9(2)(a)

s9(2)(a)

To:	Policy Webmaster
Subject:	Design of the interest limitation rule and additional bright-line rules
Date:	Monday, 12 July 2021 9:59:53 PM
Attachments:	Submission Design of the interest limitation rule and additional bright-line rules s9(2)(a) 2021.docx

Dear Sir/Madam
Attached is a submission on the Design of the interest limitation rule and additional bright-line rules.

yours sincerely
s9(2)(a)

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

s9(2)(a) July 12 2021

Summary

1.New Zealand has a tax system that differs substantially from the tax systems used in most OECD countries. There are reasons to believe that these differences are reducing housing affordability in New Zealand. These differences create distortions that, according to standard economic theory, lead to artificially high land prices and, at least in the medium term, higher rents. For this reason, changes in the tax system that reduce the extent that residential land and house prices and rents are artificially inflated are welcome. Unfortunately, the tax changes suggested in the document "Design of the interest limitation rule and additional bright-line rules" are not guaranteed to reduce land prices by a significant amount, and may well increase rents in the medium term.

2.Currently residential property investments are undertaxed relative to an income tax norm. The under-taxation takes two forms. First, real capital gains are not taxed. Secondly, residential properties that are financed by debt are undertaxed, because nominal interest payments rather than real interest payments are deductible. This under-taxation is to some extent offset by the failure to allow deductions for house depreciation. These three rules differ from standard international guidelines and practices and are likely to distort the housing market. To the extent that residential property investments are undertaxed, housing prices can be expected to be higher than otherwise, with the extent of over-valuation depending on both elasticity of housing supply and the extent that owner-occupied housing has tax advantages that lead to even higher valuations. It is likely that in many circumstances the tax advantages gained by owner-occupiers will dominate the tax advantages gained by residential landlords, and in these circumstances the tax advantages accruing to landlords will not be the marginal factor determining house prices.

3.The proposed tax rules suggest future landlords will be overtaxed, as no interest payments will be deductible, depreciation of housing structures will not be allowed and a capital gains tax on nominal gains rather than real gains will be imposed on property held for less than ten years. Since residential landlords will be overtaxed the proposed changes will still distort housing markets. It is plausible that rents will increase in the medium term. This is because property prices are likely to remain at artificially high levels as owner-occupied property is currently taxed advantageously relative to an income tax norm. If prices do not fall substantially, because of the tax advantages accruing to owner-occupiers, rents will need to rise in the medium term to compensate property investors for the unusually high tax rates they face. Such an increase will reduce the welfare of future generations of low-income people.

4.The proposed changes will mean New Zealand's tax system will continue to distort housing affordability. For this reason, the changes should not proceed. Rather, New Zealand should adopt some of the standard tax policies used in other high income and progressive OECD countries.

(1) Debt-funded investors should only be able to deduct the real interest component of their interest payments from their profits, and lenders should only pay tax on real and not nominal interest.

(2) Real but not nominal capital gains on all investments should be taxed

(3) New Zealand should tax retirement savings in dedicated saving accounts on an "Exempt-Exempt-Taxed" basis so that people can easily hold investments other than owner-occupied housing that are taxed on an expenditure tax basis. This will reduce housing prices by reducing the tax incentive to purchase owner-occupied houses rather than invest in other assets.

1. Housing markets and the tax treatment of landlords and owner-occupiers

1. New Zealand has a tax system that differs substantially from the tax systems adopted in most OECD countries. These differences create distortions that, according to standard economic theory, lead to artificially high land prices and, at least in the medium term, higher rents. For this reason, changes in the tax system that reduce the extent that house prices and rents are artificially inflated are welcome.

2. There are two sets of people who purchase property: owner occupiers; and residential landlords. Approximately 65 percent of houses by number and 75 percent of houses by value are owned by occupiers, and the rest by landlords. It is necessary to understand the tax advantages facing both types of buyer, because even if a landlord has some tax advantages that make them bid an artificially high amount for a property, this tax advantage may not matter at the margin if they are outbid by an owner-occupier with a higher valuation. What matters is the extent that tax rules affect the valuation of both types of buyer and the extent that both types of buyer can finance the acquisition of property. Large and valuable houses are disproportionately owned by owner-occupiers suggesting that any tax advantages landlords receive are not the dominant factor in large parts of the housing market.

3. Standard economic theory suggests that if land is taxed less than other classes of assets, either by landlords or owner-occupiers, the price of land will be bid to artificially high levels (Feldstein 1977). There are now a large number of sophisticated models incorporating heterogenous agents, borrowing constraints, housing supply and detailed tax rules that suggest that when either owner-occupiers or landlords are taxed less on investments in properties rather than other investment classes, housing prices will be artificially high (for example Chamley and Wright 1987; Skinner 1996; Gervais 2002; Jeske 2005; Petrucci 2006; Chambers et al 2009; Hilber and Turner 2014; Sommer and Sullivan 2018). The contention that tax advantages are capitalised into land prices is supported by empirical evidence (for example Palmon and Smith 1998; Hoj et al 2018). This type of modelling has been used to analyse the effects of the New Zealand tax system, and while it differs considerably from the tax systems in most overseas jurisdictions, similar results have been found for the effects of New Zealand's taxes on house prices (Coleman 2010; Coleman and Grimes 2010; Coleman 2019). In short, there is widespread support in the literature for the contention that if property is taxed less than other classes of assets, its price will be bid to artificially high levels. The literature further suggests that this has considerable potential to create an intergenerational transfer that reduces the welfare of current and future generations of young people, particularly low-income people who find it difficult to borrow to purchase housing.

4. Until 2021 New Zealand landlords did not pay tax on any real capital gains they made from the ownership of residential property. Moreover, landlords could deduct nominal rather than real interest from their rental income before paying tax. Both of these practices created a tax advantage for residential property investment that can be expected to lead them to bid artificially high prices to purchase property (Kearl 1979; Coleman 2019). This does not necessarily mean they would bid higher than potential owner-occupiers, and it is clear that in a majority of property sales they did not outbid owner-occupiers as owner-occupiers own most property. In particular, landlords do not have sufficiently large tax advantages to frequently outbid owner-occupiers for high value properties. Nonetheless, the rising fraction of properties owned by residential landlords since 1990 suggests that for some quality levels and price ranges the tax advantages obtained by residential landlords have been sufficient for them to 'win the auctions' against young or lower income households.

5. While the tax advantages obtained by residential landlords until 2020 have helped them outbid potential owner-occupiers, the tax advantages obtained by New Zealand owner-occupiers are potentially even larger than those obtained by land-lords. Owner-occupiers are not liable for capital gains taxes and they do not pay tax on the imputed rent that is implicit from owning a house. This is a tax advantage in New Zealand because alternative investments such as bank investments or company shares or funds in KiwiSaver and other retirement accounts are taxed on an income tax basis. These tax advantages may explain why New Zealand owner-occupying households are prepared to pay so much for their houses, and may help explain why high value houses are predominantly owned by owner-occupiers. Residential landlords may outbid low income households for low-value houses because the latter face binding credit constraints that prevent them bidding as much as they would like to buy property. Nonetheless, the price that low income people are prepared to pay to purchase housing is likely to be artificially high because of the tax advantages they receive relative to other investments. Many New Zealanders treat owner-occupied housing as the best investment they can make, and follow advice to buy the best property they can afford, partly because of tax reasons.

6. The proposed tax reforms for landlords mean that many landlords will face capital gains taxes, will not be able to charge depreciation allowances on structures, and will not be allowed to deduct real or nominal interest costs against the rental income they receive. This means residential property will become a tax disadvantaged class. This will reduce the amount landlords are willing to pay, and is likely to lead to some reduction in property values, particularly for classes of property where landlords are currently dominant purchasers. The extent to which property values will decline is limited by the tax advantages obtained by owner-occupiers. Since these advantages are large, these properties are still likely to have artificially high prices. Property prices may not fall by much, because the government is not proposing to reduce the tax advantages obtained by owner-occupiers.

7. In all countries a large fraction of the housing stock is leased. This will be the case in New Zealand in ten year’s time. A large fraction of property will continue to be leased because many people want to rent property. A lot of young people do not have enough money to place a deposit on a house. Many young people only want to lease a single room in a shared house, so they can spend their limited funds on other items. Many young people are mobile, moving from city to city or between countries and have no desire to undertake the transactions costs associated with property ownership. Others cannot be bothered with maintenance. For all these reasons, and others, people will continue to rent. This means landlords need to be attracted into the residential property market. If they are taxed more on residential property than other investment classes, and they need to pay the artificially high prices that tax-advantaged owner-occupiers are willing to pay they will need to raise the rents they charge if they are to make competitive returns. The proposal to overtax residential landlords while under-taxing owner-occupiers is a combination almost certain to artificially increase the rents that will be prevail in the medium and long terms rents. Since lower income people disproportionately rent, the incidence of these reforms will disproportionately fall on young, low-income people.

8.As suggested, the problem is two-fold. First, the proposal will make residential property leasing an over-taxed activity. Secondly, the proposal does nothing to reduce the tax advantages obtained by owner-occupiers, and thus house prices will remain artificially high, even if the prices of some classes of property decline. The solution is therefore two fold. First, leased residential property should only be taxed on the same basis as other investments. Secondly, the relative tax advantage of owner-occupied property should be reduced.

9. The most sensible way to tax leased residential property on a similar basis to other investments is to follow standard international tax practice. This means that (i) depreciation allowances for structures should be reinstated; (ii) real interest payments (but not the inflation component of interest payments) should be allowed to be deducted from residential property income; and (iii) capital gains should be paid on real (not nominal) capital gains, for residential property as well as other classes of assets. Most OECD countries apply (i) and (iii) and allow nominal interest deductions, indicating the proposal is technically straightforward. (Some countries also index interest payments for inflation; see Elkins 2007.) It appears that New Zealand politicians lack the will to adopt standard international tax practices, and thus are willing to risk imposing large welfare costs on vunerable people. In addition, the government should start taxing real rather nominal interest earnings, so ensure that property and lending are treated symmetrically. This proposal has been advocated by almost all economists since Viner (1923) but has been assiduously ignored by the designers of the New Zealand tax systems for reasons that have never been well explained despite evidence that the taxation of nominal interest earnings falls most heavily on relatively low income and unsophisticated investors (notably widows) and also on young rent paying households (Coleman 2019). This package seems likely to have superior welfare properties to the proposed tax package as it would tax residential property investments consistently with other investments.

10. If the government wants to avoid creating artificially high property prices, it also needs to reduce the tax advantages obtained by owner-occupiers. There are two ways it could do this. The first method would be to tax owner-occupied property on an income tax basis, which would mean taxing real imputed rent and capital gains. Very few countries, if any, do this (A counterexample is Switzerland, which taxes imputed rent). Alternatively, since the current tax treatment of owner-occupied property is equivalent to a prepayment form of an expenditure tax, the second method is tax other major asset classes frequently owned by households on an expenditure basis. For example, following the Meade Review (1978), Great Britain taxes deposits in special bank accounts on an expenditure basis. (The Mirrlees Review (2011) recommended this treatment be extended.) More generally, a large number of governments tax funds placed is special retirement income accounts on an "Exempt-Exempt-Taxed" expenditure tax basis. This means that most people in most OECD countries have their income from their two largest assets (their own house and their retirement income account) taxed on an expenditure basis, so that housing is not unduly tax advantaged. New Zealand did this until 1989 when it departed from standard international theory and practice and taxed retirement accounts on an income tax basis, while taxing the major asset class in New Zealand, owner-occupied housing, on an expenditure basis. It is perhaps not surprising that New Zealand has had the largest increase in house prices of any OECD country since 1990, when it changed its tax laws away from international norms. This topic has been comprehensively analysed in Coleman (2017), where it is argued that New Zealand's unusual tax policies impose large welfare losses on young people because they artificially increase land prices and rents.

11. For these reasons, I recommend that if the government is concerned about the welfare of young and low income people that it changes the current proposals. These proposals do not address the core tax problem facing housing markets. They reduce the current tax advantage enjoyed by residential landlords but instead of adopting a neutral tax treatment for residential property investors they suggest that residential property investments be taxed by highly than other classes of investments. Standard tax theory suggests that part of the incidence of these taxes will be borne by low income and young people who will face higher rents in the medium term. If the government is concerned to improve welfare, it should adopt a neutral tax system including the taxation of real capital gains. In addition, the proposals do nothing to reduce the tax advantages enjoyed by owner-occupiers and thus it remains likely that property prices will remain artificially high. If it does not

address this issue it will perpetuate the transfers from current and future generations of young people to current land owners. While this may be welcomed by some older people, who will continue to enjoy artificially high prices for the properties they sell, it is not at all clear why the government should be transferring income from young people to older people in this manner.

2. The tax treatment of old and new residential properties

12.The proposal suggests that landlords who build or buy new properties should be treated differently from landlords who buy and lease older houses. This position appears to recognize that the proposed tax changes will lead to the over-taxation of leased property relative to other investment classes, and may reduce the supply of new housing at a time that New Zealand has a pronounced housing shortage (Coleman and Karagedikli 2018). However, it fails to take in account international evidence that most leased housing is older housing (Anas, Arnott and Small 1988; Arnott and Braid 1997; Rosenthal 2014). This means that most leased housing will be over-taxed if the proposals are adopted, so landlords will need to raise rents to make returns competitive with other investments

13. This would not be the case if owner-occupied were to buy the older houses from landlords. International evidence suggests this exceedingly unlikely to occur. The policy of allowing nominal interest rate deductions on new leased homes provides a tax advantage to debt-financed investors. There is no reason for this tax concession. All economic modelling suggests such concessions are distortionary. Rather the government should allow real interest to be deducted by all residential property landlords to prevent distorted housing markets.

3. Modelling the effect of taxes on housing markets

14. New Zealand has a tax system that differs substantially from the tax systems in most OECD countries. It makes very limited use of social security taxes, and for this reason it has some of the highest taxes on business and capital income in the world[1]. It does not have capital gains taxes. It taxes funds in retirement savings accounts on a "Taxed-Taxed-Exempt" basis unlike the "Exempt-Exempt-Taxed" basis used in a majority of OECD countries. It is now proposing to not allow the deduction of interest payments from a residential investor's rental revenues. In all of these cases it would be useful to estimate the incidence of New Zealand's unusual tax rules on housing markets, and estimate the welfare consequences of these interventions.

15. The international literature on the effect of taxes on housing markets routinely uses complicated economic models to untangle the various effects of taxation and estimate the incidence of tax on different parties. Most of these models features over-lapping generations, as land values capitalise the effects of tax and can shift the incidence from one generation to another; they have agents who differ in terms of age, income and wealth, in order to explore the effects of credit constraints; they feature a supply housing function; they allow renting and owner-occupancy; and they tend to feature detailed modelling of taxes on different types of capital assets. Economists have found it necessary to include all these details so they can explore feedback effects and different substitution margins and estimate the final incidence of taxes, something that is exceedingly hard to do with partial equilibrium models or without models.

[1] See : https://stats.oecd.org/index.aspx?DataSetCode=REV
Category 1200 - Taxes on income, profits and capital gains of corporates

16. As far as I know, neither the New Zealand Treasury nor the Inland Revenue have invested in building the standard models used in other countries to evaluate the welfare consequences of their unusual tax system. This means they are unlikely to have reasonable estimates of the possible effects on housing markets of the proposed changes. This is disappointing, because while the intention of the government is to undo the distortionary effects of previous tax rules, the effect and welfare consequences of the new proposed rules is not clear. It is unclear why these institutions have not developed suitable models to conduct this analysis over the last two decades. Without the types of models routinely used overseas, New Zealand officials appear to be flying blind. It is to be hoped that in the future these institutions develop models capable of investigating the welfare consequences of New Zealand's unusual tax system, so that interested policymakers and economists can better understand the likely consequences of different policy options in advance of the policies being adopted.

4. Author's Background

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

[redacted]

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s9(2)(a)

To:	Policy Webmaster
Subject:	"Design of the interest limitation rule and additional bright-line rules"
Date:	Monday, 12 July 2021 10:02:39 PM
Attachments:	Submission-IRD Interest Limit Rules 7.2021.pdf

Kia ora koutou katoa,

Attached is my tuppence on these proposals.

Nga mihi,

s9(2)(a)

"You don't stop riding because you get old, you get old because you stop riding"

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<u>Summary</u>

I can see the merits of the proposed phasing out of residential investment mortgage deductions, but it does seem to create a lot of complexity and unintended consequences.

Something needs to be done to cool the property bubble whilst the RBNZ watches, waits, proposes studies and thinks...and credit pours into the mortgage market. But I prefer Susan St. John's proposal and I have one of my own that I hope you will consider. Namely, Ms. St. John supports the **Risk Free Rate Method (RFRM)** and I propose something I call **"The Excessive Home Equity Tax".**

<u>Discussion</u>

So, I quite like Susan St. John's idea.

It seems that she doesn't favour a comprehensive CGT, as it will tax things that aren't really the problem - such as peoples' investment in Kiwisaver, though she might be ok with a targeted CGT instead of a comprehensive one.

However, she clearly prefers the **Risk Free Rate Method (RFRM)** which was also preferred by a minority of the TWG**.** The RFRM is a targeted, annual tax on home equity exceeding an exclusion amount. She suggests $1 million per person. To that, I would add a transactional tax, again based on a $1 million exclusion per person, sort of like a CGT, but more targeted, that occurs when the property is sold or at the owner's death.

To explain, let's take a hypothetical couple named J & B Key. They have a $20 million house in Parnell and a modest bach in Omaha Beach valued at $6.5 million. That's $26.5 million in home equity.

Now each person would be able to exclude $1 million of equity from both taxes. So that leaves $24.5 million subject to tax for the couple. To adapt this to the more typical circumstances of most people and to make this more politically palatable, I would allow each person to exclude $1 million of equity over 2 homes, which would cover the primary residence plus either a bach or 1 rental/investment property. A couple could exclude $2 million of equity over 3 homes. But if you have more equity or more homes, you'll be caught by these taxes.

So first of all, each year John and Brony would pay the risk-free rate on $24.5 million. Currently that would be a little over 1% if we use either the current 10-year NZ Gov't bond rate or an average of 1-year term deposits at registered banks. So that would be roughly a little over $250,000 per year for the RFRM. Historically the RFRM averages about 3.5%, but pre-GFC, it was 7-ish% as memory serves. So we would typically expect this couple to pay about $850,000 annually for the priviledge of having so much home equity.

Then when they sell one of their homes, they would need to designate how they want to apportion their Excessive Home Equity Tax. Or going forward, everyone with more than 1 home would need to do that by a deadline and from then on, those with 1 home would make the designation when they purchase the second (and third for a couple).

For this reason, I strongly support the creation of a property registry. It would provide a lot of useful information about what is going on in our property markets. Currently, we are very uninformed/ignorant about something that is so critical to the well-being of our society.

The $1 million exclusion would only be available to NZ citizens and permanent residents. NZ registered corporations, trusts and foreigners would not be eligible.

As Susan St. John explains, most of the problems & complexity with the CGT (and the proposed interest limitation/bright-line rules) disappear.

Most of the problems of the comprehensive capital gains tax disappear – roll over, lock in, timing, inflation, and accounting for capital expenditure. All houses and land zoned residential would have an official CV at the beginning of the year. Any mortgages repaid during the year would increase net equity. Young people with high mortgage debt would have little net equity while older people who benefited from past gains would have more. The exemption of $1million net equity for the family home means that the vast majority of people would be unaffected.

There are advantages of simplicity. Landlords would no longer be able to write off interest costs or generate rental losses. They would not have to pay accountants to determine what is capital, and what is deductible expenditure. All they would do is pay the tax on the interest imputed from their net equity. Accruing capital gains would be captured as they inflate the net equity base. If there is a serious crash then net equity would fall as the CVs fall.

Landlords would have an incentive to rent their houses and not just let them stand idle. If houses are sold because they are no longer a gold mine for landlords supply of housing for first home owners may increase. Overseas owners would not have any exemption and any home held by a trust would not have an exemption either. Home owners would be free to generate income from Airbnb, boarders, flat mates and home offices to help meet any net equity tax.

https://www.newsroom.co.nz/@ideasroom/2018/12/14/362106/tax-working-group-unlikely-to-sort-housing-inequality

Other articles from Ms. St. John re Risk-Free Rate Method:
https://www.interest.co.nz/opinion/108521/susan-st-john-makes-case-taxing-deemed-rate-return-excessive-real-estate-holdings
https://www.interest.co.nz/opinion/98846/susan-st-john-says-minority-report-tax-working-group-should-be-taken-seriously

I think her ideas are much better than what's being proposed and I truly hope they get more consideration.

I would be delighted to discuss this further with the folks at the IRD.

Nga mihi,

s9(2)(a)
[redacted]

s9(2)(a) [redacted]

To:	Policy Webmaster
Cc:	s9(2)(a) [redacted]
Subject:	[WARNING MESSAGE ENCRYPTED]Design of the interest limitation rule and additional bright-line tests [KPMG_NZ-ACTIVE.FID2648813]
Date:	Monday, 12 July 2021 10:50:06 PM
Attachments:	Design of the interest limitation rule and additional bright-line tests - CCHL.pdf

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Dear Sir / Madam

Please find attached our submission on behalf of s9(2)(b)(ii) [redacted]

Please do not hesitate to contact me with any questions.

Kind regards,

s9(2)(a) [redacted]

KPMG
10 Customhouse Quay
PO Box 996
Wellington 6011
New Zealand
s9(2)(a) [redacted]

At KPMG we work flexibly. So while it suits me to send this email now, I do not expect a response or action outside of your own working hours.

KPMG
10 Customhouse Quay
PO Box 996
Wellington 6140
New Zealand
T: +64 4 816 4500

Our ref: IRD submission - interest deductibility KPMG.docx

Design of the interest limitation rule and additional bright-line tests
C/- Deputy Commissioner, Policy and Regulatory Stewardship
Inland Revenue Department
PO Box 2198
Wellington 6140
s6(b)(ii) [redacted]

12 July 2021

Dear Sir

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

We write on behalf of our client, s9(2)(b)(ii) [redacted] in submission on the recent Government discussion document, *Design of the interest limitation rule and additional bright-line rules* (June 2021).

We note that some aspects of this submission may be commercially sensitive. As such, we request that Inland Revenue consults with s6(b)(ii) [redacted] before any matters are disclosed to third parties.

1 Summary of our submission

s9(2)(b)(ii) [redacted] support the Government's wider objective of increasing the availability of housing for those in need, including through the provision of social and community housing. However, s9(2)(b)(ii) [redacted] are concerned that the proposed interest limitation rule in the Discussion Document is likely to discourage or prevent Council Controlled Organisations ("CCO") from providing optimal levels of social housing to the extent that they are required to fund housing assets with debt.

In summary, we submit that:

— A specific entity-level exemption from the interest limitation rule should be provided to CCOs that are responsible for the provision of community or social housing, because:

  - CCOs carrying on social and community housing functions are in an equivalent position to Kāinga Ora, albeit at a local rather than central Government level. The same policy rationale for allowing an exemption to Kāinga Ora should therefore apply to CCOs carrying on social housing operations;
  - CCOs' activites, including as these activities relate to the provision of social housing, are ultimately constrained and subject to decisions by councils and the regulatory frameworks for local authorities;
  - Although an alternative might be for local authorities to hold residential property directly to receive an income tax exemption, Inland Revenue officials have previously

recognised that councils hold assets via CCOs in order to achieve better governance as well as creating decision-making efficiencies and improved accountability. Councils should not be discouraged from carrying on their social housing activities through CCOs when doing so creates efficiencies;

- Without an exemption, CCOs could expect to face a higher tax cost in provision of social housing, and a resulting housing shortfall due to reduced capital to invest. That shortfall would almost certainly be imposed on Kāinga Ora, which is already under considerable pressure.

— The proposed property developer exemption should make it clear that it is not limited to property developments undertaken as part of a "business", so that it clearly applies to social housing providers who may not have a traditional profit-making intention but are nevertheless involved in property development.

We discuss our submissions in detail below.

2 Background

s9(2)(b)(ii)

[redacted]

s9(2)(b)(ii)

3

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

6 Proposed Interest Limitation Reforms

The Discussion Document proposes that interest deductibility is limited for "residential property investors" from 1 October 2021. The proposal is for interest deductions on existing debt at that date to be phased out over four years, and any interest on new borrowings (subject to new build exemptions) to be non-deductible.

The long-standing policy approach has been that companies are entitled to interest deductions without having to trace the use of borrowed funds to income-producing assets. The Discussion Document proposes a departure from this approach in favour of tracing borrowings, and restricting related interest deductions, where:

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

— the company is a "close company";

— the company is "residential investment property-rich". Broadly, this is where residential investment properties form more than 50% of the value of the company's assets.

s9(2)(b)(ii) is not a close company because it does not have natural person shareholders. However, to the extent that s9(2)(b)(ii) (or a subsidiary) is to acquire or increase its residential land holdings land to meet Councils social housing objectives, there is a risk that it could be deemed "residential investment property-rich" and subject to the proposed interest limitation.

s9(2)(b)(ii) is concerned that the while exemptions for land being developed and new builds are proposed for property development entities (discussed further below), the absence of an entity-level exemption for CCOs may increase the tax cost for s9(2)(b)(ii) in the provision of social housing. In turn, this is expected to limit the funding available to CCHL and its ability to provide patient capital to support the Council's social housing objectives. Further, any additional tax cost for s9(2)(b)(ii) in the provision of social housing will need to be factored into any acquisition or transfer price paid to Council to acquire existing housing stock, transferring this tax cost back to Council.

To the extent that Council and s9(2)(b)(ii) social housing capacity is diminished by the proposed changes, social housing 'gaps' will need to be filled by central Government. This only serves to place even more pressure on Kāinga Ora and the few CHPs in the s9(2)(b)(ii)

As a broad policy objective, Council and s9(2)(b)(ii) are concerned that any interest limitation rule should not be designed in a way that impedes the provision of social and community housing. Council and s9(2)(b)(ii) note that they have closely followed overseas social housing models and reforms, which have involved a spectrum of social housing providers and models. For instance, the most recent public housing reforms in the UK have specifically sought to attract 'for profit' providers. Any interest limitation rule should therefore be designed to allow innovation and flexibility in the provision of social housing.

Council and s9(2)(b)(ii) suggest that the most appropriate way forward would be a specific entity-level exemption from the proposed interest limitation rule for CCOs and their subsidiaries. We provide further comment on this suggested approach below.

7 Specific entity-level exemption

The Discussion Document currently proposes that Kāinga Ora would receive an entity-level exemption from the interest limitation rule. It also asks whether any other entities should receive an entity-level exemption and the reasons why.

We understand that Kāinga Ora will be "residential investment property-rich" under the proposed test, and prima facie subject to the interest limitation rule. The Discussion Document proposes an entity-level exemption for Kāinga Ora (and its wholly-owned subsidiaries) on the basis that:

— Kāinga Ora plays an important role as a public housing provider for people in need of assistance; and,

— In any event, Kāinga Ora (or its subsidiaries) undertakes property development and building activity that would likely be exempt even in the absence of a specific exemption.

CCOs carrying on a role in the provision of social and community housing provide equivalent housing support to those who require assistance. In that way, CCOs carrying on social and community housing functions serve an identical function to Kāinga Ora, albeit at a local rather than central Government level. The role that CCOs s9(2)(b)(ii) play in the provision of social housing is aligned with central Government objectives and provides a further and alternate delivery mechanism to supplement Kāinga Ora social and community housing.

s9(2)(b)(ii) (and we expect all other CCOs carrying on social housing activities) would, subject to approval of the Investment Case, provide social housing in both new and existing housing stock. In terms of the provision of new housing stock, and subject to our comments below, like Kāinga Ora, s9(2)(b)(ii) also intends to carry out property development and building activities that should be exempt from the proposed interest limitation rule.

Given the equivalence between CCO-based social housing and Kāinga Ora, the same policy rationale for allowing an exemption to Kāinga Ora should therefore apply to CCOs carrying on social housing operations.

We note that the Discussion Document suggests that an entity-level exemption may be more likely where the organisation's functions are prescribed or circumscribed by law. In essence, a CCO's activities are ultimately subject to local authority regulatory frameworks and decisions and are directed by local authorities' long-term strategies. In s9(2)(b)(ii)'s case, it is ultimately directed by Council and its social housing activities are prescribed and circumscribed by the CHS.

We observe that, as for a charity or CHP, a Council carrying on a social housing activity directly would be exempt from income tax. Inland Revenue officials have noted in prior reforms that where CCOs hold land they are doing so because it is necessary for their operations to ensure that they are individually accountable for the use of the land and able to more easily make commercial decisions in relation to the land.[2] In that way, Councils should not be disincentivised from carrying on their social housing activities through CCOs when doing so creates efficiencies.

We note that because Council and s9(2)(b)(ii) can leverage the Council's or their own balance sheet in any borrowing, the likely interest rates that can be achieved by them may be lower than those for private 'for-profit' property investors. Further, s9(2)(b)(ii) would not expect to gear properties to the extent that a private property investor might. As such, an entity level exemption is expected to come at a reduced fiscal cost to Government.

8 Property developer exemption

While a full entity-level exemption would be preferable because it would allow s9(2)(b)(ii)/CCO's the flexibility to achieve social housing objectives via the purchase of new builds or existing housing stock, we also comment on the proposed exemption for property developers.

The exemption for property developers is intended to ensure that where taxpayers carry on debt-funded property development activities that increase the total housing stock they will still be allowed deductions for their interest costs.

The Discussion Document states that "property development" for this purpose is intended to be defined with reference to concepts within the existing land sale tax rules. The land sale tax rules broadly capture land sales as part of a land dealing, dividing, development or building "business". We observe that the Discussion Document anticipates that the vast majority of property developments are likely to be carried on through traditional 'for-profit' property development operations, where it should be relatively clear that a property development business exists and s CB 7 is likely to apply.

In our view there is some additional risk for social housing providers where their property development activities may not resemble a property development business in a traditional

[2] *Taxation (Annual Rates for 2016-17, Closely Held Companies, and Remedial Matters) Bill: Commentary on the Bill*, May 2016, page 140.

sense. This is in part due to the wider objectives in the provision of social housing that go beyond an intention to profit.

The Discussion Document proposes that some "one-off" developments, beyond those carried out by property developers subject to s CB 7, should be allowed to benefit from the property developer exemption. The Discussion Document proposes that this should apply where:

- There is interest on debt relating to residential investment property;
- The debt is used for subdivision, development, or erecting a building; and,
- The activity is carried out for the purpose of creating one or more new builds.

Council and s9(2)(b)(ii) are broadly supportive of a definition of "property development" that follows the approach above, subject to the following comments:

- We understand that the term "one-off" may be used in the Discussion Document in contrast with a "business" which might be expected to have an 'on-going' nature. However, for clarity we consider that any definition of "property development" for the purposes of the exception (and beyond the existing definitions in the land sale rules) should not be limited to a "one-off" development. A "one-off" requirement might appear to limit the number of times the exemption can be relied on when the objective is to encourage housing development.
- Consistent with the approach in ss CB 13 and CB 14, it may be useful for the avoidance of doubt for the definition to state that the activity need not be in the nature of a "business".

9 Employee accommodation

Council and s9(2)(b)(ii) note that the Discussion Document proposes a carve out for employee accommodation on the basis that it does not generally compete with owner-occupied housing. Officials have sought further feedback on the design of the carve out.

Council and s9(2)(b)(ii) are supportive of a wide exemption for employee accommodation and wish to ensure that, to the extent that Council and s9(2)(b)(ii) are required to provide accommodation to key Council and s9(2)(b)(ii) workers (for instance, for business continuity or other reasons) any interest costs will remain deductible.

10 General

If you would like to discuss our submissions further, we would be happy to provide further written submissions or arrange a call. Please contact s9(2)(a) on s9(2)(a) or by email at s9(2)(a)

Yours faithfully

s9(2)(a)

PUB-0449

s9(2)(a)

To:	Policy Webmaster
Subject:	submission
Date:	Monday, 12 July 2021 10:53:51 PM

My name is s9(2)(a)

My husband and I have only over the past 3 years started on our property journey with a view to being self-sufficient in retirement, now this is looking less likely and more likely we will end up needing the superannuation payments to supplement our incomes more than ever. Would it not be preferable that we be able to fund our own retirement and not be a drain on the government coffers?

We have worked hard all our lives and not wasted our money. This tax change will effectively cost us an extra $16000 a year in tax, and imagine if interest rates increase, which they will, it will make it even more. It makes it seem impossible to try and get ahead and we feel penalised by this change. it may even force us to sell or increase rents which is not ideal., or is this the aim of the new legislation?

In summary:

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 homes to call their own”. I believe rents will increase over time as more existing rentals are sold to personal house owners.

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 than the gain they made.

What is defined as a new build?– Interest deductions should be allowed for new builds that have had a code of compliance issued within the preceding 12mths of 23 March 2021. The current proposal to allow a build that was issued with a code of compliance within 12mths to be deemed a new build if the property is sold after 23 March is grossly unfair on the initial owner who has built the house as a new build and then will have their ability to claim interest deductions phased out and the new owner will be able to claim interest deductions. One of our properties got it's coc in Dec 2020, so how is it fair that we become unable to claim interest but if we sold it to someone else now they can? **Again, grossly unfair.**

s9(2)(a)

s9(2)(a) [redacted]

To:	Policy Webmaster
Subject:	"Design of the interest limitation rule and additional bright-line rules"
Date:	Monday, 12 July 2021 10:58:12 PM

Dear Sir,

Main points:

- Increasing investor costs does not increase or improve housing stock.
- This is not in the best interest of tenants and their ability to move into home ownership.
- This policy has limited impact on the housing crisis and a detrimental impact on the rental crisis.
- If the Government insists on implementing this policy the incentive to increase housing stock needs to be the broadest spectrum.

It is difficult to see how this policy brings about benefits to renters and first time buyers. Reducing the cashflow of investors only reduces their ability to improve the existing building stock. It must be borne in mind that the existing building stock cannot be completely replaced with new builds.

I believe lobbyist have highlighted that the impact will ultimately be increased rental costs. This is not in the best interest of those who want to rent and only punishes those saving to buy.

This policy, together with the extended Brightline period and the ring fencing of losses, will only reduce rental investment, increase rents and intensify the rental crisis.

As the government seems intent on this policy then the incentives to increase housing stock to rent or buy should be as broad as possible. The following should be exempt and considered part of the New Build rules:

- AS-is-where-is properties which cannot be insured should be considered uninhabitable. Therefore renovating these properties to be insurable or bought to code should be considered new build. This would incentivise providing higher quality property to rent or buy.
- This should also extend to properties such as those contaminated with mould, asbestos or meth. These should be treated as uninhabitable and the remediation treated as providing a new dwelling.
- Adding a property on the same title should mean all properties on that title are exempt in the same way as adding to or dividing the property.

The above encompasses the purpose of these proposals by increasing the amount of good quality dwellings for which the New Build rules should apply in full.

I would be happy to discuss this further if required.

s9(2)(a) [redacted]

oakpropertyltd
480 collins road, RD4, Christchurch, 7674
s9(2)(a) [redacted]

s9(2)(a) [redacted]

To:	Policy Webmaster
Subject:	Design of the interest limitation rule and additional bright-line rules
Date:	Monday, 12 July 2021 11:20:52 PM

Section CB 6 can now be removed

The bright-line rules (all of them) are really a fix for a piece of very poor tax law - Section CB 6 Disposal: land acquired for purpose or with intention of disposal.

The idea that you can easily prove the purpose for which someone acquired land (essentially reading their mind) is ridiculous. Nearly all privately acquired will be sold at some stage so it has to be judged how much the eventual sale was in the mind of the purchaser! What happens in practice is that all circumstances surrounding the sale have to be looked at and carefully considered to see if it fits the case law on section CB 6 that has developed over time. This means it is a complex, uncertain and expensive process for IRD to apply section CB 6.

There is now no longer any need for Section CB 6 as it would almost never apply to any sales made more than 5 years let alone 10 years after purchase date. It is really of very little use.

However, even if section CB 6 is now unlikely to apply, taxpayers and tax advisers will still have to consider whether it might apply so it will still cause added expense and uncertainty for taxpayers, along with IRD who is meant to police this totally outdated piece of tax law.

It would improve the efficiency and certainty of the tax system by removing section CB 6. Even though it is a very simple piece of tax law on its face it does actually also impose a lot of complexity because interpreting its effect relies on extensive case law, as mentioned above, so it doesn't even meet the simplicity test of good tax law.

s9(2)(a) [redacted]

s9(2)(a)

To:	Policy Webmaster
Subject:	Design of the interest limitation rule and additional bright-line rules
Date:	Monday, 12 July 2021 11:33:50 PM

Thank you for the opportunity to provide feedback on the proposed changes to interest limitation and additional bright-line rules.

Section 2.1- Property Type

- *Properties such that are pre-existing multi-accommodation units and not built (*E.g., Three flats on a single title built/converted before xx date) *should be excluded, if the physical structure and configuration* of the accommodation units are configured in such a way that they couldn't easily be occupied by a private owner-occupier as a stand-alone dwelling unit.
- *Regulation should not encourage conversion of existing* private owner-occupier or single title units and therefore new/conversion to *multi-accommodation units could be excluded.*

Section 5.11 Options for deferring or denying the deductibility of expenses

When properties are sold within the bright line test deductions should be allowed at the point of sale (Option B).

Option A – Deductions denied – Will result in over-taxation especially when properties are sold within the bright-line period and therefore subject to capital gains tax.

Option D – Anti-arbitrage restriction for interest is preferred over Option C, however this only benefits property owners with other properties and encourages property ownership. If the property owner has other properties, then this would be a suitable option, however, there should be options to withdraw funds. Option B is still preferred.

Should some interest deductions be allowed when the property is sold on a capital account?

Consider the following example:

Additional tax payable per $1,000,000 of lending is $9,750 p.a. at 2.5% at 39% tax rate. Over twenty years that is $195,000 of tax payable.

Additional tax payable per $1,000,000 of lending is $9,750 p.a. at 5% at 39% tax rate. Over twenty years that is $390,000 of tax payable.

If the property price increased optimistically from $1m to $1.8m then the landlord would realise a $800,000 profit and pay $312,000 in tax.

Landlords could end up paying more tax over time under proposed changes than via a capital gains tax on the sale of the property.

Could landlords choose whether they want a bright-line test (tax-free sales after 10 years) or a revenue account with interest deductibility to be applied and pay tax on sale? (Similar to allowing choice on how assets are depreciated)

Alternatively, property owners could be allowed to claim any difference between the tax paid vs what would be payable in capital gains tax. In the example above $78k.

General feedback

The variable nature of interest costs and thus increases in interest rates will become increasingly and very concerning and could materially impact affordability, the financial wellbeing of property owners, especially Mum and Dad investors and NZ's economy if not controlled.

Potential solution: Apply a maximum interest rate/cap for deductibility of 2%. This could be reviewed annually.

Additional tax payable per $1,000,000 of lending is $9,750 at 2.5% at 39% tax rate.

NZ is currently experiencing a low-interest environment and there is no guarantee they will stay low in the medium/long term. Tax payable increases substantially at a 5% interest rate to $19,500 of extra tax payable.

A maximum interest rate that applies to deductibility would provide greater certainty and protection.

Thanks

s9(2)(a)

s9(2)(a) [redacted]

To:	Policy Webmaster
Subject:	Design of the interest limitation rule and additional bright-line rules
Date:	Monday, 12 July 2021 11:41:01 PM
Attachments:	Design of the interest limitation rule and additional bright-line rules.docx

Dear Sir/Madam

Attached is my submission on the Design of the interest limitation rule and additional bright-line rules

My personal details that are **not** for release under the Official Information Act are as follows:

s9(2)(a) [redacted]

I have not included them in the submission but my name may be added if that is required.

I am happy to be contacted for clarification or to answer questions at a committee(via zoom)

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

Sir/Madam,

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

1. **General Comments with cut across many areas and provide background to the specific answers on questions**

Landlords are more diverse than pictured. The current policy changes will unfairly affect home owners who become short term landlords with family property, limiting their ability to purchase subsequent dwellings that met their changing personal needs. It could also affect small time landlords facing tougher economic situations

a. **Large Pain Points for Home Owners and particularly First Home Owners who become landlords for short periods, or have flatmates or provide second dwellings for family members**

A home buyer who rented their house out when they entered a partnership; or moved locations for several years so they could eg continue their education, extend their career, to undertake volunteer work overseas is affected negatively by their inability to deduct interest costs while renting out their home even if they have no other income. They may have to defer career advancement, educational opportunity, starting a family, social contribution through voluntary work etc as it is no longer viable due to unclaimable interest costs/ring fencing limitation.

The impact of ring fencing and the removal of interest deductions will increase as interest rates rise making it a more punitive tax outcome in times of hardship –contrary to standard business practice.

Similarly for home owners who have bought a property with a minor dwelling they planned to rent, bought a second dwelling for family or to reduce travel to work times. They may no longer be able to fund their house purchase or their ability support eg their children in a separate dwelling, ageing parents later in life in the minor dwelling on their property might be made more difficult/impossible due to the inability to claim interest earlier on.

These home owners will then be subject to capital gains tax for the portion of the time that they rented the dwelling out if they sell before 10 years. …. This means that may not be able to purchase a suitable home for the next phase of their life.

If home owners are stuck in entry level or later dwellings no longer suited to their lifestyle this creates a blockage in the dwelling succession and will make it harder for new home owners to find suitable dwellings. Some home owners will lose so much money they may not get back on the property ladder.

b. **Landlords facing extreme financial pressure exacerbated by the new laws**

Financial pressure –people need to sell due to hardship from the current rules and/or financial pressure due to loss of job, tenant damage, major dwelling issues such as leaky homes. If this is a rental affected by the bright line test the loss will be even greater and the person may not be able to recoup the extreme loss to regain their financial position particularly if they are closer to retirement.

Recommendation: the current laws are reviewed to ensure they are not creating undue hardship particularly but not limited to the cases of homeownership above.

2. Specific Comments

Interest limitations and Ring Fencing

The new taxes will favour the well-heeled property investors who have high equity and great cashflow. These people will be able to take advantage when small time investors suffer hardship and have to sell, further increasing the wealth inequality.

Bright Line Rule

The policy paper discusses the capital gains extension of 10 years. This is well beyond the median time (7.4 years) home owners and investors hold their homes (https://www.corelogic.co.nz/news/how-long-do-owners-hold-their-properties#.YOuq-OgzZ9B). As such it will encourage investors to hold on longer in the new regime, not shorter. How this will affect stock available for new home owners is unknown.

Investor and home owners seldom compete for the same homes. General advice is the home owner buys on emotion so pay more when competing in the same market. Home owners dominate the market for the more expensive homes. For investors it is a numbers game.

The problem with changing the rules and discouraging investors someone has to provide the dwellings that are purpose built for renters. For example, flats of 3 or 4 unrelated people work best if the bedrooms are all a good size (and facilitate working/studying from home). Conversely, large groups of unrelated people are unlikely to buy a house together and commit to remain together for possibly 10 years now (To avoid being disadvantaged in their first home by interest and bright line tests should they want to rent their share).

Investors need to maintain cash flow to continue investing.

If the changed laws make these dwellings uneconomic to own at interest rates of 4-6% then there may be an exodus from this market resulting in students and other groups of young people competing in other sectors of the market for rentals potentially competing with other renters or will the prices drop disproportionately affecting investors. Will the government step in to fix the distortions?

Recommendations:

1. Certain segments of the market (such as student accommodation provided by private landlords or inner-city apartments) that do not normally have high capital gains traditionally are excluded

from the ring fencing and interest deductibility laws (Perhaps there is no capital gain tax if the growth is less than a certain percentage per year) **or**

2. A more comprehensive capital gains tax is introduced that does not distort markets in the way the proposed legislation is against residential property or
3. A “softer: set of bright line test, ring fencing and interest deductibility laws. This point is discussed in the following section: Ring-fencing, Bright Line Rule. And Interest Deductibility

Ring-fencing, Bright Line Rule. And Interest Deductibility

In a very short space of time 3 significant pieces of Tax Legislation have been introduced

- Ring fencing: Investors lose access to 30-39% tax rebate on their loss (These people are most likely in the higher or highest tax bracket).
- Removal of interest deductibility. This has increased the size of investors losses from interest (usually a significant proportion of newer investors’ expenses) by 30-39%, with no warning on how they might find a significant amount of extra income. Investors may have locked into principal and interest loans rather than interest only loans to satisfy the banks they are being prudent with their money when interest rates are lower planned renovations with the extra money and cannot change without incurring break fees.
- Extension of Bright Line test to 10 years. For investors facing hardship –job loss or reduction in income from eg Covid 19 they now face bright line tests of 5 or 10 years if they try to exit due to hardship. Ie a new tax will force some investors to sell at a significant (unfair) cost (high tax and/or economic loss).

Losses from ring fencing and the removal of interest deductibility would not be permitted in any other sector of the business community. This is creating an iniquitous situation.

The situation is further compounded by bright line tests which tax capital growth over a significant period at the marginal tax rates (possibly the highest tax rate if the property has been held some time.

Other countries such as the US and UK have much lower capital gains tax rates than the marginal income tax rates and they allow interest deductibility and other expenses on the way.

ie Based on international standards NZs capital gains tax rate is unrealistically high and does not reflect that the market has moved. Investors and home owners who are affected by the bright line test will be severely penalised and possibly unable to buy a replacement property even close to equivalent value.

The groups which will be harmed most are those with negatively geared property or low cash flow or other high outcomes unexpected outgoings Investors with few investment properties (income margins will be tighter and they are more likely to be negatively geared),

- those who are buying a second property to help a family member – eg students living in another city or older parents (including minor dwelings on their property with tight cash flow

- Future (first) home owners renting out their property out until they can reduce the mortgage and move in
- Investors who have been dealt some other shocks such as loss of job/business income, substantial tenant damage, major building problems

This seems contrary to sound policy that is well rounded. See earlier recommendation to soften the laws.

Recommendation: Permit revolving credit accounts in the definition of existing loans and do not cap the limit on a particular day as expenses can be quite variable.

Are there other organisations that should not be subject to the interest limitation proposal? P 38-39

I would exclude charitable organisations providing residential housing from the interest limitation proposal. They are most likely to provide to provide it to needy families not covered by other social agencies. As such they would not be providing for a sector that could not get into a home.

Revolving credit versus offset loans p 48-50. Mathematically the data from revolving credit and offset loan accounts can be used to track/classify/apportion income and expenses, loans and loan repayments in the same way. The loans cost the same if the mortage interest rates are the same. They should be treated the same to be fair to landlords-particularly when some major banks do not offer offset loans.

If the size of the revolving credit of offset loan is the issue, then that should be stated. …. Setting the revolving credit limit on a particular day is not equitable. I have large quarterly, 4-montly and 6-monthly body corporate fees as well as end of month mortgage costs. That means in the space of a few days around month end my account may be diminished by a 5-digit amount. My financial position is great (relatively) a few days earlier.

A fairer approach would be to identify how much of the initial borrowing was for the dwelling in question. It if has been temporarily reduced by earnings from other sources it could be redrawn as needed. If there are other landlord costs such as healthy homes, replacement of a leaky hot water cylinders, ongoing maintenance this is exactly what a revolving credit/offset account should be used for-dwelling expenses that vary per month.

Otherwise, an inefficient banking structure is being proposed adding extra unnecessary costs as interest cannot be minimised.

New Builds p 82-98

It is unfair recent purchasers of new builds are subject to the bright line test and excluded from full interest deductibility. They would have budgeted on low interest rates giving them an opportunity to get ahead and pay down the mortgage before rates rose.

Adding an extra bedroom to a dwelling should be treated the same way as new builds. It reduces the need for more housing, or reduces overcrowding in existing housing.   Valuers could be used to certify standards (aesthetics, functionality).

Recommendations

1. Include recent new builds in the exceptions for new builds
2. Include adding extra bedrooms to the category of new builds.

PUB-0454

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 11:51:48 PM

Dear Sir/Madam,

s9(2)(a)

My general position on interest limitation is that the proposal should be abandoned, or if that is not possible, then delay the start of interest limitation to the start of the 2022-2023 tax year, instead of halfway through the 2021-2022 tax year, which creates unnecessary complication in the accounting of my business.

My area of submission is Chapter 10, Rollover relief. I am generally in support of the proposals, with the following specific comment:

- Cl. 10.32 Re the Government's proposed date of rollover relief of 1 April 2022; I propose that rollover relief be provided retrospectively to disposals prior to 1 April 2022, to cover the period when the brightline test was in place and that disposals were made during that time that qualify for rollover relief
- Trusts Questions for Submitters; In my opinion, the conditions proposed should cover the vast majority of family trust situations

My situation is that in 2020 for me to be able obtain bank finance to purchase a second investment property, I had to gift both my owner-occupied property and my investment property (acquired in 2019), which was owned by both s9(2)(a), into a newly created family trust. This transfer in 2020, though it was still effectively controlled by myself, was a disposal that did not meet the rollover relief criteria, so triggered the bright-line test. I propose that the timeframe of settlement of property into a trust that qualify for rollover relief be applicable to transactions prior to 1 April 2022, to cover off people like myself who were inadvertently caught in the bright-line dragnet.

Yours sincerely,
s9(2)(a)

s9(2)(a) [redacted]

To:	Policy Webmaster
Subject:	Submission on the design of the interest limitation rule and additional bright-line rules
Date:	Monday, 12 July 2021 11:54:33 PM
Attachments:	Submission on the design of the interest limitation rule and additional bright-line rules.pdf

Dear Webmaster
I attach my submissions on the above topic.

Please let me know if anything further is required at this stage. I am happy to be contacted to discuss my submissions.

s9(2)(a) [redacted]

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

From s9(2)(a) [redacted]

Preliminary

A I am a semi-retired consultant lawyer with over 40 years experience in private practice. My trust owns two residential rental properties.

B The first was bought to be my residence but, when I moved into a house owned by s9(2)(a) [redacted] I rented it out. It has no borrowings.

C The other one was bought in 2019 with substantial loans from my bank. My trust bought the property mainly because s9(2)(b)(ii) [redacted] Despite the high borrowings, the purchase was cash-positive from day one.

Submissions on the design of the interest limitation rule

1 General

Success doubtful

1.1 I am not qualified to assess whether the design will achieve the objectives stated in the discussion document. However, I note that the government's Tax Working Group Information Release Document, Tax and Housing discussion paper, March 2018, stated under the heading "**5.4 The relative importance of tax**" stated:

> 87. Most official observers do not identify tax policy as the primary cause of high house prices. The OECD, for example, conducted a detailed survey of New Zealand's housing sector in 2011, and concluded that tax settings 'exaggerated' rather than caused the rise in prices in the mid-2000s (OECD, 2011, p. 9). Similarly, in its submission to the Productivity's Commission Inquiry into Housing Affordability, the Reserve Bank of New Zealand (RBNZ) stated:
>
> > *Taxation regimes can affect house price movements and house price cycles, but our judgement is that they have not been of decisive importance compared to supply factors, migration factors or fiscal and monetary policy. At times, tax provisions, in conjunction with other shocks, may have served to amplify or extend a housing boom that had initially been triggered by quite unrelated factors. Our reading of the international literature suggests that the presence or absence of a capital gains tax is not a decisive factor explaining house price behaviour here or in other countries.* (RBNZ, 2011, p. 2.)
>
> 88. The RBNZ's submission also noted that it is unclear whether housing is more tax-favoured in New Zealand than in other countries, and that a wide variety of countries – with quite different tax regimes – experienced housing booms in the mid-2000s (RBNZ, 2011, p. 8).
>
> 89. It is likely that tax policy has exacerbated the house price cycle in New Zealand over the past two decades. But the existence of substantial constraints on the supply of housing – arising from excessive land use regulation, inadequate infrastructure provision, and poor

productivity in the building sector, among other things – means that tax policy is unlikely to be the dominant driver of high house prices.

90. Thus, while tax reform could certainly affect the future trajectory of house prices, it is unlikely to result in a meaningful improvement to housing affordability in the absence of broader reforms to unlock the supply of housing.

1.2 I would, therefore, be surprised if something has happened over the intervening three years so that "tax reform" would assist would-be owner-occupiers. Although prices have increased, it seems the main problem is still the lack of new housing.

1.3 There are people who are not in a position to buy a house irrespective of cost and so, there is still a need for rentals. If all rental properties were sold to owner-occupiers, who would house the people who cannot afford to buy a house at any price?

2 No loophole

2.1 I understand the government has labelled the ability of residential landlords to deduct interest on loans incurred for their business a "loophole".

2.2 I resent that label and the implication that landlords are being devious or underhand in claiming interest deductions.

2.3 It is a universal principle that businesses may deduct interest on loans incurred to produce assessable income. It is true that, residences often increase in value, which is not the case of many other business assets, which generally depreciate in value. But shares in listed companies also generally increase in value and there is no suggestion that investors should not be able to deduct interest on loans incurred to buy shares, let alone, that the interest should be ring-fenced to the income from the shares.

2.4 So, why such a hard-out attack on residential landlords?

2.5 I consider it is acceptable to introduce measures to achieve government policies but the measures should only apply to arrangements undertaken after the change and should not be backdated or applied in such a way that people who arranged their affairs according to the tax and other laws at the time are penalised.

2.6 For example, the ring-fencing of interest deductions to the income from the particular property that the money was borrowed for is acceptable in my submission so long as it is applied to loans borrowed after the policy change.

2.7 I know from my circumstances, the proposed distortions to interest deductibility will create their own distortions. First, I will cancel all my charitable deductions (over $10,000 a year) and I will sell all my listed company shares and apply the funds released to reduce the bank loans relating to my trust's second residential property.

2.8 Obviously, my trust will be keen to increase the rents to cover the interest that it cannot deduct.

3 My main submission—retrospective application of the "tax reforms" is unfair.

Explanation

3.1 By "retrospective application" I mean the application of the new limitation of interest deductibility rule to properties bought prior to 27 March 2021 ("the effective date").

3.2 I consider it is one thing to announce a tax change to apply to arrangements made from a future date but quite a different thing to apply the tax change to arrangements made before the announcement of the change, especially where, the arrangements were not out of the ordinary at the time they were made. That is, the arrangements were not based on devious or extreme strategies at the time.

3.3 It has long been held that taxation should not be retrospective. This principle arises from the principle that the tax people have to pay should be certain, and not arbitrary, as expounded by Adam Smith in *The Wealth of Nations,* <u>1776.</u>

3.4 Cancelling the deductibility of interest will significantly increase the tax liability of residential landlords and decrease their net income. In my trust's case, using the figures from its 2020 tax return, a return of s9(2)(b)(ii) As interest rates increase (as they are now expected to do), the small net profit will disappear and the rental property venture will run at a loss, which is ring-fenced to the venture. The venture will cost the trust money to run.

3.5 I estimate that, if interest rates increase by only 1% a year, my trust's venture will have a s9(2)(b)(ii)

3.6 I am sure my trust's situation is common to others who bought before the effective date.

3.7 I consider the retrospective application of the new limitation of interest deductibility rule to properties purchased before the effective date massively distorts the outcome of rental property ventures legitimately entered into before that date.

3.8 I think that it is unfair for the government to apply the new rule to defeat the natural expectations of people who bought rental properties before the effective date, especially as, the Tax Working Group Information Release Document, Tax and Housing discussion paper, March 2018, quoted from above under section 1 General, determined that "... while tax reform could certainly affect the future trajectory of house prices, it is unlikely to result in a meaningful improvement to housing affordability in the absence of broader reforms to unlock the supply of housing."

3.9 I do not consider the proposal to incrementally apply the new rule to people who bought rental properties before the effective date avoids the unfairness mentioned—it only mitigates the effect of the rule for this and the next three financial years.

Entrapment

3.10 I consider people who bought rental properties before the effective date are trapped in an unfair position in these respects:

(a) If they bought less than five years before the effective date, and they sell within five years of purchase because, for example, they cannot afford to hold their rental under the new interest limitation rule, they will be taxed on the profit;

(b) If they sell earlier than anticipated due to the new interest limitation rule, they may incur break fees for repaying fixed term loans before maturity;

(c) If the rental is owned by a trust or a company, the tenancy may not be terminated to make it available for family use under section 51(1)(a) of the Residential Tenancies Act 1986 because the landlord, not being a natural person, cannot be said to have a family.

Undue haste

3.11 I do not appreciate the haste of the new measures. They are proposed to come into force from October of this year but the discussion document seeks input on many aspects of the measures and that it is likely that the final legislation will have changes which may impact adversely on plans made after the effective date pending the final legislation. In other words, the new legislation will be “doubly” retrospective—firstly it is proposed to apply to rentals set up before the effective date and, secondly, it may introduce changes to the initial announcement of the rules applying to rentals set up after the effective date.

Solutions

3.12 The only honest solution is for the limits on interest deductibility to apply only to rental ventures set up after the effective date. This is the only fair solution to avoid penalising people who set up residential rental ventures before the effective date based on the tax laws at the time.

3.13 In my opinion, such people should not be blamed or penalised for the current high demand for residences and anything less than this solution involves compromising the principals of certain taxation.

3.14 At the very least and as a compromise, I submit fairness demands that the new limits on interest deductibility should not apply to rental properties bought before the effective date, for the balance of their applicable bright-line rule period.

3.15 For example, for a property bought before the effective date, say, on 1 October 2019, when the bright-line period was five years, expiring, in this example, on 30 September 2024, the limits on interest deductibility would apply only from 1 October 2024, which is five years after purchase.

3.16 I think this solution is a reasonable compromise which allows people who set up residential rental ventures before the effective date to retire from their venture with respect and without penalties. I consider this to be a fair outcome because they have acted within the law at all times and it is unfair to blame them for the competitive housing market.

4 Summary

4.1 In conclusion and by way of a summary, I submit:

(a) It is unfair and unproven to blame landlords for the high prices of residences. The main cause for the high prices seems to be the lack of supply, as was found in the Tax Working Group Information Release Document, Tax and Housing discussion paper, March 2018, which I have quoted from;

(b) Ring-fencing losses has not moderated house prices and there is no reason or evidence to suggest that the new rules will assist in this respect;

(c) Penalising landlords by imposing the new rules seems driven more by a desire to be seen to be doing something than any rational reason relating to the usual deductibility of interest on finance used to derive taxable income or evidence that holding a rental property for ten years will keep prices for other houses low;

(d) Taxpayers should know how much tax they are liable to pay at any given time, which means tax laws need to be certain and not retrospective in effect;

(e) Applying the interest limitation rule to rentals set up before the effective date is applying a tax retrospectively because it adds extra tax to the tax that applied to the venture at the time it was set up;

(f) The only honest position is for the interest limitation rule to only apply to rentals set up after the effective date;

(g) As a compromise, the new limits on interest deductibility should not apply to rental properties bought before the effective date, for the balance of their applicable bright-line rule period.

4.2 Officials may contact me to discuss my submissions. s9(2)(a)

s 9(2)(a)

12 July 2021

PUB-0456

s9(2)(a)

To:	Policy Webmaster
Subject:	Design of the interest limitation rule and additional bright-line rules
Date:	Monday, 12 July 2021 11:56:23 PM
Attachments:	Interest Limitation Submission 20210712.pdf

Hi there,
Please find my submission attached.

I request that my name be excluded from publication.

Thank you.

With gratitude,
s9(2)(a)

My name is s9(2)(a) I am a residential property investor with a small portfolio of properties that were purchased in the 1990s with s9(2)(a) . I have worked really hard to hold on to the portfolio in the years since s9(2)(a) . The objective of our investment has always been (and remains) the provision of retirement income to supplement a dwindling New Zealand superannuation.

I absolutely oppose the proposed interest limitation legislation.

In my view, the proposed legislation flies in the face of every known accounting and taxation principle. In fact, the Income Tax Act 2007 provides in **Section DB6 Interest: not capital expenditure** that: *(1) A person is allowed a deduction for interest incurred.*

Residential property investors are told we are running a business (taxable activity); among other legislation we are obligated to comply with, rent must be declared as income. It follows that under DB6(1), interest incurred is an allowed deduction. The discussion document even spells this out in the first paragraph of Chapter 4 (i.e. "nexus" with assessable income).

The general principle is that expenses incurred in deriving taxable income is tax deductible. The proposed legislation targets residential property investors unfairly and jeopardises the integrity of New Zealand's tax system. This legitimate expense incurred by residential property investors has been erroneously labelled a loophole. We do not receive favourable treatment in this regard compared to other businesses. To compare our ability to deduct interest from our income to home owners who are unable to do so is seriously flawed logic – homeowners are not taxed on any deemed income from their home; the interest they incur has no nexus to any taxable income.

Furthermore, Section 6 of the Tax Administration Act 1994 states:
Every Minister and every officer of any government agency having responsibilities under this Act or any other Act in relation to the collection of tax and for the other functions under the Inland Revenue Acts must at all times use their best endeavours to protect the integrity of the tax system.

The shock-horror reaction to the Finance Minister's announcement of the proposed legislation in March 2021 is well-documented in the media. Reactions from economists, tax advisors, media commentators, property industry bodies, political parties on the opposition benches, individual property investors, my own circle of residential property investor friends and acquaintances, tenants who understand the relationship between taxable income and deductible expenses, etc. show there is a real public perception of a loss in the integrity of the tax system. Residential property investors are the current targeted group for this draconian tax, which is in effect a tax on a legitimate business expense.

What will we be hit with next if this fails to achieve the objectives? This proposal has created distrust of the government and uncertainty in the economy – who will be the next target and what legitimate expenses will be removed from them? If this legislation is passed, it will undermine the integrity of New Zealand's tax system. It has already undermined trust that New Zealand's taxation system will remain fair.

One of the objectives of this legislation is to ensure that every New Zealander has a safe, warm, dry, and affordable home to call their own – whether they are renters or owners. The proposed legislation will not achieve this objective. It is a fact that there will always be renters and the government is currently unable to house them all, as evidenced by the number of families in emergency housing. This is a supply issue. By imposing tax on interest expense (which, in essence, is what the proposed legislation will do), will not magic up the additional properties required to ease emergency housing pressures.

As for safe, warm, dry and affordable homes – there will be less funds available for maintenance and upkeep of the properties if the interest limitation rule is implemented. This is exacerbated by disallowing interest deductibility on additional borrowings for properties acquired before 27 Mar 2021. The effect will be a pulling back on major refurbishments and the quality of stocks will deteriorate.

A second objective is to support more sustainable house prices, including by dampening investor demand for existing housing stock, which would improve affordability for first-home buyers. Again, the problem here is one of supply. Removing investors may make some properties available for first-home buyers. However, it will also displace renters who have been renting the property being sold by an investor to a first-home buyer. In addition, when cost of goods goes up (effect of interest limitation and being taxed on non-deductible interest), prices of goods (in this case, rent) will go up to keep the business viable. This will make it harder for renters to save towards a deposit. The wrong tool is being deployed. To dampen investor demand, it would be more effective to increase the deposit required to buy investment properties. Make it 50% or even 60% and that will surely put a big dent in investor demand.

It is evident in the section on "Issues for further discussion" (in Chapter 2 of the discussion document) and the questions on carve outs that this will make the tax law around residential rental properties a minefield to navigate. As it stands, interest deductibility is not a loophole. Some of the carve outs are attempting to patch possible loopholes that will be created by the proposed interest limitation regime. However, it is not possible to anticipate every conceivable scenario. Moreover, the issues around Māori collectively-owned land and papakāinga housing will also drive further divisions between the people of New Zealand. The whole interest limitation proposal is extremely complex and will come with undue compliance costs for taxpayers as well as the Inland Revenue Department.

Having a different class of residential investment properties called "new builds" complicates the tax system even further. There are so many dates to keep track of to figure out whether or not a property is a new build and/ or whether or not interest is grand-parented. Furthermore, a property that is not a new build for the original purchaser could be a new build for a subsequent purchaser. It is extremely unwieldly and too complex for taxpayers to easily understand. Penalties for getting tax matters wrong are prohibitive. This will create unnecessary costs for taxpayers who now need to obtain specialist tax advice for something that they used to be able to handle themselves.

Interest limitation coupled with ring-fencing of residential rental losses may tip newer investors over into untenable financial hardship, especially when they become caught by the provisional tax regime. These are mostly middle-income New Zealanders who, like myself in my early widowhood years, have worked hard and saved hard to secure their future. Had this regime been instituted around the time my partner died, I would not have been able to hold on to my investments and would not be in a position to ensure my own financial future. This proposed legislation punishes New Zealanders who have put their endeavour into securing their own financial future and rewards those who can and refuse to work. Is this the New Zealand we want?

Residential property investors provide a service that the government is unable to fulfil on its own. The government needs to work with us and let us be a part of the solution; not knock us down at every opportunity.

Feedback on discussion document questions

If this is implemented (despite all the objections from this consultation process and against all the advice the government has received), then my feedback is as follows:

<u>Chapter 4</u>

Refinancing – having a specific provision as described goes hand in hand with tracing … so yes, agree there is benefit

Pre-27 March loans that cannot be traced – stacking preferred; simpler solution … scrap the proposed interest limitation legislation

<u>Chapter 5</u>

The options A to F either unfairly tax taxpayers who have planned their retirement based on the existing laws or increases compliance costs. For residential rental properties acquired pre-27 March, it would be grossly unfair for the disallowed interest incurred to just disappear into the ether. It is a legitimate expense with a nexus to income and must be available for use against assessable income when the property is disposed of, regardless how that tax liability may have arisen (be it a second-hand or new build property, whether from bright-line, depreciation clawback or other taxable income).

<u>Chapter 6</u>

I have a s9(2)(b)(ii) property with no cavity that needs remediation work. Additional borrowing would be required to carry out this work. If interest limitation applies, then this work will be deferred until such time when I have built up sufficient funds without obtaining a loan.

In my view, interest on loans for remediation work should be exempt from the interest limitation rule. This will help to improve the quality of housing stocks. The exemption should be for the life of the loan; it should not stop when the work is complete.

I have not had time to read the whole 143-page discussion document. This is all I can provide feedback on before the deadline.

Interest Deductibility Consultation Feedback

This submission focuses on two detrimental impacts not already considered:

1. Impact on residential Historic Heritage and Character
2. Impact on future maintenance/capital improvements to residential rental properties

It gives a view on the discussion topics:

3. Classification of "new build" in relation to uninhabitable dwellings
4. Period of deductibility for "new builds"

Issue 1: Impact on residential Historic Heritage and Character

Removing interest deductibility will completely disincentivise renovation of Heritage/Character homes in rental locations such as North Dunedin and other main city centre/city fringe locations and incentivise demolition.

If you own a Heritage/Character property and <u>demolish/rebuild</u> then your interest on total borrowings will be tax deductible, if you renovate (spending a similar amount) no interest will be tax deductible. The incentive to make a property "tax deductible" will be immense hence this policy will cause a significant loss of historic and character homes.

Historic Heritage and Character homes are of enormous social and cultural significance. They record the story of New Zealand through the individual and collective memories of those who lived in and around these areas. Erasing this history <u>only because of tax policy</u>, when restoring/renovating would be *more environmentally sustainable*, more *economical* (if the tax distortion didn't exist) and lead to *more diverse and inspiring* character neighbourhoods, is completely counter to the normal expectation of Government policies.

Given the timeframe of the proposed changes has *<u>Heritage New Zealand</u>* even been made aware or consulted on the potential impact of these changes?

Suggestion 1:
The impact of the policy could be mitigated by a small change such as:

Where an existing dwelling is built prior to 1940 (or meets a criteria identified and approved by Heritage New Zealand), then a renovation/repair of the home that exceeds a fixed rate per square metre (say $1200 per square metre) shall qualify the home as a "new build".

Issue 2: Impact on future maintenance/capital improvements to residential rental properties

For existing property owners (who may have owned their rental homes for many years) there will be no incentive to make any capital improvements (beyond tax deductible maintenance) to their properties.

Any debt taken on to complete renovations that improve the quality of their rental homes (such as new kitchens, new bathrooms, improvements to heating, new windows/doors, alterations to internal layouts that go beyond general maintenance) will no longer be tax deductible.

This will lead to a fall in upgrade work on rental properties and therefore will impact directly on the quality of rental homes available for lower income tenants who will not be able to access more costly "new build" accommodation. This will also lead to the dereliction of older rental properties, further impacting on the retention and conservation of our Historic Heritage.

Suggestion 2:
The impact of the policy could be mitigated by a small change such as:

Where additional capital spending is undertaken on an existing rental property (other than the purchase of land) any debt taken to fund the capital improvement is tax deductible for a maximum period of 20 years for the original owner of that property (or anyone who inherits the property).

For instance an owner who paid $300,000 in 2000 for a property that is now worth $700,000 with $100,000 remaining in mortgage decides to borrow $50,000 to improve the home and bring it up to modern standards beyond normal maintenance. This owner would then be able to claim a deduction on the interest of the $50,000 debt only.

Issue 3: Classification of "new build" in relation to uninhabitable dwellings

It is important that it is possible to classify an uninhabitable dwelling as a "new build" so that there is incentive to spend money to reinstate the property. This is particularly important in Christchurch where many homes are still abandoned 10 years after the Christchurch Earthquakes. Two suggestions for determining "uninhabitable"

Method 1: Power supply. Lines companies keep detailed records of when properties are connected to power. A test for "uninhabitable" could be no power connected for 2 years.

Method 2: Electoral Records. As a landlord, with uninhabited homes (following the Christchurch Earthquake), I know that Elections NZ send out letters to all homes where they have no registered electors just prior to each election. Elections NZ must have a database of which properties have no registered electors and are therefore likely “uninhabitable”.

<u>Issue 4: Period of deductibility for “new builds”</u>

This should be aligned to the length of a standard mortgage, which would be between 20 and 30 years.

For an original owner the mortgage should be repaid in that time period. Subsequent owners beyond that time period should not get deductibility.

If the subsequent owners had deductibility beyond the same period it would create a two tier market in 20 or 30 years time where the value of a home built in 2018 is cheaper than one built in 2021 for no real reason other than an indefinite tax deductibility. The question should be: *why would someone paying $3m in 2050 for house (that cost $700,000 in 2021) get a tax deduction (at the expense of the Government) relative to an identical house built in 2018 which might only be worth $2.5m in 2050 because of the tax distortion?*

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

s9(2)(a) [redacted]

To:	Policy Webmaster
Subject:	DESIGN OF THE INTEREST LIMITATION RULE AND ADDITIONAL BRIGHT-LINE RULES
Date:	Tuesday, 13 July 2021 12:00:41 AM
Attachments:	Findex-email-Signature---Evergreen2_21c01f51-52cd-414f-a5bc-33646bc7896b.png s 9(2)(a) [redacted] LTR 210712 IRD Submission - Interest Limitation Rule.pdf

Please refer to attached letter and submission in relation to the Design of the Interest Limitation Rule

Kind regards,

s 9(2)(a) [redacted]

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12 July 2021

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

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 make a submission in relation to the abovenamed Government discussion document.

Please find our submission **attached**.

Should you have any questions in relation to this submission, please contact the writer.

Yours sincerely,

s9(2)(a)

[redacted]

The title 'Partner' conveys that the person is a senior member within their respective division, and is among the group of persons who hold an equity interest (shareholder) in its parent entity, Findex Group Limited. The only professional service offering which is conducted by a partnership is the Crowe Australasia external audit division. All other professional services offered by Findex Group Limited are conducted by a privately owned organisation and/or its subsidiaries.

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

Introductory Comments

1. While we accept that the Government has the right to set tax policy, we do not agree with the proposal to remove the deduction for interest on money borrowed to acquire residential land for deriving income. We consider that the proposed change is ad hoc and unprincipled and will lead to unintended consequences.

2. We consider it a fundamental principle of our tax system that a taxpayer is entitled to a deduction from their assessable income for expenditure incurred in deriving that assessable income. This proposal denies a deduction for such expenditure incurred in relation to deriving income from a specific class of assets. By doing so it runs counter to the fundamental principles underlying our tax system.

3. In seeking to treat a particular expenditure in relation to a specific asset class differently from other types of expenditure and from expenditure on other asset classes, the proposed rule necessarily creates artificial boundaries and unfair and inequitable outcomes due to the creation of these boundaries. This results in additional complexity in our tax law and inevitably additional compliance costs for taxpayers seeking to apply and comply with these rules.

4. On the basis it is Government policy to introduce the interest limitation rule, while not agreeing with the policy, the purpose of our submission is to ensure that rule is as workable, simple and as equitable as possible.

Summary of Submissions

5. We agree:

    a. The current definition of "residential land" and "dwelling" are the appropriate starting point for identifying property that is subject to this rule (see para 8).

    b. Employee accommodation should be excluded from the proposed interest limitation rule (see para 14).

    c. Student accommodation should be excluded from the proposed interest limitation rule (see para 16).

    d. Short-stay accommodation that is not substitutable for long-term accommodation should be excluded from the proposed interest limitation rule (see para 18).

    e. When a taxpayer draws down a new loan to repay a pre-27 March loan on property acquired before 27 March 2021 that new loan should be treated as a pre-27 March 2021 loan to the extent it does not exceed the amount of the loan being refinanced (see para 32).

    f. In the case of complex builds where a new build and existing building are on the one title that apportionment of the property between the new build and existing building should be allowed (see para 60).

    g. That rollover relief should be provided for transfers pursuant to relationship property agreements, on death, company amalgamations, and for transfer involving look-

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through companies and partnerships where there is no change in economic ownership (see paras 69, 70, 71, 84).

h. The interest limitation rule should apply before the residential rental loss ring-fence rule or mixed-use asset rules are applied (see paras 92 and 95).

6. We disagree with:

a. The proposed amendment to the definition of close company (see para 25).

b. That the refinancing of an NZD loan with a loan in another currency should not be subject to the refinancing exception (see para 33).

c. The proposal to prohibit interest deductions for pre-27 March 2021 loans denominated in a foreign currency from 1 October 2021 (see para 38).

d. The continued investment rule (see para 63).

7. We consider that

a. The current all-or-nothing business premises carve out is inappropriate for the proposed interest limitation rule and favour an apportionment approach (see para 10).

b. There is no need for a special apportionment rule for dual use buildings and that apportionment should be undertaken based on existing general tax principles (see para 12).

c. Serviced apartments should be excluded from the proposed interest limitation rule (see para 21).

d. Apportionment of untraceable loans based on cost is likely to provide more equitable outcomes than Stacking (see para 29).

e. Interest deductions on pre-27 March 2021 loans denominated in a foreign currency should be subject to the same rules as per-27 March 2021 loans denominated in NZD (see para 39).

f. Option B and Option F are the preferable options regarding deductions for interest on disposal (see para 42).

g. Land dealers that are subject to section CB 7 should not be included in the development exclusion (see para 48).

h. Remediation work should be included in the development exception (see para 51).

i. A property that was previously uninhabitable that has been made habitable should be included in the definition of new build (see para 54).

j. The new build exemption should be available to both early owners and subsequent purchasers of a new builds (see para 56).

k. The second option suggested in paragraph 8.20 of the Discussion Document is preferable (see para 57).

l. Where a new build is added to land with an existing building on it that taxpayers should have the ability to apportion interest incurred on funds borrowed to purchase the land based on land area (see para 60).

m. The proposed rollover relief for trusts will have little practical application and fails to adequately issues around trusts and the bright-line test and interest limitation rule (see para 74).

n. The residential rental loss ring-fence rule should be repealed or at least should not apply where the interest limitation rule applies (see para 87).

Chapter 2 - Residential Property Subject to Interest Limitation

8. We agree that use of the current definition of "residential land" and "dwelling" are the appropriate starting point for identifying property that is subject to this rule. However, we consider that some modifications are required as discussed below.

9. We agree that the following should be excluded from the proposed rule:

- Land outside New Zealand
- Farmland
- Business premises
- Care facilities such as hospitals, convalescent homes, nursing homes, and hospices
- Commercial accommodation such as hotels, motels, and boarding houses
- Retirement villages and rest homes

Business premises and dual-purpose buildings on the same site

10. We do not consider the current all-or-nothing business premises carve out is appropriate for the proposed interest limitation rule and favour an apportionment approach where land is used both as business premises and for residential purposes.

11. We consider an all-or-nothing approach may encourage behaviour that is inconsistent with the Government's policy objectives around housing supply. An all-or-nothing approach may encourage the owners of dual-purpose buildings to reduce the residential use of the building to ensure that it is "*used predominantly as business premises*" to protect the deductibility of their interest expenditure.

12. The concept of apportionment arises throughout the Income Tax Act 2007. The core deduction provisions, the general permission is section DA 1 and the general limitations in section DA 2, allow and permit deductions *"to the extent to which"*. The requirement to apportion expenditure arises in numerous circumstances and is a concept with which taxpayers and their advisors are familiar. The Inland Revenue Department has also published several items discussing apportionment. For example, the Department is currently consulting on apportioning expenditure between business use and private use in the context of motels, hotels, and boarding-houses.

13. Accordingly, we consider that there is no need for a special apportionment rule and that apportionment should be undertaken based on existing general tax principles.

Employee Accommodation

14. We agree that employee accommodation should be excluded from the proposed interest limitation rule.

15. We consider that the exclusion from the residential rental loss ring-fence provides for employee accommodation by section EL 13 is an appropriate basis for this exclusion.

Student Accommodation

16. We agree that student accommodation should be excluded from the proposed interest limitation rule.

17. We consider that the legislative framework in sections 5(1)(h) and 5B of the Residential Tenancies Act 1986 is an appropriate basis for identifying student accommodation that should be excluded from this rule. We consider that it is preferable to use existing legislative frameworks rather than a specific definition for the purposes of this rule.

Short-stay accommodation substitutability issues

18. We agree that short-stay accommodation that is not substitutable for long-term accommodation should be excluded from the proposed interest limitation rule.

19. The exclusion should apply to properties that are not capable of being used as long-stay accommodation.

20. However, we consider that there are likely significant boundary issues with such an exclusion.

Serviced Apartments

21. We considered that serviced apartments should be excluded from the proposed interest limitation rule.

22. We consider that there are significant boundary issues in distinguishing between a hotel room and a serviced apartment. Property developers commonly construct complexes designed for short-stay accommodation with the intention of selling units to individual owners subject to the requirement that the unit is placed in a letting pool that is managed by a third party, often a hotel operator. Often these units can easily be reconfigured for letting as a serviced apartment or hotel room depending on market demand. Consequently, distinguishing between a hotel room and serviced apartment can be problematic, and unit owners can easily switch between the two configurations of their units.

23. We consider that subjecting serviced apartments to the interest limitation rule will likely result in serviced apartments being converted to hotel rooms.

24. Further, a serviced apartment is not generally used for long-term accommodation due to the cost of the services over the long-term. Generally, if a unit was to become long-term accommodation services would no longer be supplied bringing the unit back within the interest limitation rule.

Chapter 3 - Entities affected by Interest Limitation

Close Companies

25. It is not clear that the wider implications of the change in the definition of "close company" have been considered. The concept of close company is used widely through-out the Act (a search of the Act gives over fifty references to "close company").

26. The proposed change to the definition will treat the trustees of trusts with the same or associated settlors as a single trustee. This potentially greatly increases that number of companies that will be considered close companies. This has flow on effects for various other regimes. For example, the definition of family scheme income, which companies can pay non-PAYE shareholder-employee salaries, and the fringe benefit regime.

27. Accordingly, we disagree with the proposed amendment to the definition of close company. Consideration of the wider implications of this change are required.

28. We do not favour a change in the definition of close company solely for the interest limitation. We consider that having different definitions of the same term for different parts of the Act can lead to confusion and adds unnecessary complexity to the Act.

Chapter 4 - Interest Allocation: How to Identify which Interest Expenses are Subject to the Limitation

Tracing

29. The document suggests that to make tracing easier taxpayers should raise separate loans for different types of assets. This is not always practical. Some taxpayers will have funding arrangements in place for commercial reasons and will not wish to or are unable to change those arrangements.

30. While tracing may be simple for those with less complex business structures and a clear link can be seen between drawing down a loan and the acquisition of an asset for those with more complex affairs this may not be so simple. This will be the case where businesses are refinancing and there is no longer a clear link between the drawdown of a loan and the asset it is financing.

31. The tracing approach means that the interest limitation rule will impact "mum and dad" investors and those whose main investments are in residential properties. Investors with a more diversified portfolio will have the ability to restructure their borrowings so that their debt-funding is traceable to their non-residential investments while their residential properties are equity-funded.

Refinancing

32. We agree that when a taxpayer draws down a new loan to repay a pre-27 March loan on property acquired before 27 March 2021 that new loan should be treated as a pre-27 March 2021 loan to the extent it does not exceed the amount of the loan being refinanced.

33. We disagree that the refinancing of an NZD loan with a loan in another currency should not be subject to the refinancing exception.

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34. As discussed at paragraph 40 there are several reasons why a taxpayer may choose to finance a residential rental property with a foreign currency denominated loan. Excluding those taxpayers from the refinancing exception seems arbitrary and unfair.

Transition

35. For taxpayers with a mix of asset classes and borrowings it will be difficult for them to trace borrowings to an asset. The Discussion Document suggests dealing with this issue through either Apportionment or Stacking.

36. Stacking is simple to apply. However, it may lead to inequitable outcomes. Mum and dad investors with only one or two investment properties will be significantly impacted by the interest limitation. However, wealthy investors with a diversified investment portfolio and enough debt-to-equity will be unaffected by the rule due to being able to "stack" all their debt on to non-residential property. This would seem to skew the residential investment market in favour of larger investors with diversified investment portfolios.

37. Apportionment based on cost will ensure that all investors, regardless of the composition of their investment portfolio and debt-to-equity ratio will be affected in some degree by the interest limitation rule. This seems to provide a more equitable outcome.

Foreign Currency Loans

38. We disagree with the proposal to prohibit interest deductions for pre-27 March 2021 loans denominated in a foreign currency from 1 October 2021.

39. We consider that interest deductions on pre-27 March 2021 loans denominated in a foreign currency should be subject to the same rules as per-27 March 2021 loans denominated in NZD.

40. A taxpayer may choose to borrow in a foreign currency for several reasons. For example, the cost of borrowing in a foreign currency may be cheaper than in NZD. Many non-residents and absentees elect to finance the purchase of New Zealand residential properties with foreign currency loans. These may be due to having existing banking relationships offshore, using offshore assets as security, or due to the difficulty of obtaining banking borrowings in New Zealand. We have noted a growing reluctance on the part of New Zealand banks to lend to non-residents and absentees.

41. We consider it inequitable for foreign currency denominated loans to lose deductibility at 1 October 2021 and consider that the phase out of interest deductions should be available to such loans on the same basis as NZD loans.

Chapter 5 - Disposal of Property Subject to Interest Limitation

Options for treatment of revenue account disposals

42. We consider that a deduction for interest should be allowed at the point of sale.

43. Permanently denying interest deductions will result in property investors paying tax on a gain that does not factor in the costs of deriving that income. Investors could be left paying tax on what is a loss when borrowing costs are considered.

44. We prefer Option B.

45. If a limitation is to be placed on the deduction of interest on sale we prefer Option D over Option C. Investors should be able to carry forward any loss on the disposal of one property to offset against the gain on disposal of other properties.

46. Consideration is required as to how the denied interest deduction will be allocated to properties on sale where the taxpayer own multiple residential properties that are not financed by separate loans.

Options for treatment of capital account disposals

47. Of the two options presented we favour Option F as this has the potential to at least provide property investors with some deduction for the costs they have incurred in providing rental accommodation and deriving residential rental income. Ideally, they would be entitled to a deduction for all expenditure incurred, including interest, in deriving assessable rental income.

Chapter 6 - Development and Related Activities

Qualifying Development

48. We are largely in agreement with the identified types of development and activity that should be covered by this exemption, subject to the comments below.

49. We do not consider that land dealers that are subject to section CB 7 should be included in the development exclusion.

50. Land dealing involves purchasing and selling land in the same condition as it was acquired. This is not an activity that results in a new dwelling that will qualify as a new build, which is the stated purpose of this exclusion.

Remediation

51. We consider remediation work should be included in the development exception.

52. Making an uninhabitable building habitable adds to the housing stock and such work should be considered as resulting in a “new build”.

53. There are obvious boundary issues between what is remediation to make a property habitable and repairs and maintenance/ renovation. However, we consider that further work is required to determine whether a meaningful distinction between the two can be found. In times of natural disaster emergency services have criteria for determining whether a property is uninhabitable. We presume that insurance companies have their own criteria when assessing whether a property is habitable or not. Further investigation of the criteria used by these organisations may assist in identifying a workable boundary between the two.

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Chapter 7 - Definition of New Build

54. The proposed categories of "new build" seem reasonable.

55. However, as discussed in relation the development exclusion we consider that further consideration is required of whether a property that was previously uninhabitable that has been made habitable should be included in the definition of new build.

Chapter 8 - New Build Exemption from Interest Limitation

Who should the exemption apply to and for how long?

56. We consider that the new build exemption should be available to both early owners and subsequent purchasers of a new builds.

57. We agree with the second option suggested in paragraph 8.20 of the Discussion Document. That is in "perpetuity" for early owners and for a fixed period for subsequent purchasers.

58. We consider that the new build exemption should be available to an early owner until the earlier of the date the early owner:

    a. Repays the loan traced to the property; or

    b. Sells the property.

59. We consider the new build exemption should be available to a subsequent owner until the earlier of the date the subsequent owner

    a. Repays the loan traced to the property;

    b. Sells the property; or

    c. A fixed period has passed since the issuing of the Code Compliance Certificate.

Mixed New Build and Non-new Build Properties

60. We consider that where a new build is added to land with an existing building on it that taxpayers should have the ability to apportion interest incurred on funds borrowed to purchase the land. This should be done on a land area basis.

61. The interest apportioned to the land used for the new build should be subject to the new build exemption.

62. Interest on funds borrowed to provide a separate title for the new build from the existing property should also be subject to the new build exemption without the need to apportion between the two titles.

Continued Investment Rule

63. We do not agree with the continued investment rule.

64. We consider that such a rule will add unneeded complexity and create uncertainty for a subsequent purchaser. A subsequent purchaser will need to enquire as to the use that previous owners have put a property and will be reliant on the information provided to them by the previous owner without the ability to independently verify that information.

65. A subsequent purchaser may apply the new build exemption in good faith and in reliance on the information supplied to the vendor, only to find the new build exemption is not available due to the vendor or early owner having used the property as their home. Not only will the subsequent purchaser have taken an incorrect tax position, their decision to acquire the property and price paid will have been influenced by the assumption an interest deduction was available.

Chapter 9 - Five-year Bright-line Test for New Builds

66. We agree that in the case of complex builds where a new build and existing building are on the one title that apportionment of the property between the new build and existing building is required. In these cases, the five-year bright-line would only apply to the new build, unless the existing building was itself subject to the original five-year bright-line test.

67. We note that the recent change to the main home exclusion may be problematic in the case of new builds, particularly when the land is bought off the plans. When land is acquired off the plans the bright-line period commences when the agreement to purchase the land is entered (we understand this was intended to be a concessionary rule). When land is purchased off the plans it is not uncommon for it to take longer than 12 months from when the agreement is entered for title to issue, the new house to be built, and the purchaser to occupy the new build as a main home. Under the new main home exclusion, a sale of the property within 5 years of entering the agreement (assuming the property qualifies as a new build) will attract at least same tax as there is a more than 12-month period when the property is not a main home. This will potentially discourage purchasers from buying off the plans and potentially limit the supply of new homes.

68. We consider there are several issues with the bright-line test that need to be addressed. These are discussed in the rollover relief section of this submission.

Chapter 10 - Rollover Relief

Relationship Property Transfers

69. We agree that rollover relief should be provided for pre-27 March 2021 land transferred under a relationship property agreement and transfer of land cover by the new build exemption under a relationship property agreement.

Transfers on Death

70. We consider that rollover relief from the interest limitation should be provided for transfers from a deceased person to their executor or administrator and from the executor/administrator to the beneficiary of the estate.

Company Amalgamations

71. We agree that rollover relief from the interest limitation rule should be provided for resident's restricted amalgamations.

Natural Persons Who Dispose of Land to Themselves

72. We consider that the distinction between joint ownership and tenants-in-common are not generally well understood by taxpayers (and some advisors). We do not consider a legislative change is required to achieve the outcomes in paragraph 10.49 of the Discussion Document. However, we recommend that Inland Revenue consider issuing guidance on this issue.

73. We consider that explicit rollover relief for pre-27 March 2021 land and new builds should be provided for transactions of the type referred to in paragraph 10.49 of the Discussion Document.

Trusts

74. We understand that the proposed rollover relief for trusts is only to apply to settlements on trusts for no consideration or where the settlor the only consideration is the right of the settlor to occupy the property free of charge. We consider that such transactions are very rare.

75. Accordingly, the proposed rollover relief will have very limited application which will be even further limited by the restrictions on the nature of the trust discussed in paragraphs 10.53 to 10.63 of the Discussion Document.

76. We note that this rollover relief also proposes amendments to the associated persons rules for the specific purpose of the relief. We consider that such an amendment would add further to the complexity of the rules and add further confusion as to the appropriate test to apply and who is associated to whom.

77. The extending of the bright-line test to 10-years means that the bright-line test now has significant overreach from its original policy intention of buttressing section CB 6. Practically, it now acts as a capital gains tax on all residential property that is not the main home of the owner or, in the case of a trust, the main home of a principal settlor of the trust. Changes to the main home exclusion mean that main homes may be subject to tax on their disposal within 10 years of acquisition.

78. The 10-year bright-line test significantly hampers the ability of taxpayers to undertake restructuring of their affairs where residential land is involved without incurring tax on the transfer of the property to associated entities and resetting the bright-line period. We consider an urgent review of the 10-year bright-line test is required with full consideration of what rollover reliefs is required and to prevent the taxing of transfers between associated entities and the resetting of the 10-year period.

79. As with the proposed rollover relief from the bright-line rule for trusts, we consider that the proposed rollover relief for trust from the interest limitation rule will have little practical application.

80. As increasing house prices have made it difficult for young people to save for a deposit for their first home and secure bank finance mean prevents have assisted their children into their "first home" often using their family trust. Often these arrangements involve the trust acquiring the property with the intention that the settlors' child and family will occupy the property as their main home. The child will meet outgoings on the property, including interest payments on the mortgage. The intention is that eventually the child will be able to acquire their own home either through acquiring their current home from the trust (usually the expectation being the trust will sale at cost) or by having the trust sell the property and distribute the net proceeds to the child to buy a new home.

81. Such arrangements are problematic under both the bright-line rule and the interest limitation rule. The sale of the trust will be caught by the bright-line test as despite the property being the main home of the beneficiary it does not qualify as a main home as it is not the main home of the principal settlor (the parents). The transfer cannot occur at cost as the property is revenue account property, therefore the trust is left with a tax liability and the child potentially with a smaller deposit toward their new home.

82. The proposed interest limitation rule exasperates this issue. Payment of the interest on the Trust's mortgage by the child is effectively rental income to the Trust. Under existing tax rules, this rental income is offset by the deduction the Trust is allowed for the interest on the mortgage. However, the interest limitation rule will remove the Trust's interest deduction leaving it with taxable income and a tax liability to fund, potentially be requiring additional payments from the child. Thereby, reducing their ability to save to buy a property outside the trust arrangement.

83. This outcome seems to run counter to the Government's policy of assisting first home buyers into a new home. The combination of a 10-year bright-line and the removal of interest deductions on residential property places onerous tax outcomes on a mechanism many are using to get into their first home.

Look-through Companies and Partnerships

84. We agree that the transfers of residential land to look-through companies and partnerships by look-through owners and partners respectively should be given rollover relief from the bright-line rule where there is no change in the economic ownership of the residential land.

85. Similarly transfers of residential land from look-through companies and partnerships to look-through owners and partners respectively should be given rollover relief from the bright-line rule where there is no change in the economic ownership of the residential land.

86. We agree that similar transaction between look-through owners and look-through companies, and partners and partnerships should be provided with rollover relief from the interest limitation rule.

Chapter 12 - Implications for the Rental Loss Ring-fencing Rules

87. The rental loss ring-fencing rules would seem largely redundant where the interest limitation rule applies. Losses from residential property investment predominantly arose from depreciation (which has not been available on residential property since 2011) and due to interest deductions, which are to be removed.

88. In the absence of depreciation and interest deductions a loss from a residential property is only likely to arise where significant expenditure on repairs and maintenance has occurred. Such significant repairs are likely to only occur rarely, such as replacement of a roof.

89. Accordingly, we suggest consideration should be given to repealing the rental loss ring-fence rule or at least provide that it does not apply where the interest limitation rule applies.

90. As is discussed in the Discussion Document the proposed interest limitation rules and the existing ring-fence rule are complex and the interaction between the two sets of rules adds further complexity. The interest limitation rule largely does the work of the rental loss ring-fence rule.

91. Consideration also needs to be given to whether it makes sense to allow interest deductions for new builds to expand the housing stock, only to deny the full benefit of that deduction through the rental loss ring-fence rule.

92. If the rental loss ring-fence is to continue to apply, we agree that the interest limitation rule should apply first to determine if interest is deductible.

Chapter 13 - Interest Limitation and Mixed-Use Residential Property

93. The mixed-use asset rules are intended to prevent the owners of property used for income-earning and privately from gaining a tax advantage by claiming a deduction for expenditure when the property is unused. This is a different purpose than both the interest limitation rule and the rental loss ring-fence rule. Therefore, unlike the rental loss ring-fence rule we consider that these rules still have a role to play once the interest limitation rule is enacted.

94. We note that the proposed change to the definition of "close company" (which we disagree with) will expand the number of companies that are subject to the mixed-use asset rules.

95. We agree when a mixed-use asset is held by a taxpayer other than a close company the interest limitation rule should apply to determine deductibility of the interest before any permitted interest deduction is subject to apportionment under the mixed-use asset rule.

96. We agree that where a close company owns a mixed-use asset that is residential land subject to the interest limitation rule that section DG 11 should continue to apply rather than the proposed tracing rule.

From: Stephanie Watts
To: Wendy Watkin; Thomas Minot; Policy Webmaster
Subject: FW: submission on interest denial
Date: Tuesday, 13 July 2021 9:39:29 AM
Attachments: submission on interest deductibility July 21.pdf

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Not in scope

Hi Wendy

Here's a sub we received from s9(2)(a) last night. I don't know if it was sent through the usual policy subs mailing address separately, so am also sending it through to you now.

Cheers

Steph

From: s9(2)(a)
Sent: Monday, 12 July 2021 4:39 PM
To: David Carrigan s9(2)(a) Chris Gillion s9(2)(a)
Cc: s9(2)(a) Stephanie Watts s9(2)(a)
Subject: submission on interest denial

David and Team

Attached is our submission on the proposal to deny interest deductions. As always, happy to meet or discuss our submission.

Kind regards

s9(2)(a)

s 9(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.

We provide our comments on the above discussion document (the DD). We are happy to meet with officials to discuss. All references are to the relevant paragraph number in the DD.

Initial comment

It goes without saying do not agree with these proposals. More specifically:

- we are concerned that removing interest deductions for residential landlords will have an adverse effect on the rental property market. There is always a need for rental accommodation including:
  - tertiary students
  - taxpayers who have left their family home and have not the capital to fund the acquisition of a new home
  - taxpayers that have moved cities
  - new migrants into New Zealand
  - taxpayers who simply cannot afford a home including retired and low wage earners
  - taxpayers whose family circumstances have changed that have results in being unable to buy a home (relationship break ups etc)
  - taxpayers that have moved cities for employment for only short or medium terms
  - taxpayers that are planning an OE or move to a new city in the foreseeable future
  - taxpayers that have come to New Zealand for an OE or work experience
  - taxpayers that simply chose not to buy a home

  There needs to be an efficient and well operating rental market for these taxpayers to obtain good rental accommodation. The effect of these proposed changes seems likely to remove a significant portion of landlords from the market or otherwise lead to higher rents to compensate for the removal of interest deductions. We cannot see how this will be a benefit to the rental market and it will likely mean few rental properties on the market which would increase rents. Further the proposals will still benefit new builds which generally, if not totally, have a high rental cost, again all putting upwards pressure on rental rates.

Broader economic analysis suggests that all these proposed measures will achieve is a change in asset portfolios held by investors. Investors dependent on borrowed funds will likely sell out of rental properties given the interest costs will no longer be deductible. They are likely to be replaced by those investors who can fully equity fund rental property investment. A simple example is a rentier with two 50% geared rental properties and a new home buyer intending to purchase a new build home. The rentier sells one of the rentals making the other fully equity funded. The rentier then buys a new build 100% geared. The new home buyer then buys the rental property the rentier sells. The end result is no change in rentals, no decrease in new home prices, and no revenue to the government. Just complex laws that make the tax system incoherent. As the market adjusts to these changes prices will alter in the interim and the end result may be impacted by the details discussed in the DD.

- Even if these proposals merely change who owns rentals, significant costs can be expected to occur on some socially useful investment that may have limited options other than existing arrangements dependent on interest deductions. An example seems to be a multi-unit residential building acquired as a rental investment. Investors in such investment blocks will be subject to interest denial. The Tax Working group noted the following into its interim report (para 48 of the TWG interim report)
    - "The restoration of depreciation on multi-unit residential buildings would increase the supply of housing and support greater intensification in urban areas."
    - From our understanding many multi-unit residential buildings provide long terms accommodation to taxpayers that cannot afford their own family home including pensioners. Denying interest deductions for these investments seems extremely harsh as these properties do not "tilt the playing field away from property investors and towards first home buyers" (2.4). These properties are generally not unit titled and only ever to be used as rental accommodation. Consistent with the Tax Working Group, there should not be tax penalties discouraging this form of investment. These reforms are thus inconsistent with the direction of reforms recommended by the Tax Working Group.
    - We can see a boundary line that revolves around whether the units are separate title as opposed to one title. We are happy to expand out comments if required.

- Denying interest for existing investments send a strong message that New Zealand tax settings can materially change in an ad hoc incoherent manner that is a reversal of the settings for the last 30 years. Over the last 30 years the tax settings have revolved around ensuring there is a limited tax bias. This is best demonstrated by aligned, or closely aligned tax rates, economic depreciation rates and generally taxing all forms of income and generally on an accrual basis. The proposed changes signal a considerable departure from these historic settings which has no tax policy rationale. As a result the tax risk premium of investing into New Zealand can be expected to increase causing lower investment across the economy. That is likely to be a significant economic cost with no revenue gain to the government (because the lower investment is a reaction to expected not actual future incoherent tax measures).

The remainder our of comments are made on the basis that these reforms will progress and hence our comments are seeking to make the proposals as workable as possible. Given the complexity we have focus on what we see are the key issues.

1 **As a general comment** these proposals will need to be understood by the least sophisticated part of the taxpayers whose income is not subject to withholding at source and who are thus required to file tax returns. Given this, if there is to be general compliance with these rules, they should be made as simple as possible without unexpected (and unnecessary) rules. Some of the issues we strongly advise against are as follows. If these created adverse issues, they should be addressed through the normal GTPP.

a. The continuous investor rule for new builds. A new build should never be disqualified from being a new build simply due to its having an owner occupier for a period. While compliance cost intensive, this rule is effectively unworkable and not enforceable by the Inland Revenue.

b. The DD's suggested change to the closely held definition (treating multiple trusts as one shareholder) should not be proceed as part of these reforms (3.5). If there is a valid concern here (which we dispute) it is a general one not relevant for these reforms. If it needs to be addressed this should be done as a stand-alone technical amendment with adequate prior consultation. The way it has been explained in the DD it seems an unrealistic concern that should, if it happened in practice, be subject to the general anti avoidance provision.

2 **Interest deductions for section CB 7 taxpayers.** Currently officials are recommending that taxpayers who are in the business of dealing etc obtain immediate deductions for interest. Our submission is that this should be wider and should cover <u>all</u> taxpayers who hold their property on revenue account other than revenue account due to be triggered by the bright line rules or a ten-year rule. Currently revenue account taxpayers pay tax on property gains. They do not focus on what specific provision makes them subject to tax. Having different rules for section CB 7 taxpayers and other taxpayers raises complex arguments as to which section applies to them. We believe all revenue account taxpayers should be able to claim immediate interest deductions whether under the new build phase or the development phase.

3 **Short term accommodation providers** should not be subject to interest denial. This should be worked on through the normal GTPP to see if a workable solution can be found to address the issues raised by the government. Issues that need to be considered include:

a. The boundary between short term accommodation that has interest denied and hotels, service apartments. We see this border being particularly complex and subjective.

b. If all short-term accommodation is not, as a general rule, allowed interest deductions to continue, then some recognition needs to be made for the interest on borrowing to meet the sometimes considerable cost of providing fitout and meeting associated costs. That is, short term providers generally supply furniture and fittings, appliances, bedding, etc. It seems particular inequitable and distorting that short term accommodation providers should be caught by these rules whereas hotels and potentially serviced apartments are not caught by these rules.

4 **Dual-purpose buildings**. The proposal is to deny interest deductions if the business premises is less than 50%. This is wrong. We believe the correct policy position should be:

a. If the commercial premise's is greater than 50%, interest deductible in the normal course

b. If the commercial is less than 50%, then apportionment (as opposed to all interest denied).

5 **Rest homes and retirement villages**. We agree that rest homes and retirement villages should continue to be allowed deductions for interest costs. These facilities allow the elderly to vacate other homes and thus increase the overall supply of housing. We also note the difficulty that would be involved in apportioning interest between independent living, treatment of common areas or vacant space and then determining how to treat bare land held for future development. We are concerned that a rule may create issues for land held by a rest home or village operator but not yet actually used in that activity. For that reason exemption from the interest denial rule should apply to any borrowings of a rest home or retirement village operator if the funds are borrowed for the purpose of that business.

6 **Student accommodation.** We agree that these should be excluded from the rules given that providers of such accommodation do not compete with homeowners. In addition to what officials proposed, an alternative exclusion should be where supply of accommodation is subject to GST. Similar to rest homes, there are added services with hostels (and the like) which make the supply subject to GST. Our concerns with official's proposal is whether it meets the strict wording of the Residential Tenancy Act (RTA). This is a complex area with commercial nuances and some bulk student accommodation may not strictly be caught within the provisions in the RTA. For example, if the accommodation is supplied to the tertiary institution and they lease accommodation to the students, the question arises who supplies the additional services in section 5B(2) of the RTA. As such the proposal should be wider to catch all provision of accommodation to students. In addition to rest the rest home exclusions, perhaps all long term provision of accommodation should be excluded if the provision is subject to GST. We cannot think of a situation where the long-term provision of accommodation that is also subject to GST should also not be excluded from these rules. We note that retirement villages supply some services not subject to GST so that our above submission on them still applies.

7 **Short term accommodation**. We have noted our concerns above. We think this is better to exclude all short term accommodation and work through more carefully where the short term accommodation boundary should reside.

8 **Close company/residential investment property rich**. The application of the close company boundaries and residential investment property (RIP) rich should be simplified. We refer here to the situation where an entity (normally a company) is claiming interest deductions itself. The issue of a shareholder claiming deductions is considered under the interposed entities heading below. The proposal in the DD is that the entity claiming the interest deduction must trace the use to which the borrowed funds are put (with no interest deduction if used to fund RIP) if it is a closely held company. If it is not a closely held company it must trace if 50% or more of its assets are RIP. These proposals are too restrictive and complex with high compliance and administrative costs. Ultimately (perhaps after a short period of time) any widely held company would structure its affairs so that it meet the tracing requirement for full interest deductions making these costs pointless. The focus should be on situations where instead of owning a geared rental that could otherwise be purchased by a new home buyer, a rentier established a company that borrows the funds to buy the rental probably with a personal guarantee over repayment. We suggest a clearer and simply exemption as follows:

a. Interest deduction denial does not apply to any widely held company. That would mean that any listed company or similar widely held one would not heave to apply these proposed rules. The reason for this is as above. In any case it seems very unlikely that a widely held company would be based on investment in the type of dwellings attractive to first home buyers.

b. If not a widely held company, tracing be required if the assets of a company are 50% or more RIP.

c. The proposals are to apply on a company-by-company basis. This is sub optimal policy, the rules should allow all group companies to group to determine whether 50% of their assets are in RIP. If this is accepted, obviously assets should not include an investment in another group company or any advance to another group company.

d. Requiring the 50% test to be maintained at all times during the year simply raises compliance costs and uncertainty. This should just be at year end. If taxpayers are undertaking complex structure to avoid this, then they are likely to be subject to the general anti avoidance provision.

9 **Kainga Ora**. The reason given for exempting Kainga Ora from the interest deduction proposal is that it provides social housing. However, the same reasoning suggests it should be exempt income tax generally – that is it is not a business and other entities providing social housing are as the DD notes expected to be tax exempt.

10 **Tracing of interest**. For simplicity and compliance cost reasons, all dates that refer to 27 March should be changed to 31 March. The impact on fiscal income is immaterial.

11 **Interest deductions when property is sold** – revenue account taxpayers

a. Interest should be deductible when incurred for section CB 7 taxpayers (as proposed by officials). As above this should cover all revenue account taxpayers except for contingent revenue account as it requires a time period to elapse.

b. For other revenue account holders, ideally those subject to the bright line rule or a 10 year rule, we believe all previously non deducted interest costs should be deducted when the property is sold. This is option B. These are revenue taxpayers and if they make net losses, like any taxpayer that has losses, they should be allowed as a deduction. Again, if there is any limitation on the deduction, these taxpayers will simply argue that they should be taxed under section CB7.

c. We do not believe the arbitrage issues raised in the DD are real and need to be addressed (5.26). We note officials believe this is important to prevent selective sale of properties (5.37). Taxpayers will never incur a loss to claim a tax loss, rather they are always incentivised to maximise profits. Given the costs and the time to sell properties, especially if losses are arising (which suggests a slow down in the market), then it is highly unlikely that taxpayers will be bringing sales forward for tax reasons. These rules will bring in considerable complexity for what appears little risk to the tax system. We discuss loss ring fencing further below.

d. Officials need to consult on the issue of when a property that is subject to the bright line has interest costs. For example, where a taxpayer hold a bare section and it is sold within the bright line period, there should be consultation of what interest costs are deductible.

12 Interest deductions when property is sold – capital account taxpayers

a. The tax treatment of interest deductions on the sale for rental properties held on capital account highlights the lack of rationale for this policy. Consider a taxpayer that makes no capital gain from investing into a rental property not subject to the bright line rule. Option E gives no deductions and results in a poor policy design. For a high leverage taxpayer, this effectively means this is an investment they would struggle to make. What this means is the number of investors substantially reduces and hence the supply of residential rentals will reduce. This reduced supply will increase the rental rates on the remaining residential properties.

b. Option F provides a full deduction less the quantum of the capital gain. This recognises that actually losses were incurred and should be allowed as a deduction. This supports that Option E is poor policy design. We support option F, noting we do not support these proposals. Option F raises questions on the rationale for denying interest deductions up to the point of sale.

13 Development exemption and new build exemption.

a. As an initial comment we do not support having different rules for the development stage and the new build stage. This adds complexity and potentially incorrect results. It seems most taxpayers during the development stage should also get the new build relief. Apart of remediation (discussed below), all "developers" would get the new build deduction. We would combine the new build and development rules.

b. If for some reason the two regimes are to be maintained, we strongly submit the development exemption is called something else. A developer is generally regarded as holding the property on revenue account, however someone who can claim their interest through the development phase can be a capital account holder. Having these terms will be confusing.

14 **Remediation (7.9, 7.10)** . Large scale remediation projects for residential property (usually associated with bodies corporate) are very stressful and there can be a fine balance whether such projects proceed or not. They take considerable time and generally, both leveraged and unleveraged unit holders, have to arrange bank finance. Also in our experience, some of these apartment blocks have a substantial number of unit holders being owned by landlords. Disallowing interest deduction to landlords for the remediation costs will likely be the tipping point that means the building does not get fixed. This could be partly the additional financial costs of non-deductibility and the emotional factor of the impact of non-deductibility. With this background, our submission in this regard is as follows:

a. *Initial comment, interest should not be limited to the development phase*. Remediation costs should obtain interest deductions through the development phase <u>and the new build phase</u>. The DD suggests it is only during the development phase (7.9). If landlords cannot obtain interest deductions during the new build stage, then this becomes overly harsh and is likely to be viewed as not providing interest deductions at all. As above, we would recommend there is only one category, being the new build. With remediation expenditure, this should occur over both phases.

b. The next question is: what remediation capital costs qualify for the associated funding costs being treated as deductible? The simplest legislative relief would be the interest costs relating to all capital expenditure other than the initial acquisition of a rental property is deductible. That is, simply allow interest deductions on all capital expenditure post acquisition. This is rejected by officials (7.9) on the basis that this will not increase housing stock. However, it is government policy that all rental properties should meet a minimum healthy home standard and incurring interest costs to undertake the necessary capital work to do so brings an otherwise uninhabitable property (under government standards) up to a property that can safely be made available for rent. A rule that interest on borrowings to fund any capital expenditure would be the clearest with no boundary needing to be drawn between good and bad remediation expenditure. The only issue would be whether landlords believe they need to undertake that expenditure. Official note that interest deductions should not apply when a landlord replaces a bathroom or kitchen (7.9). If a landlord considers the replacement of a bathroom or kitchen it probably means that the Kitchen or Bathroom is in a state of significant disrepair and hence. Allowing interest deductions on all capital expenditure, other than the acquisition costs, means the quality of rental homes increases. We also note that unless the capital expenditure is substantial there is relatively little tax benefit from allowing interest to continue to be deductible (the costs and thus borrowings will be low). The proposal in this sense self-policing – it will only apply in substance where the remedial work is of a substantial nature which is likely to be where it is necessary to make the property habitable. If this is accepted, we appreciate there should be a fixed period for subsequent interest deductions, we suggest 25 years.

c. If the above submission that funding cost for all capital costs are not accepted, then what is qualifying remediation expenditure will need to be determined. We suggest any capital expenditure that is required to maintain the property being able to be used for rental accommodation. That is any expenditure that is required for the property to meet the healthy home standards. This is effectively the above point.

d. If the above is not accepted, then we all support all significant capital expenditure and leave it to the courts to determine what is significant.

15 **Period of allowable interest deductions.** The DD suggests different periods for early owners (i.e. acquired with 12 months of the CCC) and subsequent owners. This is a political judgement call. In this regard we note the following:

a. It is critical that interest deductions are allowed for both earlier owners and subsequent owners. Without interest deductions there will be many new build buildings that simply will not find sufficient funding to enable that project to proceed. For example, if the deduction was only allowed to the early owner, then the pool of potential subsequent owners materially reduces. The market price of the new build will reflect the fact that a subsequent buyer will not qualify for interest deductions. That will be capitalised into the market value of the new build. That would make new builds unattractive to investors (contrary to stated government policy). New build investors would an increased risk of losses when the property is sold.

b. If the period of deduction is relatively short (for example 10 years), this will also materially (and adversely) effect the willingness of investors to invest in such projects. We do not believe that any significantly leveraged investor will work on the basis that all debt will be repaid within the first 10 years.

c. While it is a judgement call, we favour interest deductions for perpetuity but at least 25 years.

d. As noted above, we do not support the proposal that if any stage the property was owner occupier, then the interest deductions cease. This is illogical and difficult foe the Inland Revenue to enforce.

16 **Rollover relief.** There should be rollover relief for the brightline test (so that a sale between associated parties does not trigger the beginning of another 10-year period) and the rules that remove interest deductions. We do not support the proposed rules in this regard seem overly complex and too restrictive. We propose:

a. Rollover relief applies where the property is transferred between associated persons. Basically, the bright line rules only reset when the property is transferred to someone who is not associated with the vendor and a sale between associated parties should not result in the loss of interest deductions otherwise available.

b. There is no restriction that the sale is for no consideration.

17 **Interposed entities.** We make the following high-level comments:
The rule should focus only on the situation where a rentier transfers a rental property to a company and then the rentier as shareholder seeks an interest deduction based on nexus to dividends where an interest deduction would not be available if the rentier and, if not the rentier, the company had borrowed to purchase the property.

a. We do not understand the reference to how a trust can be an interposed entity.
b. We do not agree with the proposal that, "for simplicity purposes", there should be no transition for interest deductions where the interest deduction is to acquire an interposed entity. This has no policy basis and should be addressed. A possible example is a flat owning company. These are already specifically dealt with in the Income Tax Act (section CD 31) and the proposals should consider their treatment in detail.

18 **Implication for the loss ring fencing rules.** We are very concerned about the complexity of these rules especially noting many landlords do not used professional advisers. With the removal of interest deductibility we can see real benefits in removing the loss ring fencing rules. Apart from new builds, there should not be significant tax losses made by residential landlords, hence why are the loss ring fencing rules retained when the quantum of tax losses is not significant. For new builds, given the focus by the government on wanting to increase new builds, removing the loss ring fencing rules will assist that objective. We would recommend all loss ring fencing rules being removed and existing ringfenced losses can only be used against rental income (or bright line income etc).

19 **Mixed use property**. The interest apportionment rules in the mixed use assets in corporates is incorrect and should be aligned with the proposals in these rules, namely interest that is traced to mixed use assets. As you are aware, for many SMEs FBT on motor cars has been turned off and now relies on a regime that denies deductions based on private use of that motor car. The interest associated with such motor cars also relies on tracing rules. This should be extended to all mixed use assets. Having one rule to calculate interest associated with mixed use assets and residential rental homes (i.e. using tracing) ensures consistency and more simplified rules compared with different interest apportionment rules.

20 **Administration issues**. We do not comment on the administrative issues. These are best consulted on and considered when the final form of the regimes has been established.

21 **Existing bright line rule**. With the extension to the bright line rules from 5 years to 10 years a technical change was made to when the main family home is subject to these rules. There was no consultation with this technical change. The previous rule was that the exemption for the main home was where it was used by the owner for at least 50% of the period of ownership. The change makes the main home subject to the bright line rules is where it is not used as the main home for a continuous period of 12 months or more (and the home is sold within the bright line period whether 10 years or the proposed 5 years for a new build). We make the following comments:

a. The 12 month rule gives rise to some surprising results, namely where the main home was not used due to:
   i. A section being purchased by the homeowner which the home was then built, and the period of building takes 12 months
   ii. The taxpayer undertakes a secondment for more than 12 months

   iii. The taxpayer has to vacate the home for 12 months due to flooding, earthquake, or some other natural disaster
   iv. The taxpayer permanently moves into a rest home and the home remains vacant for 12 months.

b. Also, somewhat surprisingly, the period on non-use does not require that the home was rented and hence the homeowner is likely to be a non-filing taxpayer.
c. We recommend the 12 month rule should be consulted on through GTPP.
d. We believe a better answer is that the main home should be subject to the bright line where it is not used as the main home for 12 months **and** that period is greater than 50% of the ownership period.

22 **Drafting**. We strongly recommend that officials consult on the structure of the drafting for these proposals to ensure that it is practical, effective and workable.

As above, we are happy to work through our submission with officials.

Yours faithfully

s9(2)(a)

[redacted]

s9(2)(a) [redacted]

To: Policy Webmaster
Subject: 2021-7-12 BCL interest limitation rule submission updated
Date: Tuesday, 13 July 2021 9:58:48 AM
Attachments: s9(2)(a) [redacted]

I attach an updated submission for your attention. The submission filed yesterday contained an incorrect summary of how a deemed return approach might work. This has now been corrected.

Please contact me if you have any queries.

Regards,

s 9(2)(a) [redacted]
Baucher Consulting Ltd

s 9(2)(a) [redacted]

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Please note from 1 October 2018 we will be asking clients to supply more information. New Anti-Money Laundering legislation affecting tax agents, requires us to gather more information from our clients. For an explanation please click http://baucher.tax/amlcft

Mailing address: PO Box 32-582, Devonport, Auckland 0744, New Zealand

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

I s 9(2)(a) [redacted] Baucher Consulting Limited, a tax consultancy established in August 2004 which provides tax consulting services to individuals and small businesses.

I am a member of the Accountants and Tax Agents Institute of New Zealand (ATAINZ) and on behalf of ATAINZ I was involved with the s9(2)(a) [redacted]. I wish to thank Inland Revenue Policy Officials for enabling our participation in these discussions.

This submission has been prepared after feedback from clients and fellow advisors and our involvement in preparing ATAINZ's submission.

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.

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5. Alternatively, rather than the eventual disallowance of all interest deductions (except for the "new build" exemption), interest deductions should be limited to 50%. This would partly redress the current position where 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 D (on the basis the rental loss ring-fencing rules remain in force).

9. In relation to sales on capital account we support Option E allowing no deductions.

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.

16. We consider the complexity of these proposals' merits considering the adoption of the suggested deemed return method outlined in the final report of the Sir Michael Cullen chaired Tax Working Group.

B. General comments

17. 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.

18. 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 exemption and allowing deferred interest deductions to become deductible on a revenue account sale may create unforeseen arbitrage possibilities.
   c. *Complexity* 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.

20. Coming on top of the recent introduction of the rental loss ring-fencing rules the proposals further complicate the tax treatment of residential rental investment property. In our view the proposals demonstrate the limits of present tax policy around the taxation of residential rental investment property. We therefore consider adopting the suggested deemed return method outlined in the final report of the Sir Michael Cullen chaired Tax Working Group[1] (the TWG).

21. We suggest that as a low-compliance alternative individual investors with two or fewer properties must adopt the deemed return method. Other taxpayers outside these parameters can elect to join the regime but may only do so on a portfolio basis, that is all residential rental properties held by the relevant taxpayer must adopt the deemed return method.

22. As outlined by the TWG a residential property investor's taxable income would be determined using the following formula *Equity value at the beginning of year x Deemed rate of return*. All rental income and expenditure would be treated as non-assessable/non-deductible. We do not propose limiting the debt to be taken into consideration when determining the relevant equity value. This is on the grounds that interest is non-deductible but must still be paid so artificially increasing debt to reduce the deemed return would still require interest to be paid by the investor. To that extent the proposal is self-policing. The deemed return rate could initially be set at 3.5% with the option of it rising to 5% in line with the present Fair Dividend Rate applying under the foreign investment fund regime in subpart EX of the Income Tax Act 2007.

23. We consider adopting the deemed return method which captures more of the economic return from housing would reduce the need for an extended bright-line test period. The bright-line period could perhaps be reduced to two years but be buttressed by the ability to tax transactions where there is a regular pattern of buying and selling property.

[1] See Chapter 5 paras 36 onwards

C. Chapter 2 – Residential property subject to interest limitation

24. 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 DD 11[2] together with the exclusion from the land sale rules in section CB19.

25. 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.

26. 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

27. 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.

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

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

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

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

30. We agree that it would be beneficial to have a specific provision in relation to the treatment of a refinanced pre 27th March loan.

31. 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.

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

F. Chapter 5 – Disposal of property subject to interest limitation

33. In relation to the treatment of interest on sales of revenue account property we support Option D – anti-arbitrage restriction for interest.

34. In relation to sales on capital account we support option E - no deductions allowed. This should have the strongest impact on reducing investor demand for residential property.

35. 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

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

37. 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.

38. 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 – Definition of new build

39. We support the government's proposed definition of new build. 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 – New build exemption from interest limitation

40. 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.

41. 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.

42. 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

43. 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 – Rollover relief

44. 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 10.57 should 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.

45. 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 bright line test or interest limitation purposes.

L. Chapter 11 – Interposed entities

46. 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.

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

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

M. Chapter 12 – Implications for the rental loss ringfencing rules

49. 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.

50. Generally speaking, interest deductions represent the largest proportion of residential rental investors deductible 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

51. 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

52. 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. Failure to do so could threaten the public's perception of the integrity of the tax system.

We would be pleased to discuss any aspect of this submission with officials.

Yours sincerely

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

s9(2)(a) [redacted]

To: Policy Webmaster
Subject: [SUSPECT SPAM]Design of the interest limitation rule and additional bright-line rules
Date: Tuesday, 13 July 2021 10:00:08 AM

To whom it may concern

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 3 year project to develop s 9 [redacted] new townhouses in s 9(2)(b)(ii) [redacted] - 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 $200,0000 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.

1. 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.

2. Secondly and we have begun the process already, we will need to sell down some of our properties s9(2)(b)(ii) [redacted] 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 s9(2)(b)(ii) 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 s9(2)(b)(ii) 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.

I trust you will take my concerns seriously.

Kind regards
s9(2)(a)

s9(2)(a) [redacted]

To:	Policy Webmaster
Cc:	Tax team
Subject:	Submission - Interest Limitation and additional brightline rules
Date:	Tuesday, 13 July 2021 11:20:12 AM
Attachments:	Submission to IRD re interest limitation and bright-line rules.pdf

Dear Sir/Madam,

Please find attached our submission with regard to the proposals outlined in the Government's discussion document as issued on 10 June 2021 per the attached link - https://taxpolicy.ird.govt.nz/publications/2021/2021-dd-interest-limitation-and-bright-line-rules.

We note the submissions closed last night, 12 July 2021 however we respectfully request that you accept our submission as attached. There was a lot to work through within the 140 page discussion document and we have worked through this as quickly as our resource allowed.

We look forward to hearing further on this matter.

s 9(2)(a) [redacted]

RSM New Zealand (Auckland)
RSM House, Level 2, 62 Highbrook Drive, Highbrook, Auckland 2013, PO Box 204276, Auckland 2161
s 9(2)(a) [redacted] W: www.rsmnz.co.nz

Deputy Commissioner
Policy and Regulatory Stewardship

Policy.webmaster@ird.govt.nz

12 July 2021

Dear Deputy Commissioner,

Subject: Design of the Interest Limitation Rule and additional Bright-Line rules

We set out below our submissions regarding the above subject matter. Overall, we do not support the extension of the bright-line period. We also do not support the interest limitation placed on residential investment property. We consider it a major policy shift. The overall objectives of the Government are:

- The support of more sustainable house prices
- The dampening of investor demand in housing stock
- The improvement of affordability for first-home buyers; and
- Creating a housing and urban land market that is competitive and affordable for renters and home owners.

We do not consider that these proposals will make any significant impact on the Government's objectives. We have however outlined our comments and concerns below with regard to each of the question points raised in the discussion document. Not all points are covered given the somewhat short timeframe provided for making submissions.

We are available for discussion if you require.

Residential Property subject to interest limitation:

Question at 2.69:

- 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?
- How could an apportionment approach work?
    - Should it follow general tax principles, or is there another approach that might be more appropriate?
    - Are there any apportionment calculations regularly done by landowners for other purposes (for example, insurance and mortgages) that might be useful in this context?
- How might "business premises" be defined for the purpose of interest limitation?
    - To what extent is it possible to reuse the definitions outlined above for this purpose? What issues might this cause?

Comments:

We support an apportionment approach in line with the general tax principles (i.e. to the extent of). We do not support a primary use approach when giving consideration to setting legislation dealing with interest limitation.

s9(2)(a) [redacted]

We support the same definition of "business premises" as covered in section DD 11 Income Tax Act 2007 ("ITA") to the extent that it only covers the normal business premises or workplace. A temporary workplace may result in liberal interpretation of what constitutes a temporary workplace and the accompanying difficulty in determining interest that would be deductible in line with policy's intent.

We also support the current definition of farm land within the interest limitation rules as it applies to land transactions is sufficient for the interest limitation rules.

Question at 2.74:

- Should a carve-out for employee accommodation be provided under the interest limitation rules?
- 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?
- What integrity issues might arise from carving out employee accommodation, and how could these be mitigated?

Comments:

We support a carve-out for employee accommodation as this is genuine business expenditure required as a condition of employment, and incurred in deriving assessable income of the business. Many businesses require employee's to live in employer provided accommodation as a condition of their employment, e.g. workers in the agriculture, viticulture and horticulture industries. Generally these are "on premises", but not always.

We support the same definition as applied in the residential ring-fencing rules.

From an integrity perspective we consider that a "change of use" should apply upon completion of a capital project or secondment. For example, if property was purchased to be used as out-of-town employee accommodation, and following completion of a project or secondment, the property was leased out to the employee, or other party predominantly as a residential investment, will the carve-out continue to apply under the interest limitation rules?

Our view is that upon a change of use of the property, the eligibility for the carve-out should cease, despite the employer/employee relationship. Section EL 13 refers to the employees being provided accommodation in connection with their employment or service. Could this be easily manufactured even after a project or secondment is completed?

Question at 2.79:

- Should a specific carve-out for student accommodation be provided? 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?
- Could a carve-out encourage the conversion of regular residential rental properties into student accommodation? How could this risk be mitigated?

Comments:

We support a carve-out for student accommodation as this should encourage more student accommodation to be provided at affordable prices. We support using the regulatory framework in

s9(2)(a)

sections 5(1) (h) and 5B of the Residential Tenancies Act 1986 as this provides good fundamental for the definition and is sufficiently prescriptive to mitigate any risks.

Question at 2.82:

- Should short-stay accommodation that is not substitutable for long-term accommodation be carved out from the interest limitation rules and why?
- How could this carve-out be designed to avoid capturing short-stay accommodation that could be substitutable for owner-occupied housing?
- How could this carve-out be designed to prevent short-stay accommodation that is substitutable for owner-occupied housing from being converted so that it is not substitutable?
- How could a carve-out be designed to reflect a sense of commercial scale akin to a hotel or motel?

Comments:

We are uncertain as to the circumstances described in para 2.80 to 2.82, where short-stay accommodation is not substitutable for long-term accommodation. Is this in reference to cabin homes or container homes etc.?

We do consider that any short-stay accommodation that is not easily substitutable for long-term accommodation should not be captured.

Question at 2.96:

Comments:

We have no comments in relation to the questions for submitters in this section.

What is not however questioned at 2.96 is any matters relating to serviced apartments. In para 2.86 it is noted that the Government is interested in exploring whether a carve-out for serviced apartments that more closely resemble hotels might be warranted, and how such a carve-out might be constructed. We have the following comments/concerns with regard to this matter:

- Where a serviced apartment is subject to a long term management contract placing restrictions on the ability to use the apartment long-term, a carve-out should be considered. For example where a person leases their property to Ramada under a 5 year contract that allows short stay accommodation only, should the interest limitation apply?
- In many instances people invest in studio units that have no kitchen facilities, and make use of restaurant or communal facilities. We do not consider the interest limitation rules should apply as it is not habitable long-term as a place of residence.

Entities affected by interest limitation

Question at 3.16:

The Government invites submissions on the proposals in relation to entities affected by interest limitations as outlined above, and is particularly interested in:

- Does treating new builds and residential property covered by the development exemption as "residential investment property" for purposes of the "residential investment property-rich" threshold cause issues for any developer companies? If so, what are those issues?
- 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?

Comments:

We support treating new builds and residential property covered by the development exemption as "residential investment property" for the purposes of determining the "residential investment property-rich" threshold.

We do not foresee issues for developer companies as properties that qualify for new builds and development exemptions will still later be excluded from the interest limitation rules, even if the company breaches the "residential investment property-rich" threshold.

With regards to any properties held that do not qualify for the exemptions (i.e. tainted properties held for 10 years), these properties should be subject to the interest limitation rules as intended by policy.

Tax book values should always be used in the first instance as opposed to accounting book values. There might be circumstance where market value would be a preferred option, however given that the "residential investment property-rich" threshold is meant to be tested on a daily basis, it can be challenging to support the market value. Furthermore, if properties held are in different regions, market values can easily distort the "true" economic value of the properties. We see no issue with the adoption of tax book values for the purpose of the formula. Adopting a market value approach is simply not practical.

With regard to para 3.10, we do not agree with the treatment of ownership interests in residential investment property-rich companies. Example 4 refers to A holding 50% of the shares in B Limited. B has assets consisting of residential investment property ($400,000) and commercial property ($200,000). This gives an investment percentage of 66.67%. As well as holding the shares in B, A holds commercial and residential investment property also, with a resident property percentage of 58.3%.

We do not consider that this is appropriate. The shares investment in B should be apportioned by A on the same percentage, i.e. B has a residential investment percentage of 66.67%. This should be applied to A's share investment in B, i.e. $300,000 x 66.67% to obtain the value that relates to the underlying residential investment.

Interest allocation – identifying interest subject to the limitation

Question at 4.12:

- Do you agree with the proposed approach to generally rely on the existing law on tracing, except where it would cause transition issues? (Transition issues are discussed at paragraphs 4.17 to 4.40.)
- Are there 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.

s9(2)(a)

Comments:

We support the tracing approach where the use of the borrowed funds are determined. There is long-standing case law support for this approach and we see no need to adjust this except where during the transitional period of phasing, difficulties arise (discussed below).

Question at 4.16:

- Do you agree that a new loan to refinance a pre-27 March loan would benefit from a specific provision?
- Are there any commercial reasons a loan that is in New Zealand dollars would be restructured to a loan in a foreign currency?
- Are there other issues with refinancing that we have not considered?

Comments:

We agree that a new loan to refinance a pre-27 March loan should benefit from the specific provision as the nature of the loan remained the same.

In practice, it is rare that a residential rental property in New Zealand would be financed by a foreign loan as banks would generally require security over the property. However, even though rare, it can occur. For example, taxpayer has significant business interests in China. Due to the low interest rate, ICBC (Industrial Commercial Bank of China) agree to lend to taxpayer for the purchase of NZ residential investment property with a general security interest over property in both China and NZ. We therefore see no reason that the refinancing exception cannot be applied to a foreign denominated loan that is refinancing pre 27 March loans, particularly if it is rare as stated.

We address financial arrangement rules further below.

Question at 4.22:

The approaches proposed are aimed at making compliance easier for taxpayers who would otherwise have to apply tracing to pre-27 March loans.

- Which of the proposed approaches do you prefer?
- Do you have any suggestions on how the proposed approaches can be made simpler?
- Are there alternative approaches you would prefer? If so, how would that alternative approach work?

Comments:

We consider the stacking option is appropriate as it's easier to apply in practice given that this is only for the purpose of transitional loans which will be phased out over time. We would agree that there would be the ability to restructure loans towards non-residential investment assets in any case to secure interest deductions.

It is noted that for this option, stacking will be based on the market value of assets as at 26 March 2021. Although we agree with allowing this option, it will not be practical to obtain an independent market value for assets. We suggest allowing options to simplify compliance. For example if the property was acquired less than 12 months prior, the acquisition cost could be used. Alternatively the

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latest quotable value (for commercial and residential property). For depreciable property other than buildings, tax book value may be appropriate. Essentially further thought needs to be given to the establishment of values as at 26 March 2021 if stacking is to apply.

Question at 4.40:

- Do you agree with the proposed approach to a high water mark?
- Are there some products that can be excluded (for example, loans that only decrease) or should the high water mark apply to all loans?
- Are there any situations when a portfolio basis for a high water mark could be necessary?
- Are there other issues with applying a high water mark that have not been considered above?
- Are there other products that raise issues that are not addressed by the high water mark proposal?

Comments:

We support the proposed approach to a high water mark proposal, and support that this should apply to all loans to minimise compliance costs. As this only applies to transitional loans, consideration should be provided as to whether one-off disclosure regarding the high water mark is required at the time of filing the 2021 tax return (i.e. as a benchmark disclosure). This is particularly relevant where a taxpayer may change accountants and the new advisor has difficulty determining the benchmark that applies.

Para 4.41 and 4.42 discusses loans in foreign currency and the difficulty in transitional phasing for these loans. We do not agree with the complete denial of interest deductions in this instance (including foreign exchange losses). Further consideration should be given to this aspect. The financial arrangement rules are a code within the act and should take precedence. We appreciate the Government's stance on interest limitations, however, these should not apply to foreign exchange gains and losses which are outside the scope of the interest limitation rules. Foreign exchange movements can be separately determined under the financial arrangement rules and related gains and losses should be separately determined under those provisions.

Disposal of property subject to interest limitation rule

Question at 5.43:

Below are questions the Government is posing to help focus discussion:

- 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?
- Should the bright-line anti-arbitrage provision be extended to sales taxable under section CB 6 (purchased with the intention of resale)?
- Should some interest deductions be allowed when property is sold on capital account?
- What are the trade-offs in considering housing market objectives and tax policy efficiency and equity objectives?
- 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

s9(2)(a)

loss ring-fencing rules to incorporate a revenue account loss? Do you have another approach to suggest?

Comments:

For revenue account property, our first preference is Option D. This option balances housing market incentives, efficient and fair taxation, and protection of the tax base against arbitrage risk. However, we view that the accumulative interest deductions carried forward should be disclosed at the time of filing the relevant tax returns. This could be by way of requiring the filing of rental income (IR 3R) disclosure to be compulsory and incorporates disclosure of the accumulated interest deductions, similar to a carried forward of tax losses.

We envisage issues in record keeping if say a property subject to bright-line is sold in the 9th year as banks and taxpayers are currently only required to retain records for 7 years.

We support the bright-line anti-arbitrage provision to be extended to sales taxable under section CB 6 (purchased with the intention of resale).

For capital account property, our first preference is Option F as this would be equitable. Otherwise, we envisage arbitrage issue with taxpayers intentionally selling within the bright-line period in order to obtain interest deductions (i.e. subject to interest deductions being allowed at the time of sale of a revenue account property).

Development and related activities

Question at 6.30

Below are several questions officials would specifically like to seek feedback on from submitters:

- Are there other types of developments or activity which should be covered under this exemption?
- Should land dealers (who are included under section CB 7) be carved out from the proposed section CB 7 safe harbour?
- Do you agree with the proposed criteria for the development exemption to apply?
- 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?
- When should interest begin to be deductible when property is not acquired for the purpose of development, but that intention is formed later?
- 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?

Comments

We agree with the intention of the exemption and that is should cover both section CB 7 activity and any other activity not captured by section CB 7 that creates a new build as pointed out in para 6.9 of the discussion document. We agree that the exemption should not just apply to property developers. This ensures alignment with the new build exemption where the criteria in para 6.15 of the discussion document are met.

Land dealers should be left in under the safe harbour rules, as the property is on revenue account under section CB 7 and dealers should not therefore be precluded from the ability to deduct interest.

We support remediation work to be included and covered under the exemption as it aligns with government's intent. Our view for the type of remediation work that should be included should encompass the following:

- Heritage Buildings
- Structural improvements (earthquake strengthening and weather tightening)
- Remediation work to the extent that it is major and extends the life of a building by more than 10 years. Generally, any work done that results in less than 10 years is arguably more akin to an improvement.
- For properties not acquired for the purpose of development, our view is that interest should be deductible from when there is a concrete affirmative action to support the intention i.e. actus rea and mens rea. Something that would be akin to tests or steps in determining whether CB 12 and CB 13 applies, i.e. the "commencement" of a scheme of subdivision or development is generally when there is an overt act evidencing such commencement.
- Our view is that interest on all loans (including existing loans prior to the commencement of development activity) should be deductible.

Definition of new build

Question at 7.11

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?

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?

Comments

We endorse the proposed definition of new build as it is sufficient to cover the various new builds as intended.

We have no comments in relation to the definition of new build with respect to papakāinga housing and heritage buildings.

With regard to renovations and remediation work, the issue is whether the housing supply increases. Renovation work does not necessarily lead to an increase in housing supply unless it is significant. If the renovation is significant, then in effect it should be labelled as a "reconstruction". Consequently, renovation or remediation work that is significant and requires reconstruction should fall under the new build definition. This is on the assumption that the works require a CCC which is the most reliable

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way to identify an uninhabitable dwelling becoming a new build. Refer further to comments above under 6.30 with regard to remediation work

New build exemption from interest limitations

Question at 8.11

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:

- Should the new build exemption apply only to early owners, or to both early owners and subsequent purchasers?
- 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.
- Are there any issues that specifically relate to the new build exemption and:
  - papakāinga housing?
  - heritage buildings?
  - the purpose-built rentals sector?
- 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 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)? (Refer to paragraphs 8.27 to 8.29 for more information).
- 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?
- 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 Government needs to consider?
- 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?

How practicable is the continued investment rule (described from paragraphs 8.22 to 8.26)? Do you think the rule is a good idea (considering the criteria mentioned in paragraph 8.26)?

Comments

Our first preference would be that the new build exemption applies only to early owners as to allow the build exemption to the subsequent purchasers is unlikely to increase housing supply which is in contrast to intention of the policy. Permitting subsequent owners this exemption would likely also result in some compliance issues once the further parts of this framework is incorporated.

However, we consider early owners that are afforded "roll over" as indicated will apply in the discussion document, should be entitled to roll over relief, i.e. a person that acquires a new build and

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settles this on a trust 2 years later, should be entitled to retain the early owner exemption as the economic ownership has not altered.

We are supportive of the transitional rule for new builds with CCC issued before 27 March 2021. We do have concerns with an early owner being someone that acquires a new build within 12 months of its CCC being issued. Consider a situation where a person buys off the plans, and then sells on completion to B but prior to CCC. Thus there is an "already constructed new build". B should then be considered an early owner as CCC has not yet been issued. However CCC runs into problems and is issued 13 months after B acquires. Will this still be considered an "off the plans" purchase? We assume in the majority of cases based on historical data that the Commissioner is satisfied that the majority of new builds involve CCC being issued within a 12 month window.

In terms of our submission on the application period, we hold split views on this. Either a limited period of 10 years, or in perpetuity for early owners has been favoured.

With regard to support for the exemption application period to be limited to 10 years, this timeframe would be in line with the bright-line rules and tainting rules. Anything further would only encourage non genuine long term investors to hold only to the extent that it is non-taxable before disposing. By setting a timeframe, it would encourage investors to reinvest the funds received into another new builds, essentially refreshing or generating new housing stocks.

However an alternative view is that these investors (early owners) should be afforded interest deductibility in perpetuity. Investors that are taking on new builds should be encouraged to do so by allowing deductions in perpetuity. Restricting this to 10 years would not encourage new build buying. New build buying is essential for the provision of housing supply as a significant portion of renters will never afford to buy their own home. Early owners should be incentivised to buy and allowing in perpetuity deductions supports this.

We do not consider a 20 year period should be applied, this in reality is no different from an in perpetuity period as generally investors will turnover their stock prior to the 20 year period in any case. If the Commissioner is set on a limited period applying, a 10 year period makes sense. As noted, the tax team are divided on this aspect.

With respect to the exemption from the interest limitation rule in the instance where interest relates to both a new build and a non-new build, we support the approach of utilising the apportionment rules. This is in line with long-standing case law and policy.

Given our preference for new build to only apply to the early owner, the CCC along with land title and/or relevant sale and purchase agreements would be sufficient to verify the person is eligible for the new build exemption.

Based on our preference of limiting the interest limitation rules only to early owners, we don't envisage any major integrity issues from the reliance on CCC as verification.

In the instance where CCC has yet to be issued, the sale and purchase agreement would be the best documentation to support that a person is eligible for the new build exemption. Generally for a person who acquires a property off the plans, the plans itself would be attached/included as part of the annexures in the sale and purchase agreement.

We do not support the denial of deductions for an early owner that subsequently moves into the property. This is too onerous and will have little impact on a person's decision to invest in new property. There can be genuine reasons for a person moving into their new build. This could be a short time-frame or could occur multiple times. If a person is an early owner, they should continue to be regardless of the fact that a period of owner-occupation is involved.

If the Commissioner is adamant on this proposal, a 12 month buffer should apply as introduced in the 10 year bright-line period. For example a new build is lived in by the owner for 3 months whilst they finish the finer detail of the renovations. After this time the property is rented for 2 years. They live in it again during tenancies as the market slows for 5 months. They then rent it again for a further 2 years. Such a buffer should be applied so only periods exceeding 12 months cause a cut-off of interest deductions. This will have the effect of stimulating the rental sector. Complete denial will discourage investment.

Five year bright-line for new builds

Question 9.13

Below are several questions that the Government would specifically like to seek feedback on from submitters:

- Are there any issues that specifically relate to the new build bright-line test and heritage buildings?
- 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 alternative approach (such as applying a predominant test)?
- Are there any simple ways to prove that residential land a person owns qualifies for the new build bright-line test?
- 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?

Comments

We are supportive of the apportionment method given this is a long-standing practice based on case-law. We do not support a predominant test, in our view this would be against the policy of objectives regarding new build exemptions.

Given the current process and potentially different treatment by the various councils around the country, CCC still remains the best form of verification.

In the instance where CCC has yet to be issued, the sale and purchase agreement would be the best documentation to support a person is eligible for the new build exemption. This is also to keep it in line for the new build for the purposes of the interest limitation rules.

Rollover relief

Question 10.45

- Should rollover relief from interest limitation be provided for transfers on death?
- 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?

Comments

s9(2)(a)

We agree that rollover relief from interest limitation be provided for transfers on death as this will be in line with other rollover relief provisions within the Act whereby the transferee is treated as stepping into the shoes of the transferor.

In line with our earlier preference the rollover relief provided should be limited to the first beneficiary of the estate as suggested in para 10.45. Alternatively, on death the new build exemption could continue for a limited window, say 10 years from issue of the CCC.

Question 10.71

- In your view, 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?
- What number of degrees of blood relationship should be permissible to determine whether a beneficiary is associated with the principal settlor?

Comments

We agree that the conditions proposed at paragraph 10.57 are appropriately targeted and reasonable. However, we would like clarification regarding the application to trusts where charities are included as a beneficiary class.

We are of the view that 2 degrees of blood relationship will be sufficient, and this is in line with the current association rules. In addition under the new Trusts Act, trusts are likely to have a narrower beneficiary class.

We would like the Commissioner to consider exercise of her discretion on application however. For example we had a recent situation where a person settled a trust and the only beneficiary was their grandmother. On her passing, they appointed a close friend. They had no other relatives. Such persons should be afforded discretion, or there should be allowance for those that the settlor has natural love and affection for.

Question 10.82

We have no comments for this section.

We would however like to comment on the provisions relating to LTCs and partnerships. It is noted that the relief would only apply where the owners of the property continue to own in the same proportion within the LTC. Thus an individual may own land that they transfer to a LTC. The proposal is they must own 100% of the LTC. However, the individual may wish their spouse to own 50%. We see no issues with allowing a person to transfer their proportional interest in the property to a relative or trust that is within the proposed roll over rules already. For example A owns 50% of a property with a friend B. They transfer to a LTC and A owns 25% and Mrs A owns 25% and B owning 50%. This should be allowed.

Interposed Entities

Question 11.30

s9(2)(a)

- What do you think of the interposed entity rules proposed above?
- In your experience, how common are interposed entities in the residential investment property context?
- 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?
- 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?
- What is your preferred frequency for the apportionment calculation for interposed entities that are close companies or trusts - daily, monthly, quarterly, annually?
- Do you agree that the proposed interposed entity rules should not be applied to LTCs or partnerships?
- Are there any commercial reasons why a taxpayer might borrow funds and on-lend them to an interposed company at a lower interest rate?

<u>Comments</u>

On the basis that the close company definition is not amended as proposed in paragraphs 3.4 to 3.6, we agree with the proposed interposed entity rules as set out in paragraph 11.4. Otherwise, to determine the 10% threshold, all asset for trusts settled by the same person (or their associates) would be treated as held by one entity for the purposes of the threshold. This can be difficult to ascertain in practice if the trust accounts information are held and/or prepared by different accountants and/or lawyers.

Interposed entities used to be prevalent however following the rule change from LTCs to LAQCs, these type of structures are now less common, even more so with the tightening of the LTC rules following the enactment of the *Taxation (Annual Rates for 2016-17, Closely Held Companies, and Remedial Matters) Act 2017*.

It is commonplace for taxpayers to have their borrowings to be at the shareholder level as banks tend to prefer assessing lending eligibility at the shareholder level, as the amount of assets that would be held (directly or indirectly) by the shareholder would be greater. Banks generally do not prefer to lend money at the entity level, particularly if it is a new or shell company as it would have no security by which the bank can lend against.

Our preference is for tax book values to be used in the first instance as opposed to accounting book values. However if the entity is required to prepare accounts on an NZ IFRS or GAAP basis, accounting values may be preferred. In practice, it is likely that close companies and trust for the purposes of the 10% threshold would be test based on tax book value (as preparing special purpose financial accounts). Other interposed entities applying the 50% threshold are likely to be utilising accounts prepared on an NZ IFRS or NZ GAAP basis. We consider taxpayers should have an option to apply either tax book values or NZ IFRS/GAAP as preferred.

Given our opted preference above, our preferred frequency would be annually to reduce compliance costs

We support that the interposed entity rules should not be applied to LTCs and partnerships.

There are commercial reasons why a taxpayer might borrow funds and on-lend them to an interposed company at a lower interest rate. The shareholder would have more equity that it could borrow against and so lending will occur commonly at the shareholder level. There are often situations where a company may be renovating or where there are start-up losses incurred and so for a period of time the shareholder may not on-charge the interest, but proposes to at a later date. This should be taken into account by the Commissioner.

Consequently it is not uncommon, the general anti-avoidance rules can be relied on, with regard to lending at lower interest rates.

We do not agree with the limitation proposed by 11.25 to existing owners. Phasing should apply to all taxpayers impacted, particularly given the short period of time that the Government is implementing this legislation under. It does not sufficiently give taxpayers time to refinance.

Implication of the RLRF Rules

Question 12.34

Below are several questions the Government would specifically like feedback on from submitters:

- How should the interest limitation rules be aligned with the loss ring-fencing rules?
- 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?
- Are there other interface issues between the rules that we have not addressed?
- How should we integrate interest limitation, ring-fencing, and bright-line anti-arbitrage rules?

Comments

Our preference is for the interest limitation rules to be applied first before the application of the RLR rules. To apply otherwise will result in complications arising from the portfolio approach versus a property-by-property approach.

There is also a potential mismatch between the RLR and financial arrangement rules in the instance a foreign mortgage is involved. It appears that currently, interest under the RLR (please do clarify if this not how it is intended to apply) for taxpayers that are in an overall loss position would have to segregate or carry forward the loss as required under the RLR. However if in a subsequent year, under the FA rules, it results in FA income, the FA income cannot be offset (even though it arises from the foreign mortgage) ring fenced loss.

With the intended proposal to not permit FX gains/losses on foreign loans (paragraphs 4.45 – 4.52), we presume a BPA as at 30 September 2021 would be required for existing properties with foreign mortgages.

Our preference to align the interest limitation rules, ring-fencing rules and bright-line anti-arbitrage rules is to apply Option B (Revenue Account) and Option F (Capital Account). Our preference is also to segregate foreign exchange gains and losses from these rules, and solely deal with them under the financial arrangement rules. The financial arrangement rules are a code, and consequently foreign exchange movements should be unaffected by the interest limitation and RLR rules.

Interest Limitation and Mixed-Use Property

Question 13.24

Below are several questions the Government would specifically like feedback on from submitters:

- How commonly are residential property MUAs held in close companies?
- How commonly are residential property and other MUAs held in the same close company?
- How do companies currently deal with the conflict between the MUA interposed entity rule and the RLR interposed entity rule, where they own both an interest in a close company with a MUA and a close company with a residential property subject to the RLR rule?

Comments

In our firm, we have a minimal amount of entities that hold residential property and MUAs in close companies. The majority hold such properties in trusts (generally where they are positively geared), or in look through companies (where loss making). The predominant reason for this however, regardless of whether loss-making or not, is due to the onerous dividend rules imposed on close companies. A close company is not an ideal structure for a holiday home or short term rental where the owners also utilise the property, particularly if it is not in the GST net.

We consider the existing interest allocation rules as stipulated in para 13.19 (close company/interposed entity/grouping rules) with regard to sections DG 12 and DG 14 are sufficiently onerous. We would have very little client base that hold MUA entities via a close company as stated.

Consequently we consider that the MUA rules continue to apply to new builds, or phasing out of interest deductions due to the limitations contained already, i.e. quarantining of expenditure per section DG 16 to DG 19. We agree where a close company owns MUA property and ring-fenced property subject to differing rules, stacking would not be appropriate or make sense due to the restrictions contained in these rules already. We consider a tracing approach is appropriate coupled with apportionment where relevant. We consider that where MUA and residential investment property are owned in the same entity, that example 47 provides a fair and simplistic approach to apportioning the debt across the assets.

Administration

Question 14.15

The Government is seeking feedback on the following:

- Are there 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 this interest that has been deducted?
- What data points might Inland Revenue be able to use to verify that a person qualifies for the new build rules?
- What records should taxpayers have to provide or keep in order to show that they are eligible for the new build rules?

- 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?
- If there are problems with relying on CCCs, what else could be used to verify that a property is a new build?
- 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?

<u>Comments</u>

We have no issue with introducing new fields into the income tax returns. In fact, we endorse this as it would help with ease of compliance and record keeping particularly in the instance where property is held long-term and say is subject to bright line in the 9^{th} year (should interest deduction be permitted depending on the finalised framework). Taxpayers change agents and records are not always as readily available. We endorse key points that provide for accumulated interest deductions to be recorded. We also endorse additional fields to advise the Commissioner if a new build or development exemption is being utilised. This assists the taxpayer, their advisor, and the Commissioner.

We support that for new builds, CCC would be the most reliant data source. For interest deduction prior the issuance of CCC, the sale and purchase agreement would be the best form of documentation. We do not endorse subsequent purchasers making use of a new build exemption.

One final comment that is not covered in the discussion document and is an issue we feel requires consideration by the Government in finalising the policy on bright-line and interest limitations.

In terms of entity types, no discussion is had with regard to flat-owning companies. Flat-owning companies are quite rare, however are still utilised. A flat-owning company is defined in the Act in section CD 31(2) as a company:

- whose constitution provides that every registered shareholder is entitled to the use of a specific residential property in New Zealand owned by the company; and
- whose only significant assets are residential properties available for use by specific shareholders and funds reserved for meeting the company's costs.

Flat-owning companies are not subject to the dividend rules. Generally property made available to a shareholder for inadequate consideration would amount to a dividend. However where a company is a flat-owning company, an exemption applies. A flat-owning company cannot be a look-through company.

Our firm is at times asked to assist with advice with regard to co-housing communities. These are communities of like-minded people that wish to partake in affordable housing with shared facilities and common interests. They are well established in Europe and the US. Some New Zealand co-housing communities collaborate to find a sustainable and eco-friendly way of living together. Each must be considered on a case by case basis to determine the best structure for such a development. The majority of people involved in such communities are involved as they want the housing to be their family home. One such structure that may work for these communities, is a flat-owning company.

A flat-owning company normally derives income in the form of subscriptions or levies imposed upon shareholders. This income is applied to meet administration and management costs, as well as depreciation, repairs and maintenance and other outgoings on the property. As a matter of practice, the Commissioner does not assess a flat-owning company on income of this nature. The same practice applies to surplus contributions held in suspense to meet the outgoings to be satisfied in future years. A flat-owning company remains assessable on income not raised by way of subscription to meet outgoings on the property. This means that the company would be assessable on any rents and investment income. Again, the dividend rules do not apply. From a legal-perspective, a flat-owning company may be a less complicated ownership structure.

What we are concerned with here, is that the main home exemption does not currently apply to such companies. A main home exemption can apply to a natural person or a trust, potentially, it could apply in a LTC structure, but does not apply to flat-owning companies. We consider that the Commissioner should allow the application of the main-home exclusion to such a structure. The objective of using such a structure is to allow the shareholder a right to reside in the property as their main home. Thus the exclusion should apply.

We look forward to the finalisation of the Government's views on the matter. Should you require further discussion please do not hesitate to contact us.

Yours sincerely

s9(2)(a)

PUB-0463

s9(2)(a)

To:	Policy Webmaster
Cc:	s9(2)
Subject:	Interest limitation and bright line rules - CPA Australia submission
Date:	Tuesday, 13 July 2021 11:47:39 AM
Attachments:	NZ IRD - Interest limitation and bright line rules - CPA Australia submission - July21.pdf

Hello

Please find attached CPA Australia's submission on the interest limitation and bright line rules discussion paper.

Thank you for granting us with additional time to lodge.

If you wish to discuss further, please contact s9(2)(a) or myself.

s9(2)(a)

[redacted]

s9(2)(a)

[redacted]

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13 July 2021

Deputy Commissioner

Policy and Regulatory Stewardship
Inland Revenue Department
Wellington 6140
New Zealand

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

Dear Sir or Madam,

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

CPA Australia represents the diverse interests of more than 168,000 members, including over 2,700 members in New Zealand, working in over 100 countries and regions supported by 19 offices around the world. With the assistance of our New Zealand Member Tax Committee, we make this submission on behalf of our members and in the broader public interest.

The Government's Discussion Document, **Design of the interest limitation rule and additional bright-line rules** (**the Discussion Document**), sets out the proposed design of the interest limitation rule and additional bright-line rules.

We maintain our view that this policy is an inappropriate mechanism by which to achieve the Government's housing market objectives. We believe that the tax changes proposed in the Discussion Document will not necessarily achieve the desired outcomes and will unduly complicate the tax system. We consider alternatives policies, such as increasing the supply of greenfield land and improving the planning process, will be more effective.

We also reiterate that the existing deductibility of interest expenses incurred in earning assessable income, including residential rental income, is not a tax loophole, and that this should not be the basis upon which limitations are introduced.

In response to the Discussion Document, our main comments are:

- We support the use of the Generic Tax Policy Process (**GTPP**) to develop policy and believe that use of this process would have enhanced the design of the interest limitation rule and additional bright-line rules.
- The greater the number of exemptions and carve-outs to remedy the tax distortions created by the proposed changes, the higher the likelihood that further changes will be required to ensure integrity and compliance. We anticipate it will also place pressure on professional advisers, the Inland Revenue Department (**IRD**) and other regulatory authorities to ensure compliance with the new rules.
- Taxpayers should not be retrospectively penalised for investment decisions made prior to the announced changes. Consideration should be given to protecting existing affected investors by grandfathering residential investment properties acquired prior to the Government's 27 March 2021 announcement and allowing full deductibility of interest on post-27 March 2021 borrowings traceable to the old build.
- The proposed rules should not distinguish between tenants residing in the main dwelling or a secondary residence on the property.
- An apportionment approach is more suitable in relation to business premises and dual-purpose buildings.
- Carve-outs should be provided for employee, student and short-stay accommodations.
- The use of tax values for calculating the residential investment property percentage for assets other than land, improvements and depreciable property is preferred.

- Taxpayers should be allowed the choice to use either apportionment or stacking for tracing purposes, depending on which is most appropriate.
- Pre-27 March loans in foreign currency should be afforded the same phase-out treatment as pre-27 March New Zealand dollar (**NZD**) loans.
- Option B for revenue account disposals is favoured, where deductions are allowed and deferred to the point of sale, although with a modification that upon the taxpayer triggering a re-characterisation of the land to being held on revenue account (e.g. they commence a subdivision of land within 10 years of the date of acquiring the land), the interest costs from that point forward are immediately deductible, with a wash-up calculation in the year of disposal for any interest costs incurred prior to the taxing trigger date.
- Option F for capital account disposals is favoured, as this methodology would ensure that the net real cost to the taxpayer (i.e. costs in excess of any untaxed gain) is deductible.
- The timing of the development exemption commencement should be at the point the relevant taxing provision is triggered.
- We support the inclusion of office conversions to apartments in the new build exclusion as this is likely to be an area of growth for B and C grade office blocks that have high vacancy rates post-COVID.
- Remediation of “leaky buildings”, along with earthquake strengthening, should be included in the new build exemption.
- The new build exemption should apply to both early owners and subsequent purchasers, and for a fixed period.
- The five year bright-line test for new builds should apply to both early owners and subsequent purchasers.
- Roll-over relief from interest limitation should be provided for transfers on death. The time limit should be the remaining time left under the new build exemption after the transfer of the investment property to the executor/administrator of the estate or beneficiary, whichever is earlier.
- The financial arrangement rules in a cross-border transaction are, in substance, a capital gains tax as the New Zealand holder of such financial arrangements is taxed on the net wealth increase/decrease. As such, foreign exchange loss will not be able to be offset as it is not residential income. This means a New Zealand tax resident will have a ring-fenced loss and a fully taxable recovery of the interest income from the foreign exchange profits.
- We do not see any issue with adding new fields, including fields for total interest and allowable interest.

Our detailed responses are contained in the Attachment.

If you have any queries about this submission, contact s9(2)(a) [redacted]

Yours sincerely,

s9(2)(a) [redacted]

CPA AUSTRALIA

Attachment

Chapter 1 Overview of proposals and process

Tax policy process

We note that the Generic Tax Policy Process (**GTPP**) was not used to develop these interest limitation rule and additional bright-line proposals as detailed in this Discussion Document. In our view, the GTPP has proved to be very effective since its introduction in 1994 and is highly regarded worldwide.

We believe that tax policy issues can arise, including unnecessary complexity and compliance costs, when the GTPP is not used. Examples include the previous 39% marginal rate and associated changes (1990-2000), the introduction of look through companies (2010) and the reinstated 39% marginal rate and associated changes (late 2020).

It is our view that outcomes are improved when evidence-based policy is developed through external consultation over time, prior to a firm commitment to the final version of proposed changes. Feedback from stakeholders and the community will enhance the policy design and lead to better drafted legislation. The views of the Inland Revenue Department (IRD) and Treasury are key in this process and we believe that proposed rules should be reviewed before being presented to the Finance and Expenditure Committee (**FEC**). In this instance with the interest deduction denial and bright-line test extension, the policy decision appears to be contrary to advice provided to Government[1] and/or it has needed more time to analyse the implications. This creates certain risks and is likely to lead to undesirable and unintended outcomes.

While we appreciate that the detail of the interest deduction denial has been developed in a consultative document, the time frame is too short, and many of the proposals are seemingly being made without sufficient and robust evidence in support of them. Use of the tax system to achieve goals that may best be achieved through other avenues (here, the goal of more affordable housing), will, based on previous experience, most likely lead to unintended and undesirable outcomes for taxpayers. It is also unlikely to achieve the intended outcome, in this case, more affordable housing.

Our preferred approach would be further work be done to develop clearly articulated policy proposals with evidence supported by IR and Treasury, which is then put out for public consultation, and on the basis of an analysis of submissions, draft legislation be developed with sufficient time for submissions and consultation via the FEC. However, we acknowledge that in this instance, the Government is exercising its prerogative not to take this approach.

Thus, our response is premised on attempting to reduce the unintended consequences, excessive complexity and compliance costs that will be faced by taxpayers.

We urge the government to fully reinstate the GTPP and use it fully with all future policy proposals and draft legislation.

Policy design

We understand that the Government wishes to encourage the supply of new builds to the market (retaining a five-year bright-line and deduction of interest costs) and discourage the purchase of established housing by investors. Specifically, the Government intends to remove the ability to deduct interest as an expense from income from 1 October 2021, arising from residential investment property acquired on or after 27 March 2021. For residential investment properties acquired before 27 March 2021, investors' ability to deduct interest will be phased-out over four years from 1 October 2021.

The Discussion Document sets out the policy objectives of housing affordability, housing supply, efficiency, and the coherence and complexity of the tax system.

We do not agree that the existing deductibility of interest expenses incurred in earning assessable income, including residential rental income, is a tax loophole. Furthermore, section DB7 of the Income Tax Act 2007 expressly allows a deduction for interest for companies.

We also highlight that both Treasury and the IRD opposed the increase in the bright line test from five to ten years. Furthermore, the IRD favoured retaining the status quo on interest deductibility which aligns with our view that expenses incurred in earning assessable income should be deductible.

We observe that the proposed limitation of interest deductibility and additional bright-line rules will significantly increase the complexity of the tax system, as reflected in the details of the Discussion Document. The numerous exemptions and carve-outs presented throughout the Discussion Paper to remedy the tax distortions created by the proposed changes are likely to create administrative and compliance challenges and place enormous strain on investors, advisers, the IRD and other regulatory authorities to ensure compliance with the new rules.

The Government believes this change in tax policy will dampen house price growth and make it easier for people to own their own home. However, Australian research has found that if, in Australia, negative gearing was to be abolished from investment property and capital gains tax discount reduced from 50 to 25 per cent, property prices would only be 1 to 2 per cent lower than

[1] The Treasury, *Tax measures to moderate house price growth – extension of the bright-line test* (2021); available at: **https://www.treasury.govt.nz/sites/default/files/2021-03/ria-tsy-tmmh-mar21.pdf**

if the changes were not made[2] and the overall impact on house prices would be small[3]. A summary of other studies[4] shows mixed results.

Therefore, it is possible that the proposed tax policy of removing interest deductibility to dampen house prices growth may not be realised. Our view is that the solution to housing affordability is structural reform. That is, rather than making tax changes, change planning laws to removing restrictions to release (greenfield) land to increase the supply of land for housing[5].

Current investors

There are many New Zealanders who have acquired residential rental investment properties over many years, with no speculative purpose in mind nor intention to sell anytime soon, or at all. Many of these investors may have placed their life savings into this type of investment to support their retirement, with the plan that ultimately, the property will be debt free and provide a level of passive income to supplement national superannuation entitlements.

For these investors, the bright-line rules are essentially irrelevant – or at least they were up to now – as they had no intention to sell within the bright-line period, they have owned the land since pre bright-line introduction, or their bright-line period has already expired. The removal of interest deductibility is of great significance to these investors, given that the ability to deduct interest expenses against the income earned from the property ensures that, for many, the investment remains affordable. Furthermore, this type of investor provides essential stock to the rental property market and reduces the burden on government in retirement.

Experienced investors have already seen the removal of depreciation deductions which has led to increased tax costs and a reduction in capital improvements to rental properties[6]. The removal of interest deductibility will make investments even more costly and feedback from our members indicates that some clients will have no choice but to sell. For some, not only will a forced sale see the end of their potential retirement nest egg, but for those who have invested since March 2018, they will encounter the added burden of taxation under the bright-line rules, despite never being the "speculator" the Government was targeting when the bright-line rules were introduced.

Therefore, we recommend that the Government consider protecting existing investors who will be impacted out by the proposed changes. An option would be to remove the proposed interest deduction phase-out period, and instead grandfather residential investment properties acquired prior to the Government's 27 March 2021 announcement.

Given that the new build exemption is available for a period of up to 20 years, a similar treatment for existing investors should be made available, as they are already locked into the market supply and should not be retrospectively penalised for their investment decision.

This supports the policy objectives outlined in the Discussion Document, as interest deductions in relation to existing housing stock (**old builds**) will decline over time as either the debt reduces, or the old build is sold. These investors will be incentivised to acquire new builds over old builds going forward, thereby achieving the Government's objective of having reduced the incentive for non-owner-occupiers to invest in old builds.

We submit that interest on post-27 March 2021 borrowings traceable to the old build should remain fully deductible. The old build does not impact market supply post-27 March 2021 and the Government has not stated that it intends to force existing investors to sell their old builds. This will reduce the complexity of the interest limitation rules as the property title register can be used to determine whether a property qualifies for continued interest deductions, removing the need to determine when the borrowings were drawn down. It also removes the complexity associated with revolving credit and other types of variable debt lending facilities that may have been in place with respect to the old build pre-27 March 2021.

We believe that a mechanism linking the interest incurred with both the property itself, and an income producing use of the funds would almost certainly be required. In our view, legislation would need to cope with the increased difficulty in determining interest deductions in certain situations. Examples include where fixed loans have expired, when redraws have happened to fund either private non rental related expenditure or property related expenditure such as renovations, and when a property's use has changed from private to rental. This would need to be addressed by excluding the denial of interest deductions in relation to residential land where:

- the residential land was acquired on or before 27 March 2021, and
- any interest or other financial arrangement deduction satisfies the general permission (i.e. has a nexus to the earning of income).

[2] Danielle Wood, *Negative gearing changes will affect us all, mostly for the better*, Grattan Institute, 9 February 2019, see link: **https://grattan.edu.au/news/negative-gearing-changes-will-affect-us-all-mostly-for-the-better/** and John Daley and Danielle Wood, *Hot property: Negative gearing and capital gains tax reform*, April 2016, see link: **https://grattan.edu.au/wp-content/uploads/2016/04/872-Hot-Property.pdf**
[3] David Montani, *Negative gearing: separating fact from fiction*, Taxation in Australia, March 2017, p 432-435
[4] Tunny, G., 2018. **Untangling the debate over negative gearing** Policy, Vol. 34 No. 1, Autumn
[5] Jamies Smyth, Analysis: New Zealand's housing crisis poses big test for Jacinda Ardern, Financial Review, 6 January 2021, see link: **https://www.afr.com/world/pacific/new-zealand-s-housing-crisis-poses-big-test-for-jacinda-ardern-20210106-p56s1v**
[6] Wong, J., Wong, N. and Li, W.Y. (2021), ***COVID-19 and deferred tax reversals***, Pacific Accounting Review, Vol. ahead-of-print No. ahead-of-print, 1 March 2021.

Chapter 2 Residential property subject to interest limitations

We believe that Paragraph 2.54 should not apply because in owner-occupied scenarios the rationale outlined in paragraph 2.52 should flow through to the whole of the land. It therefore becomes irrelevant whether the owner-occupier (who may or may not be a first-home buyer) lets out a room in their own dwelling or in another dwelling that exists on the property. The fact that the land is owner-occupied means that it is no longer in the available supply pool for potential first-home buyers, nor is it in the residential investor supply pool that the Government is targeting.

In these scenarios, it is still a single piece of land that has simply been structurally formatted differently. Permitting a tax deduction for the interest costs where the "tenant" is under the same roof of the owner-occupier, versus denying the same interest cost deduction where the "tenant" is under a different roof on the same owner-occupied land, simply creates a potential taxing bias between two arguably identical first-home buyers.

Income derived from a main home

The proposed approach to income derived from a main home permits interest deductions in the specific instance where the tenant resides in the same dwelling as an owner-occupier. We believe that, for efficiency and consistency, the policy should not distinguish between tenants residing in the main dwelling or a secondary residence on the property. The rationale for the distinction between the main residence and secondary residence on a single owner-occupied property is unclear.

Business premises and dual-purpose buildings on the same title - questions for submitters

- *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?*

  In relation to paragraphs 2.64 – 2.69, it is our view that an apportionment approach is more suitable in relation to business premises and dual-purpose buildings.

- *How could an apportionment approach work?*
  - *Should it follow general tax principles, or is there another approach that might be more appropriate?*

    No comment at this stage.

  - *Are there any apportionment calculations regularly done by landowners for other purposes (for example, insurance and mortgages) that might be useful in this context?*

    The apportionment approach should follow general tax principles.

    An all or nothing approach for this type of land use may be appropriate under the bright-line rules where potential application of the business use exclusion only needs to be considered once. However, should there be a disposal of the land within the bright-line period, any costs incurred in relation to holding that land over a period of time should follow the more general tax principles. This includes the application of the likes of a space and time test to determine the deductible and non-deductible components of any expenditure incurred.

- *How might "business premises" be defined for the purpose of interest limitation?*

  No comment at this stage.

  - *To what extent is it possible to reuse the definitions outlined above for this purpose? What issues might this cause?*

    For the purpose of interest limitation, business premises should be defined as being where the premises or part of premises are used, in whole or in part, for the purposes of carrying out business operations, which includes a wide range of activities. Activities include those undertaken in the ordinary course of carrying on a business. They also include those activities that, although not undertaken in the "ordinary" course of carrying on a business, are nevertheless undertaken in the course of carrying on a business.

    Profit making activities that fall short of being a business are also included in ``business operations'' if they have a business or commercial character.

Employee accommodation - questions for submitters

- *Should a carveout for employee accommodation be provided under the interest limitation rules?*

  We agree that a carveout for employee accommodation be provided under the interest limitation rules. When employers build or provide their employees with employee accommodation, they are provided to attract employees moving to be closer to the location of the employer. This is particularly the case for remote locations such as mine sites, where there is a dearth of suitable rental property nearby to meet such demand. Therefore, it makes sense that employers are not be penalised for providing such employee accommodation.

- *Does the employee accommodation carveout in the residential ring-fencing rules provide a useful basis for an interest limitation carveout?*

  Yes, we believe the employee accommodation carveout in the residential ring-fencing rules provide a useful basis for an interest limitation carveout.

- *Can you see any issues with using these rules?*

  Issues may arise where the home is also used as a place of business, such as with small business owners, who are also employees of the business.

- *What integrity issues might arise from carving out employee accommodation, and how could these be mitigated?*

  No comment at this stage.

Student accommodation - questions for submitters

- *Should a specific carveout for student accommodation be provided? Is it necessary?*

  No comment at this stage.

- *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 carveout?*

  No comment at this stage.

- *Could a carveout encourage the conversion of regular residential rental properties into student accommodation?*
  - *How could this risk be mitigated?*

    We believe such a carveout will encourage the conversion or labelling of regular residential rental properties into student accommodation.

    The risk could be mitigated by defining premises used to provide accommodation to students in connection with a recognised place of education such as universities, schools and colleges and does not include premises to the extent that they are used to provide accommodation to students in connection with an education institution that is not a place of education.

Short-stay accommodation substitutability issues - questions for submitters

- *Should short-stay accommodation that is not substitutable for long-term accommodation be carved out from the interest limitation rules and why?*

  We believe short-stay accommodation that is not substitutable for long-term accommodation should be carved out from the interest limitation rules on the basis that they are genuinely carrying on a business of providing short-term accommodation.

- *How could this carveout be designed to avoid capturing short-stay accommodation that could be substitutable for owner-occupied housing?*

  To avoid capturing short-stay accommodation that could be substitutable for owner-occupied housing, the IRD will likely require detailed information and documents to determine whether there exists the carrying on a business of providing short-term accommodation. An example of potential requirements is the ATO's guidance on the supporting information required to determine whether a taxpayer is carrying on a business of providing short-term accommodation[7].

- *How could this carveout be designed to prevent short-stay accommodation that is substitutable for owner-occupied housing from being converted so that it is not substitutable?*

  No comment at this stage.

- *How could a carveout be designed to reflect a sense of commercial scale akin to a hotel or motel?*

  No comment at this stage.

Serviced apartments

Responding to the discussion in paragraphs 2.83 to 2.86 regarding serviced apartments, we consider the existing definition of serviced apartment in paragraph (b)(iii) of the Dwelling definition is sufficient to exclude these types of accommodation from the interest limitation rules. The specific need for the apartment owner to show that "paid services in addition to the supply of

[7] ATO, 2020. **Carrying on a business of providing short-term accommodation – supporting information**, Private rulings, ATO advice and guidance, viewed 2 July 2021.

accommodation are provided to a resident" will negate the ability/reduce the incentive for the owner to convert a regular apartment to a serviced apartment, simply to obtain an interest deduction.

For those who do attempt to inappropriately claim a serviced apartment exclusion for what is a regular apartment, existing risk review techniques available to the Commissioner and the Commissioner's ability to deny the expense claims (or at least put the onus back on the taxpayer to prove their tax position) should be sufficient. Having a specific carve-out, which still requires a level of interpretation by the taxpayer, simply adds complexity to the rules.

Māori collectively-owned land - questions for submitters

No comment at this stage.

Chapter 3 Entities affected by interest limitation

Companies - questions for submitters

The Government invites submissions on the proposals outlined above and is particularly interested in:

- *Does treating new builds and residential property covered by the development exemption as "residential investment property" for purposes of the "residential investment property-rich" threshold cause issues for any developer companies? If so, what are those issues?*

  No comment at this stage.

- *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?*

  The use of tax book values for calculating the residential investment property percentage for assets other than land, improvements and depreciable property is preferred. This reduces the need to keep two separate set of accounts, i.e. one for accounting purposes and one for tax.

Kāinga Ora - questions for submitters

No comment at this stage.

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

Tracing - questions for submitters

- *Do you agree with the proposed approach to generally rely on the existing law on tracing, except where it would cause transition issues? (Transition issues are discussed at paragraphs 4.17 to 4.40.)*

  The tracing approach is the most obvious way to determine deductibility but may pose challenges for some taxpayers. Smaller investors may not keep the requisite records or hold the necessary documentation due to them having no prior requirements to do so. To deal with these situations, two approaches are proposed at paragraph 4.21. We suggest that the IRD should consider allowing taxpayers the choice to use either, depending on which is most appropriate.

- *Are there 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.*

  No comment at this stage.

Refinancing - questions for submitters

- *Do you agree that a new loan to refinance a pre-27 March loan would benefit from a specific provision?*

  We agree that a new loan to refinance a pre-27 March loan would benefit from a specific provision to ensure re-financing does not change deductibility of a residential property subject to the proposal.

  With respect to paragraph 4.15, if the only additional borrowings on a refinancing of a pre-27 March loan are the break costs associated with the restructure of the borrower's funding sources when commercially sensible to do so, any interest on this additional lending should remain deductible. This retains the phase-out qualities of the pre-27 March borrowings. Denying the deduction will add unnecessary complexity and compliance costs for the borrower, while retaining deductibility is unlikely to impact the policy.

- *Are there any commercial reasons a loan that is in New Zealand dollars would be restructured to a loan in a foreign currency?*

  As an example, this could be the case for eligible foreign buyers, where accessing funds from foreign lenders are cheaper than from New Zealand lenders.

- *Are there other issues with refinancing that we have not considered?*

  No comment at this stage.

Transition issues - questions for submitters:

The approaches proposed above are aimed at making compliance easier for taxpayers who would otherwise have to apply tracing to pre-27 March loans.

- *Which of the proposed approaches do you prefer?*

  In response to paragraph 4.21, we consider that Option 2: Stacking is the preferred approach as it provides a pragmatic outcome for taxpayers. However, we suggest that the IRD should consider allowing taxpayers the choice to use either stacking or apportionment, depending on which is most appropriate in the taxpayer's circumstances.

- *Do you have any suggestions on how the proposed approaches can be made simpler?*

  No comment at this stage.

- *Are there alternative approaches you would prefer? If so, how would that alternative approach work?*

  No comment at this stage.

High water mark - questions for submitters:

- *Do you agree with the proposed approach to a high water mark?*

We have no concerns with the high-water mark proposal and the subsequent limitation to any additional borrowing.

- *Are there some products that can be excluded (for example, loans that only decrease) or should the high water mark apply to all loans?*

  No comment at this stage.

- *Are there any situations when a portfolio basis for a high water mark could be necessary?*

  No comment at this stage.

- *Are there other issues with applying a high water mark that have not been considered above?*

  No comment at this stage.

- *Are there other products that raise issues that are not addressed by the high water mark proposal?*

  No comment at this stage.

Foreign currency loans

With respect to paragraph 4.42, we are of the view that pre-27 March loans in foreign currency should be afforded the same phase-out treatment as pre-27 March New Zealand dollar (**NZD**) loans. The calculation of the interest component each income year remains unchanged under the present proposals which allows for a simple reduction of the interest amount calculated by the applicable limitation percentage.

Where the foreign exchange movement is greater than the interest cost under the arrangement, limiting the resulting net financial arrangement would limit not only deductions but also income. A potential remedy would be to only limit net negative financial arrangements. However, from a tax design perspective, this would be an unbalanced outcome.

Chapter 5 Disposal of property subject to interest limitation

Implementing anti-arbitrage provisions - questions for submitters

Below are questions the Government is posing to help focus discussion, though comments on all aspects of these proposals are welcome:

- *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?*

  In response to the discussion in paragraphs 5.10 – 5.27, Option B is favoured, as deductions are allowed and deferred to the point of sale. Although, Option B may be enhanced with a modification that, upon the taxpayer triggering a re-characterisation of the land to being held on revenue account (for example, they commence a subdivision of land within ten years of the date of acquiring the land), the interest costs from that point forward are immediately deductible, with a wash-up calculation in the year of disposal for any interest costs incurred prior to the taxing trigger date.

  A modified Option B ensures that existing tax principles are retained, permitting a deduction for all costs incurred by the taxpayer in relation to a sale of revenue account property. It would also cover those scenarios where the development exemption will not have application, for example, the subdivision of land where the bare land titles will be sold as opposed to the land being developed further with "new builds" erected unless the development exemption is intended to cover scenarios where the taxpayer is in essence providing new bare land to the market upon which "new builds" can be constructed.

- *Should the bright-line anti-arbitrage provision be extended to sales taxable under section CB 6 (purchased with the intention of resale)?*

  No comment at this stage.

- *Should some interest deductions be allowed when property is sold on capital account?*

  In response to the discussion in paragraphs 5.28 to 5.33, Option F is favoured, as this methodology would ensure that the net real cost to the taxpayer (i.e. costs in excess of any untaxed gain) is deductible.

- *What are the trade-offs in considering housing market objectives and tax policy efficiency and equity objectives?*

  The Government's approach to achieving its housing market objectives adversely impacts tax policy efficiency and equity objectives. As previously stated, we believe that structural reforms to enhance housing supply will be more effective than introducing tax distortions into the housing market and increasing the administrative and compliance burden associated with the new rules. In that sense, we do not consider that there are trade-offs between the objectives, but rather that the proposed tax changes will lead to inefficient, inequitable and ineffective outcomes with respect to attempting to resolve the stated growing housing crisis.

  The changes canvassed in this Discussion Document will unduly complicate our tax system and introduce a number of potential tax issues. The Government should consider whether other alternatives are better in attempting to tackle, for example, whether to potentially remove planning restrictions to increase the supply of (greenfield) land to build houses instead.

- *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?*

  No comment at this stage.

Chapter 6 Development and related activities

Questions for submitters

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

- *Are there other types of developments or activity which should be covered under this exemption?*

  No comment at this stage.

- *Should land dealers (who are included under section CB 7) be carved out from the proposed section CB 7 safe harbour?*

  No comment at this stage.

- *Do you agree with the proposed criteria for the development exemption to apply?*

  No comment at this stage.

- *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?*

  No comment at this stage.

- *When should interest begin to be deductible when property is not acquired for the purpose of development, but that intention is formed later?*

  In response to the discussion in paragraph 6.25, we believe that the timing of the development exemption commencement should be at the point the relevant taxing provision is triggered – for example, where the relevant taxing provision is section CB 12, the development exemption would apply from the date the scheme or undertaking is deemed to commence under existing taxation principles. This often would be at the time the first overt act to actually progress the proposed subdivision occurs; e.g. the filing of a resource consent application.

- *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?*

  No comment at this stage.

Chapter 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?*

  We agree with the IRD's definition. We support the inclusion of office conversions to apartments as we believe this is going to be an area of growth for B and C grade office blocks that have high vacancy rates post-COVID.

  There is some concern about a new build requiring a kitchen and bathroom. We understand that it is common for a family to erect a dwelling as a "granny flat" or "sleepout" without either a bathroom or kitchen.

  We believe that student accommodation and serviced apartments should also be included in the definition of a "new build".

  Remediation of "leaky buildings", along with earthquake strengthening, do not appear to be mentioned. We believe they should be included in the exclusion. These are considerable costs to investors, and both are done to maintain an asset.

- *Are there any issues that you think the Government should consider in relation to the definition of new build and:*

  - *papakāinga housing?*

    No comment at this stage.

  - *heritage buildings?*

    No comment at this stage.

- *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?*

  No comment at this stage.

Chapter 8 New build exemption from interest limitation

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:

- *Should the new build exemption apply only to early owners, or to both early owners and subsequent purchasers?*

  From the perspective of a newly built property, we are of the view that the new build exemption should be for a fixed period for both the early owner and subsequent purchasers.

  In response to the commentary in paragraphs 8.9 to 8.21, it is submitted that the new build exemption should apply to both early owners and subsequent purchasers. With respect to subsequent purchasers, this would avoid depressed prices for those early owners who, via their investment in new builds, have assisted the Government in achieving its objective of increasing the supply of residential accommodation, but are then disadvantaged when coming to sell because the prospective purchasers cannot obtain the same concessions (as they are focused on new builds only).

  Also, we recommend that the new build exemption period should be 20 years. A longer period would encourage longer continuity of ownership periods due to the retention of interest deduction concessions. This is in contrast to owners looking to sell shortly post the expiry of the relevant bright-line period, potentially flooding the market with old stock as they look to acquire another new build. The impact of the latter behaviour could be upward price pressure on new builds, resulting in new builds becoming less affordable to first-home buyers, whose only option is to acquire old stock.

- *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.*

  From the perspective of qualifying for a new build, we submit that the new build exemption should be for a fixed period for both the early owner and subsequent purchasers.

- *Are there any issues that specifically relate to the new build exemption and:*

  - *papakāinga housing?*

    No comment at this stage.

  - *heritage buildings?*

    No comment at this stage.

  - *the purpose-built rentals sector?*

    No comment at this stage.

- *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 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)? (Refer to paragraphs 8.27 to 8.29 for more information).*

  Given that the residential rental excess deduction rules already quarantine any excess expenditure (including interest costs) over rental/land sales income (which itself has already created a disincentive for investors to buy residential land), and to remove some of the complexity of the new rules where it is clear that a new dwelling has been added to the land (consequently addressing supply issues), we suggest that interest deduction entitlements be permitted to continue in full rather than having to undertake apportionment calculations for "complex new builds".

  With respect to paragraph 8.29, and as stated in submission 13, our preference would be to have no interest apportionment requirement where it can be shown that a new build has been added to the land. However, if this approach is not taken, then a predominant test should be applied. This would require apportionment of any interest deduction only where less than 50% of the land area is covered by the new build. Otherwise 100% deductibility should remain.

- *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?*

  No comment at this stage.

- *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 Government needs to consider?*

  No comment at this stage.

- *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?*

  No comment at this stage.

- *How practicable is the continued investment rule (described from paragraphs 8.22 to 8.26)? Do you think the rule is a good idea (considering the criteria mentioned in paragraph 8.26)?*

  In response to the discussion in paragraphs 8.22 to 8.26, and if interest deductibility is made available beyond the first owner, we suggest that the proposed continued investment rule should be dropped. It creates unnecessary complexity to the rules, requiring some sort of mechanism (easily accessible and up to date) to enable a subsequent purchaser to ascertain whether the new build they are considering acquiring has ever been owner-occupied.

  With the dwelling already having satisfied the new build criteria, its subsequent use during the new build exemption period should be irrelevant, with existing tax rules dictating the entitlement to claim interest deductions based on the use of the property over the new build exemption period. The residential rental excess deduction rules would then potentially require quarantining the interest claims in an event where costs exceed land-related income in the relevant year.

Chapter 9 Five-year bright-line test for new builds

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:

There are several scenarios highlighting adverse application of the bright-line test.

1. Land held in a family for many decades, where they have undertaken a very low-cost subdivision of some land into lifestyle blocks, will be impacted by the bright line because of a minor intervening restructure.
2. Land held by an individual for decades, which is transferred into a deceased estate and then has a very minor subdivision and sale, will be impacted by having no cost to deduct.
3. Bare land owned by an individual who is diagnosed with a serious medical condition, and who sells the land, will be impacted by bright lines as the land is zoned as residential.

   In response to discussion at paragraph 9.7, it is submitted that the five year bright-line test for new builds should apply to both early owners and subsequent purchasers. The Government has repeatedly promoted to the community that the bright-line rules were introduced to deal with so-called “speculators”. If one assumes that an early owner who holds a new build in excess of the requisite five year bright-line period is no longer a “speculator” and consequently should not be subject to taxation under the bright-line rules, then there appears to be no justifiable, rationale reason for not applying the same considerations to subsequent purchasers.

- *Are there any issues that specifically relate to the new build bright-line test and heritage buildings?*

  No comment at this stage.

- *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 alternative approach (such as applying a predominant test)?*

  With respect to paragraphs 9.10 to 9.13, it seems overly complex to expect an apportionment rule to apply for the purpose of the bright-line test for “complex new builds”. As previously noted in relation to the interest limitation apportionment proposals, an owner of land who has positively addressed the Government’s residential accommodation supply concerns should obtain a full concession in relation to the land upon which a new build is erected, regardless of any existing structures on that same land.

  Consequently, we believe that no apportionment calculation requirement should be triggered in relation to “complex new builds”. The whole of the land would be then subject to the five year bright-line rule. If this is not done, then a predominant test approach should apply instead.

- *Are there any simple ways to prove that residential land a person owns qualifies for the new build bright-line test?*

  No comment at this stage.

- *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?*

  No comment at this stage.

Chapter 10 Rollover relief

In relation to the commentary in Chapter 10, we recommend that section CB 15(2) be amended to apply to section CB 6A, so that in any associated person transfer, the transferee simply steps into the shoes of the transferor, and is therefore able to take advantage of any time period that the land has already been owned by the transferor. Consideration should be given to the present associated person definitions which apply for the purpose of the land provisions, to ensure that these are adequately drafted to achieve the intent of the roll-over relief concession.

The failure to treat all associated persons' land transactions in an identical manner creates potentially unfair and inappropriate outcomes, in particular where there are minor family restructures or similar. The divergence in rules increases complexity, especially on compliance and disputes.

We observe that the proposed rollover relief introduces a number of new concepts that are complex and unnecessary. A straightforward extension of the existing associated persons provisions applicable to land transactions, to the bright-line provisions, would be a seemingly straightforward way to address such matters. We believe that this change would still allow the appropriate outcomes to be achieved in the examples within Chapter 10.

Transfers on death – questions for submitters

- *Should rollover relief from interest limitation be provided for transfers on death?*

  We agree that rollover relief from interest limitation should be provided for transfers on death.

  We note that the transfer on death provisions at paragraph 10.42 specifically do not address an equitable outcome where land is not residential land when transferred upon death but becomes residential land to the estate. Having been acquired from an associated person, the appropriate outcome is that the estate should not be taxed in a manner that is different from the way the deceased person would have been taxed. Extending the associated persons provisions to apply to the bright-line test would achieve this.

- *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?*

  The time limit should be the remaining time left under the new build exemption after the transfer of the investment property to the executor/administrator of the estate or beneficiary, whichever is earlier.

Trusts – questions for submitters

- *In your view, 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 comment at this stage.

- *What number of degrees of blood relationship should be permissible to determine whether a beneficiary is associated with the principal settlor?*

  We submit that, in determining whether a beneficiary is associated with the principal settlor, the degrees of blood relationship be as follows:

  The settlor and all of the following (if applicable):

  - any parent, grandparent, brother or sister of the settlor or the settlor's spouse

Māori collectively-owned land - questions for submitters

No comment at this stage.

Chapter 11 Interposed entities

Questions for submitters

- *What do you think of the interposed entity rules proposed above?*

  No comment at this stage.

- *In your experience, how common are interposed entities in the residential investment property context?*

  Interposed entities are common for some scenarios of residential investments. This is driven by a number of advantages in having an interposed closed trust, including:

  - The primary beneficiary can claim the interest deductions in their personal tax return.
  - As the asset is acquired in a trust, it is substantially protected from any claims against the primary beneficiary.
  - Any capital gains that are made can be distributed to a wide class of beneficiaries and do not have to be included in the assessable income of the primary beneficiary who makes the stakeholder loan, provided they have recouped all the interest paid to the bank.
  - Because the net income of the trust could be significantly less than the interest payable to the bank in the early years, the primary beneficiary will get a tax deduction for substantially all of the interest payable on the bank loan

- *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?*

  No comment at this stage.

- *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?*

  The use of tax book values for calculating the affected assets percentage for assets other than land, improvements and depreciable property is preferred. This reduces the need to keep two separate set of accounts, i.e. one for accounting and one for tax.

- *What is your preferred frequency for the apportionment calculation for interposed entities that are close companies or trusts - daily, monthly, quarterly, annually?*

  No comment at this stage.

- *Do you agree that the proposed interposed entity rules should not be applied to LTCs or partnerships?*

  No comment at this stage.

- *Are there any commercial reasons why a taxpayer might borrow funds and on-lend them to an interposed company at a lower interest rate?*

  No comment at this stage.

Chapter 12 Implications for the rental loss ring-fencing rules

Questions for submitters

Below are several questions the Government would specifically like feedback on from submitters:

- *How should the interest limitation rules be aligned with the loss ring-fencing rules?*

  No comment at this stage.

- *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?*

  No comment at this stage.

- *Are there other interface issues between the rules that we have not addressed?*

  New Zealand tax residents who hold financial arrangements are required to apply the accrual or cash basis rules when their financial arrangements involve a deferral of the payment of consideration. This applies regardless of whether the financial arrangement is held in New Zealand or offshore.

  Examples of such deferral of payment of consideration in an offshore context include:

  (1) A mortgage denominated in a foreign currency to buy a rental property regardless of where the rental or mortgage is situated; and

  (2) An ordinary foreign currency bank account.

  The financial arrangement rules disregard the distinction between capital and revenue amounts, and a holder of such financial instruments might be required to spread income and expenses over the term of the arrangement. A cash basis holder does not have to use a spreading method and is able to report income or expenses on a cash basis.

  A person can only be a cash basis person when certain thresholds are not breached. These thresholds have not been amended for some time. This means that, over the years, more individuals have been pushed out of the application of the cash basis rules. A cash basis holder is required to calculate their taxable income under both the accrual rules and the cash basis rules to ensure that the net deferral amount of $40,000 Is not breached. Therefore, cash basis holders have a relatively higher compliance cost than accrual rules holders.

  In substance, the financial arrangement rules in a cross-border transaction are a capital gains tax as the New Zealand holder of such financial arrangements is taxed on the net wealth increase/decrease. The taxable income can be calculated either under the determination G9A (market-to-market) or the determination G9C (expected value). G9C requires the holder of the financial arrangement to make an election within a certain time frame to apply this determination. A returning resident or new migrant to New Zealand will not have the requisite knowledge to make an election 63 days after they ceased to be a transitional tax resident. The low deferral threshold and the complexity of the rules potentially create an environment of non-compliance.

  As at 31 March 2020 many exchanges rates strengthened against the NZD. This has had a significant impact on New Zealand tax residents with offshore investments (assets and liabilities). For example, the Euro exchange rate moved from 0.6068 on 31 March 2019 to 0.5400 on 31 March 2020. This weakening of the NZD against the Euro will trigger significant book profits for assets denominated in Euro which are financial arrangements and significant book losses for liabilities denominated in Euro which are within a taxable activity (rental income).

  The foreign exchange loss from a foreign mortgage will form part of excess deductions in the year ending 31 March 2020 (assuming there is an overall loss) as it forms part of the interest deduction. The strengthening of the NZD against the Euro in the following income year (31 March 2021) will mean the book losses are effectively reversed, and the foreign exchange loss will not be able to be offset, as it is not residential income. This means the New Zealand tax resident will have a ring-fenced loss and a fully taxable recovery of the interest income from the foreign exchange profits.

- *How should we integrate interest limitation, ring-fencing, and bright-line anti-arbitrage rules?*

  No comment at this stage.

Chapter 13 Interest limitation and mixed-use residential property

Questions for submitters

Below are several questions the Government would specifically like feedback on from submitters:

- *How commonly are residential property MUAs held in close companies?*

  No comment at this stage.

- *How commonly are residential property and other MUAs held in the same close company?*

  No comment at this stage.

- *How do companies currently deal with the conflict between the MUA interposed entity rule and the RLR interposed entity rule, where they own both an interest in a close company with a MUA and a close company with a residential property subject to the RLR rule?*

  No comment at this stage.

Chapter 14 Administration

The proposed changes introduce tax complexities into the residential housing market. If introduced, tax advisers will be critical to successful implementation and ongoing integrity. We anticipate that interpretation and guidance material from the IRD will be required and recommend that an educative approach is taken to compliance with these rules in the first years.

Where carve-outs and exemptions are available, IRD guidance on record-keeping will reduce uncertainty. We recommend that record-keeping requirements are designed in consultation with advisers and investors so that they are practical and less costly to implement. The IRD should also seek to leverage records that are already usually kept for non-tax purposes and to utilise data already held by government.

Questions for submitters

The Government is seeking feedback on the following:

- *Are there 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 this interest that has been deducted?*

  We do not see any issue with adding new fields, including fields for total interest and allowable interest. In Australia, the ATO requires details of rental income and expenses, including interest on loans, in its **rental property tax schedule**.

- *What data points might Inland Revenue be able to use to verify that a person qualifies for the new build rules?*

  No comment at this stage.

- *What records should taxpayers have to provide or keep in order to show that they are eligible for the new build rules?*

  No comment at this stage.

- *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?*

  No comment at this stage.

- *If there are problems with relying on CCCs, what else could be used to verify that a property is a new build?*

  No comment at this stage.

- *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?*

  The vendor would need to apply to the relevant building authority and provide the purchaser with a new build exemption certificate.

s9(2)(a)

To:	Policy Webmaster
Subject:	The treatment of new builds under the bright-line test and changes to interest deductibility
Date:	Tuesday, 13 July 2021 12:26:10 PM

Kia ora koutou,

I support the adoption of Option 2: ‘early owners’ are exempt for the entire time they own the property, plus any subsequent owners are exempt for a fixed period after the new build received its code compliance certificate (such as 10 or 20 years).

I am committed to building a prosperous and successful New Zealand and am wanting to invest in providing more housing stock in the Napier market, which has one of the severest housing shortages in the country.

However the additional cost that removing interest cost deducibility will cause me is stopping me from proceeding and I can’t see how that is in anybody’s interest.

I am therefore looking for your support for Option 2 that collectively we can help our community grow.

Thank you for your consideration.

s9(2)(a)

s9(2)(a)

To: Policy Webmaster
Subject: The treatment of new builds under the bright-line test and changes to interest deductibility
Date: Tuesday, 13 July 2021 12:06:09 PM

Dear Sir/Madam,

This proposal would only work if the ability to deduct interest was maintained for the entire time the entity that built the new house owned it.

Mortgages can extend up to 30 years, with associated interest payments, that any short term deductibility period, say 3-4 years, isn't long enough to offset the risk of not selling the property and being left holding the property. This is not an incentive to build more new houses.

Thank you

s9(2)(a)

s9(2)(a)

To: Policy Webmaster
Subject: Interest deductibility on rental properties
Date: Tuesday, 13 July 2021 11:51:26 AM

Dear Sir/madam,

I ask that my submission be included in the consultation for this proposed change.

My submission is as follows:

That you do not proceed with this proposed change to our tax policies.

Interest payments are a cost of doing business like any other cost. It is not a 'loophole'. It has been part of tax law for more than 100 years. Removal of this cost goes against finance and accounting principles which will undermine confidence in this government's ability to manage our economy successfully. Credibility is everything and this approach will damage yours.

Further to this, my declared interest is that I wish to build a rental property but am now reconsidering this given the extra direct costs this change will impose on me and the wider lack of certainty this type of approach creates: What other changes will be brought in that are inconsistent with tax and finance principles and which will increase the risks to me? Uncertainty causes doubt, causes failure.

The immediate impact of this change is to discourage me and others like me from investing in housing at a time when this country needs more houses, and particularly in Napier, where I was intending to build. I believe this will reduce the number of rentals available without increasing the supply to first home buyers, and rents will go up, further making home ownership unachievable for many and without increasing the housing stock.

The current housing price bubble is being driven by low interest rates, a banking system that profits from ever increasing house prices, and quantitative easing pushing up asset prices. Population growth has stalled so it clearly isn't a worsening supply shortage that caused last year's 16% increase in house prices.

Thank you for your consideration.

s9(2)(a)

[redacted]

To: Policy Webmaster
Subject: The treatment of new builds under the bright-line test and changes to interest deductibility
Date: Tuesday, 13 July 2021 12:26:10 PM

Kia ora koutou,

I support the adoption of Option 2: ‘early owners’ are exempt for the entire time they own the property, plus any subsequent owners are exempt for a fixed period after the new build received its code compliance certificate (such as 10 or 20 years).

I am committed to building a prosperous and successful New Zealand and am wanting to invest in providing more housing stock in the Napier market, which has one of the severest housing shortages in the country.

However the additional cost that removing interest cost deducibility will cause me is stopping me from proceeding and I can’t see how that is in anybody’s interest.

I am therefore looking for your support for Option 2 that collectively we can help our community grow.

Thank you for your consideration.

s9(2)(a)

s9(2)(a)

To: Policy Webmaster
Subject: Design of the interest limitation rule and additional bright-line rules
Date: Wednesday, 14 July 2021 7:11:21 AM

Hi there and thank you for the confirmation, – I see that page 2 of my submission is missing, can you please submit the entire content for assessment:

On 23 March, the Government announced that deductions for interest expenses on rental properties will be restricted from 1 October 2021.

This submission will detail how restricting the deductions on Interest expense will not fulfil the goals of their purported proposal e.g. "The Government's goal is to encourage more sustainable house prices, by dampening investor demand for existing housing stock to improve affordability for first-home buyers".

Introduction

At the moment we provide quality rental accommodation for about 20 people, if the restriction on interest deductibility rules are put into law all of these people will be adversely affected.

The proposed restricted interest deductibility rules should not apply to accommodation that is provided specifically for student accommodation.

In one property, we provide cheap and affordable accommodation for five students. Their accommodation is a privately owned apartment that is situated in amongst an apartment building that is s9(2)(a) Because the apartment is privately owned it is of superior quality and is better maintained than the leased apartments. We offer this accommodation to students at less than the price that s9(2)(a) does, making it desirable and affordable and this allows the students to focus on their studies in a quality environment. If the interest deductibility rules come into place, we will be seeking to increase their rent to recover the costs of providing this accommodation. This increase will ultimately cause them to focus less on their studies as they will have to work more to increase their incomes or force them to take out further student loans in order to meet their additional living expenses. Either of these outcomes would not be desirable for any young person who has financial constraints and has limited options for additional income.

The proposed restricted interest deductibility rules should not apply to rental accommodation.

In one of our properties there is one family in particular who will be adversely affected if the new rules are applied. The same family have been living at the property for around 20 years, a family has been raised there and at the moment the grandfather and his daughter live at the property, s9(2)(a) The children and grandchildren visit regularly and stay at the property over weekends where they can enjoy their time together. s9(2)(a) . The property is ideally suited for their accommodation and life needs, as it is single level, spacious, s9(2)(a) [redacted] We provide the property to them at below market rates and this is all they can afford, we make no profit on the property, we provide it for them out of a sense of social responsibility and as loyalty to them for being long term tenants. If the new rules come into place we will be required to increase their rent to cover the additional expense, which will ultimately force them out of the property. We know that they will not be able to afford the extra rent that would be required to cover the restrictions on interest deductibility. It is also unfortunate that the tenants come from an ethnic group that has a high risk of failing any credit checks and will find it almost impossible to find suitable accommodation at a price they can afford.

The remaining residents are all very good long-term tenants, we provide quality housing for all of them at less than market rates. They are all wonderful and take great care and pride in their homes and love their communities. If the restrictions on interest deductibility rules come into place, we will be seeking to increase their rents cover these extra expenses. This will reduce the ability of two of the families in particular, to be able to save for their first home. They will be forced to live in rental accommodation for longer than they had originally planned, and it will increase their uncertainty about being able to own a home in the future for their families.

The proposed restricted interest deductibility rules are fundamentally flawed.

As a general comment and after talking to all of our tenants, their greatest fear is that we will sell the properties that they rent, and this will force them to look for accommodation elsewhere. Their fears are very understandable because all anyone wants is an affordable, quality home to live in, to have safety for their family and to have stability with a common sense of community.

In regard to this our greatest concern relates to any changes in the Official Cash Rate (OCR), if the OCR moves upwards by as little as 1 percent our annual interest expense will increase by close to s9(2)(b)(ii) [redacted] We know that many of our tenants will not be able to meet the extra costs associated with such a change due to the combination of the proposed restrictions in interest deductibility and the increased OCR which are directly aligned.

If the OCR were to increase, we would seriously have to think about selling the tenants homes to reduce our liabilities. I know we are not alone in this situation as the effects of these combined costs will affect every landlord who has a mortgaged older property in New Zealand. Whilst this sell off might increase the housing supply for first home buyers, the undesired effects of this will mean that there will be many displaced tenants and this will create a greater demand on the need for the government to find alternative housing solutions.

In summary, the proposed restrictions on tax deductibility, might reduce investor demand in existing properties and it might lower the cost of existing homes. However, the proposed restrictions, do not factor in the specific needs of students and their limited access to financial resources and their increased costs of living as a result of the proposed changes.

The increase in rental costs for first home buyers will reduce their ability or prevent them from saving for a new home.

There will also be many other undesired consequences of the proposed restrictions. Any upward movement of the OCR will force a reduction the number of landlords in the rental business and there will be less quality affordable older properties available for rent. Rental prices will increase both as result of the restrictions on deductibility of interest rules and due to a decrease in the availability of rental properties.

There will be an increase in the numbers of those who cannot afford to live in a rental property and, or an increase in those who are displaced and deemed to be unsuitable tenants so they will never be able to be offered another rental property.

The nett result of the proposed changes is that many more people will have no option but to accept government assistance and wait for help for them to find apposite accommodation.

s9(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: Tuesday, 13 July 2021 12:11:59 PM

To the parliamentary select committee:

On 23 March, the Government announced that deductions for interest expenses on rental properties will be restricted from 1 October 2021.

This submission will detail how restricting the deductions on Interest expense will not fulfil the goals of their purported proposal e.g. "The Government's goal is to encourage more sustainable house prices, by dampening investor demand for existing housing stock to improve affordability for first-home buyers".

Introduction

At the moment we provide quality rental accommodation for about s 9([redacted] people, if the restriction on interest deductibility rules are put into law all of these people will be adversely affected.

The proposed restricted interest deductibility rules should not apply to accommodation that is provided specifically for student accommodation.

In one property, we provide cheap and affordable accommodation for s 9(2) [redacted] students. Their accommodation is a privately owned apartment that is situated in amongst an apartment building that is leased by s 9(2)(b)(ii) [redacted] Because the apartment is privately owned it is of superior quality and is better maintained than the leased apartments. We offer this accommodation to students at less than the price that s 9(2)(b)(ii) [redacted] does, making it desirable and affordable and this allows the students to focus on their studies in a quality environment. If the interest deductibility rules come into place, we will be seeking to increase their rent to recover the costs of providing this accommodation. This increase will ultimately cause them to focus less on their studies as they will have to work more to increase their incomes or force them to take out further student loans in order to meet their additional living expenses. Either of these outcomes would not be desirable for any young person who has financial constraints and has limited options for additional income.

The proposed restricted interest deductibility rules should not apply to rental accommodation.

In one of our properties there is one family in particular who will be adversely affected if the new rules are applied. s 9(2)(b)(ii) [redacted] provide the property to them at below market rates and this is all they can afford, we make no profit on the property, we provide it for them out of a sense of social responsibility and as loyalty to them for being long term tenants. If the new rules come into place we will be required to increase their rent to cover the additional expense, which will ultimately force them out of the property.   We know that they will not be able to afford the extra rent that would be required to cover the restrictions on interest deductibility. s 9(2)(b)(ii) [redacted]

The remaining residents are all very good long-term tenants, we provide quality housing for all of them at less than market rates. They are all wonderful and take great care and pride in their homes

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

From:	s9(2)
To:	Public Consultation
Cc:	s9(2)(a)
Subject:	Interest deductibility - public consultation
Date:	Monday, 12 July 2021 6:16:37 PM
Attachments:	ATT00001.png s9(2)(a)

Hi there

We are writing to you to submit feedback on the recent request for public consultation regarding interest deductibility in relation to residential rental properties.

Kiwi Property Group has prepared the attached submission document for your consideration. We hope that this provides valuable feedback. Please let us know if you need any further clarifications on our submission.

Kind regards

s9(2)(a)

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Licensed under the Real Estate Agents Act 2008

Kiwi Property Group Limited

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

12 July 2021

For more information and further queries, please contact

s9(2)(a) [redacted]

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

1.0 Introduction

1.1 Kiwi Property Group (KPG) welcomes the opportunity to submit on the Government's consultation document regarding the design of the interest limitation rule and additional bright-line rules.

1.2 KPG is encouraged by the Government's plans to increase the housing supply across New Zealand. We support legislation that provides a framework to enhance economic growth, development, liveability and growing communities.

KPG has been a leader in New Zealand's property sector for over 25 years. Today, we are focussed on reimagining Kiwi communities, creating vibrant places that encourage connection, shared experiences and a sense of belonging.

1.3 KPG is currently assessing the viability of Build-to-Rent (BTR) projects [redacted] s9(2)(b)(ii) [redacted] These projects are at risk of being deemed unviable due to the proposed law changes, which may also s9(2)(b)(ii) [redacted]

1.5 Property is currently New Zealand's largest industry with a direct contribution to GDP of $29.8 billion (13 per cent). The property sector is a foundation of New Zealand's economy and caters for growth by developing, building and owning all types of property.

2.0 Recommendation summary

2.1 KPG does not support the proposed changes to the interest deductibility rules as set out in the Government's consultation document regarding the design of interest limitation rule and additional bright-line rules.

2.2 We believe the Government should not progress these changes and should instead consider other mechanisms to reduce speculation and increase supply in the housing market.

2.3 KPG's view is that changes to interest deductibility will reduce supply and limit sources of funding, and put pressure on developers and landlords. Extra costs on landlords may lead to fewer rentals being available, and reducing incentives for developers to build new houses may lead to fewer affordable houses for New Zealanders.

2.4 However, if the Government does choose to progress these changes, KPG makes the following recommendations:

3.0 Principal submission – specific carve-out for 'Build-to-Rent' properties

3.1 KPG is currently in the process of assessing the viability of BTR projects. It is our view that the implementation of the proposed interest limitation rules would reduce the viability of investment in BTR, and have a negative impact on the policy objectives included in the discussion document:

- 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.
- *Housing supply:* The interest limitation and bright-line extension should not discourage new additions to the stock of housing.

3.2 KPG recommends a specific carve out for BTR developments that would ensure certainty to developers and future owners. For clarity, KPG defines BTR using the definition developed by Property Council New Zealand (Property Council), which is: "*an asset specifically designed, constructed or adapted for long-term residential tenancies, accommodation comprised of a portfolio of a minimum 50 self-contained dwellings and include some form of shared amenity, dwellings let separately but held in unified ownership and dedicated to residential tenancies for at minimum eight years, and professional and qualified management, with oversight under a single entity.*" KPG is happy to work with Inland Revenue and other Government agencies on any definitional issues that may arise.

3.3 s9(2)(a), s9(2)(b)(ii) [redacted] Our view is that BTR is akin to a commercial asset such as student accommodation and retirement villages. This aligns to other comparable international jurisdictions.

3.4 The activation of BTR will be a critical enabler to accelerate the supply and delivery of affordable housing across New Zealand – both affordable rental and affordable owner-occupier homes. It has the potential of being one of the largest contributors to new accommodation supply in New Zealand.

3.5 BTR does not compete with first or affordable home buyers in the secondary market, nor does it typically compete for the same land as residential developments. Most BTR projects are built on commercial land, due its proximity to other commercial and retail spaces, which don't exist in predominantly residential areas. In both of these regards, BTR does not fit neatly in with the traditional residential asset class.

3.6 If BTR is not recognised as a specific asset class, and is not explicitly exempt in perpetuity from the proposed interest deductibility changes, it is our view that BTR will not be feasible in New Zealand. This applies to all BTR products, both affordable and market ends.

3.7 We note the consultation document proposes that new builds be exempt from the changes. However, internationally the new build market is driven in part by the success and development of the secondary market. It is our submission that they cannot be separated and the Government must support both in order to create a viable sector.

3.8 New Zealand is out of step with international legislative settings around BTR, impeding the attraction of the offshore capital and expertise required for the asset class to grow at pace. This hinders the Government and private industry's ability to add supply across New Zealand and help fix New Zealand's housing crisis.

3.9 The Property Council's submission on the Overseas Investment Amendment Bill (No. 3), recommended that the Government introduces an exemption and creates a new asset class. This would allow foreign capital investment into New Zealand to specifically support BTR developments, as is the case with retirement villages and student accommodation. We further recommend the Government progress this work as a matter of urgency alongside their consultation on the proposed changes to interest deductibility rules.

4.0 Supplementary submission 1: Properties caught by the proposed rules

4.1 If the Government chooses to progress its proposed changes, KPG recommends that, in addition to BTR being specifically carved out from the rules, purpose built student accommodation and serviced apartments should also be carved out. We also believe that an apportionment approach should be used to ascertain the purpose for dual purpose properties, as opposed to a predominant use approach;

Purpose-built student accommodation

4.2 KPG supports an exemption for purpose-built student accommodation ('PBSA') on the basis that these particular student residential buildings do not compete with owner-occupied accommodation and would not typically be set up in a way that would be conducive to owner-occupation in the future. By its definition PBSA is typically on campus on in a defined 'PBSA' precinct located close to the university campus.

4.3 We agree with using the existing regulatory framework in the Residential Tenancies Act 1986 as it will reduce the risk of abusing the exemption and is a straight-forward avenue for targeting the specific carve-out. While we understand the concern regarding exemptions creating an incentive to convert residential apartment buildings into student accommodation, we think this is overstated for two reasons.

(a) Often student accommodation is necessarily more bespoke than residential apartment buildings and requires different facilities and set ups. The cost of converting a residential apartment building into student accommodation would probably exceed any benefit that might exist from an exemption.

(b) Often these buildings are situated significant distances from University or Polytechnic campuses, making that accommodation particularly unattractive from both a distance and safety perspective. The Universities of Otago and Canterbury are moving towards accommodation either on campus or very close to it.

4.4 This aligns with exemptions given to purpose-built student accommodation in other pieces of legislation, such as the Overseas Investment Act.

Serviced apartments

4.5 KPG recommends an exemption for serviced apartments. The exemption for serviced apartments in paragraph (b)(iii) of the definition of "dwelling" in the Income Tax Act 2007 (ITA) provides a good distinction between rental accommodation and serviced apartments. For the purposes of the ITA, a serviced apartment is accommodation for which paid services in addition to the supply of accommodation are provided to a resident, and in relation to which a resident does not have quiet enjoyment, as that term is used in section 38 of the Residential Tenancies Act 1986 (RTA). Section 38 of the RTA states that a tenant shall be entitled to have quiet enjoyment of the premises without interruption by the landlord or any person claiming by, through, or under the landlord or having superior title to that of the landlord. A serviced apartment, therefore, is more akin to a hotel or other commercial accommodation than residential rentals and should be treated as such.

4.6 We also disagree with the view that allowing owners of serviced apartments to claim interest deductions may lead to the conversion of regular apartments into serviced apartments and a reduction in the effective housing supply. We submit that most owners of regular apartments gain a longer term benefit of keeping the apartments as such, and the increased compliance of converting them to serviced apartments would be a deterrent on most owners.

Apportionment versus predominant use

4.7 KPG recommends using an apportionment approach when determining the tax treatment of dual purpose properties. Apportionment is a fairer, more accurate way of determining usage we believe an apportionment calculation allowing for interest deductions in relation to the business premises of a dual-purpose building is preferable over the all or-nothing approach.

4.8 Equally, we agree with the Government's position that the current rules regarding apportionment, which generally focus on time and space, should be used over developing new and potentially more complex and burdensome ones.

4.9 Using a predominant use approach likely leads to an "all or nothing" outcome, where there is the potential for mischaracterisation of usage to avoid particular tax treatment. Our tax settings should be encouraging 'mixed-use' developments across New Zealand. BTR is one example of a development which has both rental accommodation as well as commercial and retail spaces. In our view, an apportionment approach will encourage more of these developments which will allow more land to be available for affordable and market homes.

4.10 We think this aligns with approaches taken by the Government in other parts of their consultation process, particularly around exemptions for new builds.

5.0 Supplementary submission 2: New build exemption

5.1 We agree that an exemption from the proposed interest limitation rules be made for new builds. KPG believes it is important that the period of the new build exemption is of sufficient length so as not to dis-incentivise the development of new housing stock. It is also important that, where an initial owner is developing new housing supply, there is a secondary market available on the eventual sale of the properties and the tax system does not create uncertainty around valuation on sale. Given this, KPG supports the exemption being available to both the initial owner and any subsequent purchasers of properties that qualify as a new build.

We believe this new build exemption should be in perpetuity for the initial owners of the property. We also support an exemption for subsequent owners of new builds, with a preference for at least 50 years from the issuing of the CCC. We agree that existing apportionment principles should apply where a new build and a non-new build that are on the same title are purchased – i.e., an exemption would only apply to interest on the portion of the purchase price borrowing that relates to the new build.

5.2 We also agree that commercial to residential conversions should be included, for instance in situations when an office building that is converted into apartments, or a large commercial heritage building such as a harbour warehouse that is converted into townhouses. This should be treated similarly to subsequent owners of new builds, i.e. with a 50 year period from the date of completion. KPG strongly believes regulatory settings should encourage as much as possible increasing supply.

5.3 We recommend reducing the bright-line test to five years for new builds for as long as they are able to claim interest deductibility. Our preference is that the bright-line test be five years across all residential property, including subsequent owners of new builds. KPG's position is underscored by the low quantitative data supporting the idea many early owners “flip” houses as often as public discourse suggests.

6.0 Supplementary submission 3: Interest deduction on sales

6.1 KPG recommends that where property is held on revenue account, all denied interest should be deductible at the time of sale (Option B). This reflects the nature of the sale and reflects the economic gain and loss.

We agree that deducting at the time of sale when the gain is taxed ensures the owners' actual income is taxed, and not overtaxed and overcomplicated.

6.2 We would also argue that a ten year bright-line test increases the opportunity for arbitrage. Our preference would reduce the opportunity for arbitrage and deal with the concerns raised by the Government.

6.3 However, where property is held on capital account, KPG supports Option F - no deduction should be allowed for denied interest up to amount of non-taxed gain, with excess deductible (subject to ring fencing). Sellers should get a deduction to the extent that their interest cost exceeds the capital gain, as effectively the interest cost relates to both the capital gain amount and the taxable income that has already been returned during the period of ownership.

7.0 Supplementary submission 4: Developer exemption

7.1 We support the Government's proposed exemption for property developers. We agree that this should also be extended to include one-off developments.

7.2 KPG's view is that this exemption should not be overcomplicated or complex. It should follow similar rules to the exemption proposed for new builds that if a development is increasing housing supply, then an exemption should be granted to support the Government's objectives. Our view is that a wider approach towards development exemptions should be favoured over carving out too many ways in which a development may not qualify for an exemption.

7.3 We also believe remediation should be included generally under the exemption. As well as increasing housing supply, the Government's goal of more warm, dry housing extends to existing as well as future supply. To that end, supporting landlords and owners to remediate and improve existing stock should be considered as an effective lever to encourage behavioural change. We think that an effective way to administer this could be via statutory declaration at the point when claiming the exemption.

8.0 Supplementary submission 5: Entities affected by interest limitation

8.1 KPG agrees that widely held companies that are not residential investment property-rich companies should continue to be allowed deductions for interest.

8.2 KPG agrees with the definition of a residential investment property rich company applying for companies meeting a specific threshold.

8.3 We also note that it may be problematic comparing market value of land and buildings to cost or tax book value of other assets. Property usually appreciates in value, whereas the tax book value of other assets by definition would depreciate in value. This could unfairly inflate the proportion of residential assets held by companies. We therefore note that the 50% test may be too low.

8.4 KPG disagrees that this should be applied on a company by company basis, but companies that are part of a tax consolidated group would be treated as a single entity. This could arbitrarily mean that tax policy would decide structuring decisions, which should not be the intention of tax policy. Instead we would recommend the definition be applied on a group of companies basis (66% common ownership) or a wholly owned group basis (100% common ownership), which are already defined within tax legislation.

9.0 Supplementary submission 6: Application date

9.1 KPG recommends the Government push out the application date to after the parliament has passed the changes. We recommend deferring the application date, until 1 April 2022.

9.2 This will do three things which we think are important to the effectiveness of the regime:

(a) It will provide IRD and other systems to ready themselves for a smooth and effective transition that does not cause unnecessary extra cost and burden;

(b) It will allow affected parties – developers, owners, landlords and tenants - to better understand and prepare for the changes so as to avoid confusion and non-compliance; and

(c) It will allow tax practitioners time to prepare and provide timely and accurate advice to their clients in preparation for the change.

9.3 For the benefit of the integrity of the tax system, taxpayers should not be required to make decisions and effectively take tax positions (for instance, for determining provisional tax obligations) based on legislation that has not been enacted.

9.4 Our view is always that rushed application can lead to un-intended consequences. There seems no strong public policy rationale to impose the regime quicker than our proposed timeline above.

10.0 Summary

10.1 In summary:

KPG does not support the proposed changes to the interest deductibility rules as set out in the Government discussion document, as there is little evidence that the tax proposals will have any significant impact on the ability of the Government to achieve its housing affordability and supply objectives and, in any event, the tax system is not an appropriate lever to use to solve these issues.

However, if the Government does choose to progress these changes, KPG makes the following submissions:

Principal submission

> BTR, as appropriately defined, should be specifically excluded from the proposed interest limitation rules.

Additional submissions

> Serviced apartments and student accommodation should be excluded from the proposed interest limitation rules.

> An apportionment approach, based on space, should be used when determining the tax treatment of dual-purpose properties.

> An exemption should be available to “new builds”. The new build exemption should be available in perpetuity to the early owner and to any subsequent purchasers for a fixed total 50-year period.

> An exemption should be available for developers. This exemption should extend to include one-off developments.

> Widely held companies that are not residential investment property-rich companies should continue to be allowed deductions for interest. The threshold for determining whether an entity is a residential investment property-rich company should be measured on a group of companies or a wholly owned group basis, rather than at an individual entity level.

s9(2)(a)

From	Competent Account ng Services L mited [redacted] s9(2)(a)
To	Public Consu tat on
Subject	Changes to interest deductibility for res dential property feed back
Date	Monday 12 July 2021 5 23 22 PM
Importance	High

Dear Sir/Madam

I think the Changes to interest deductibility for residential property is too complicated and the application date should be aligned with financial year ended date (31 March) to reduce administration & compliance costs to taxpayers and IRD.

Government should choose a straightforward method and simple method when it comes to tax law.

Also the Changes to interest deductibility for residential property is not fair and it is kind of socialism and should be reviewed. Government policies should focus on encourage people to work hard and saving for their future needs. Current government policies discourage people to save and encourage people to rely on Government subsidy which is not substantiable in my view!

s9(2)(a) [redacted]

From:	s9(2)(a)
To:	Policy Webmaster
Subject:	Design of the interest limitation rule and additional bright- line rules
Date:	Wednesday, 14 July 2021 7:29:12 AM

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

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.

Thanks and Regards.

s9(2)(a)

From:	s9(2)(a) [redacted]
To:	Policy Webmaster
Cc:	s9(2)(a) [redacted]
Subject:	KPMG submission on "Design of the interest limitation rules and additional bright-line rules" [KPMG_NZ-ACTIVE.FID643048]
Date:	Wednesday, 14 July 2021 5:15:34 PM
Attachments:	image001.png image002.png image003.png image004.png image005.png Interest limitation design submission 14 July 2021.pdf

Hi

Please find attached KPMG's submission on the discussion document.

Kind regards

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David Carrigan
Deputy Commissioner, Policy and Regulatory Stewardship
Inland Revenue Department
P O Box 2198
Wellington

14 July 2021

Dear David

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

General comments on the interest limitation proposal

While we agree with the Government's concerns around housing affordability and objective of creating a well-regulated housing market that can respond to population growth and changes in preference, we are not convinced the interest limitation proposals will help achieve this objective. And certainly, not without significant adverse impacts on the efficiency, coherence and simplicity of the tax system.

We have attempted to analyse the following impacts:

Effect on the housing market

We understand the anticipated effect on the housing market is that house prices will either decrease or not increase as much and that rents will increase. (See Joint Report: Demand-side measures to moderate house price growth Treasury:4405852v1 ("the Joint Report")).

We understand the argument is, in short:

— the after-tax return will decrease as a result of the policy, meaning investors will be prepared to pay less. This is assumed to have a flow on consequence to the whole market, including owner occupiers.

— for the rental market it is assumed that investors will seek to equalise their after-tax returns by increasing rents in the short-term.

We have found no further extended discussion from Officials or Government supporting this analysis. We understand that standard economic approaches would suggest the above propositions generally do not hold.

Further, the residential loss ring-fencing rules were also aimed at reducing house prices. (By a similar logic, deferring net losses reduces cashflow from rental investment so that investors should pay less.) However, there has been no discernible impact on house prices. They have continued to rise which suggests that tax changes are making little difference.

This is also consistent with the view of the Tax Working Group that the tax system is not an appropriate lever to address housing affordability concerns. It is put, simply, a blunt instrument when the underlying causes are diverse.

(Mis-)alignment with tax policy objectives

We note that at the time of legislating the bright-line extension to 10 years, the accompanying regulatory analysis suggested both Inland Revenue and the Treasury were not in favour of the interest limitation proposals. In fact, the Joint Report, in Annex 3 in particular, provides analysis for why denying interest deductions should not proceed from a tax policy perspective. Apart from the impact on the tax system discussed below in the trade-offs, the proposal would unequally tax some types of rental investment. This would amount to over taxation.

Further, the Joint Report confirms that an owner-occupier is not tax disadvantaged compared to an investor. An owner-occupier is not taxed on the imputed rental income. (From a practical perspective, we note that any attempt to impose such taxation would be unlikely to succeed as imputed rental income is not intuitively income and therefore a proper object of an income tax.)

Is there a tax policy problem?

The current Act allows interest deductions if borrowed money is used to produce assessable income. There is no apportionment of interest if the money borrowed has dual purposes – to produce rental income and to allow continued holding of property which produces a gain which is non-taxable. In turn, the dual holding purpose is insufficiently strong a purpose to make a gain on sale taxable under current rules.

In short, interest which, in part, finances a non-taxable gain is fully deductible.

A possible answer to this problem is the proposed total denial of interest deductions. However, this will over-tax income as no deductions are allowed against rental income (see the Joint Report's own analysis). It is not a first best policy solution as a consequence.

Judging the trade-offs

The discussion document in paragraph 1.5 outlines a number of economic and tax policy objectives which may need to be traded off. These trade-offs are impossible to analyse/evaluate as there is no meaningful analysis provided on the effect on housing affordability or housing supply. The lack of any supporting economic, or other, analysis to suggest that limiting interest deductions would improve housing affordability whilst not limiting new housing supply is a significant concern. Even without that analysis, there are significant doubts that the housing objectives will be met, but in our view the effect of the proposals will be to:

- ***Reduce overall investment efficiency.*** The changes will have effects on the efficient allocation of investment. That must be true as the interest limitation (and bright line extension) changes are designed to make residential rental investment less attractive, from a tax perspective, relative to other asset classes. This will affect the efficient allocation of investment, after-tax, as that is the intention. It is not clear to us what "unintended" effects on investment allocation the Government is concerned about.
- ***Reduce overall tax system coherence.*** The proposal moves the tax system further away from one where different investment activity is broadly taxed in the same way (i.e. a broad-based system) to one where there are multiple "jagged edges", depending on investment type/activity. We recognise that Government may have non-tax policy objectives for certain

tax changes. The interest limitation proposal is simply the latest in the proliferation of ad hoc taxation measures by different Governments. Every ad hoc measure, in our view, further reduces the coherence of the system and risks eroding confidence in the stability and, importantly, predictability of the system.

— ***Significantly increase tax complexity***. The length of the discussion document, at over 140 pages, is instructive in this regard. What sounds simple in a media statement – limit interest deductions on residential property investment, with a carve out for new builds – is anything but due to the various definitional and boundary issues and inter-linkages with other regimes. While the rules will be simple for some, there will be a myriad of ways residential rental properties are owned and finances are organised, which will mean there will be considerably complexity for others. Our detailed comments touch on these issues.

As we have not seen the evidence which justifies the proposal for its effect on non-tax policy, judging the tax policy trade-offs is effectively meaningless. To the extent there is a relevant principle to be derived, it is "do the least harm".

KPMG's principal submission: the Government should not proceed with the interest limitation changes

If there is any analysis of the impact of the interest limitation proposals that supports the non-tax policy objectives, we strongly recommend ***that analysis supporting the proposals is released*** so that submitters are able to make informed submissions.

However, as the proposal has not been shown to produce the non-tax policy objectives and is detrimental to tax policy objectives, we submit that ***the policy should not proceed***.

Despite this conclusion, we understand that the Government has decided to proceed. Our supplementary submissions and detailed analysis proceeds on this basis.

Supplementary submission 1: simplicity should be preferred in the design of the rules

Given the proposals is unlikely to advance any tax policy objective, the "least harm" is likely to be generated by making simplicity the primary objective. Wherever there is a choice to deal with potential behaviour which may be of concern or a perceived need to produce a perfect answer, ***we submit the simplest approach should be preferred. This should be kept in mind when designing the rules***

Supplementary submission 2: the application date should be deferred

To ensure that the rules can be appropriately designed and legislated for and to allow taxpayer education to occur, ***we strongly recommend that the application date be shifted from 1 October 2021 to 1 April 2022 (the start of the 2022-23 tax year) at the earliest.***

Given the truncated consultation process on the detail design and time pressures on legislative drafting, there is a high risk that the interest limitation draft legislation will be sub-optimal when introduced later this year. The 1 October 2021 application date as announced in March will mean that investors will become subject to the rules as the legislative process is still ongoing.

In our view, given the potentially wide impact of these rules and the possibility for change during the process (e.g. at Select Committee stage), it is better for the rules to have application from a prospective date to provide certainty (and the best chance to get the rules right before they apply).

This would have the added benefit of ensuring that only one set of rules needs to be considered for the 2021-22 income year (i.e. full interest deductibility), rather than 100% denial of any interest costs arising on or after 1 October for residential land acquired on or after 27 March 2021 with a 25% denial of the interest cost for residential land acquired prior to this.

As an alternative, the application date could be split so that the rule for acquisitions prior to 27 March 2021 would only apply from 1 April 2022. This would allow investors to properly consider the new rules and apply them prospectively. The new rules would however apply for any acquisitions after announcement date.

Our submission is consistent with Officials views as expressed in the Joint Report.

Detailed submissions

Our submissions on the discussion document are attached.

Further information

Please do not hesitate to contact us, s9(2)(a) [redacted]

Yours sincerely

s9(2)(a) [redacted]

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Chapter 2 – Residential property subject to interest limitation

In defining the type of residential property that should be subject to interest limitation, if the proposal proceeds, we agree that starting point should be whether the property can be used to provide residential accommodation on a long-term basis in New Zealand. Therefore, we support carving out any residential property / land situated outside of New Zealand.

We also support excluding from the scope of the interest limitation rules property that is carved out under paragraph (b) of the "dwelling" definition.

In the "issues for further discussion" feedback is requested on the following:

Change of use from main home during the phase out period for properties acquired before 27 March 2021

We agree the phase out of interest deductions should be available in this scenario.

Dual purpose (business and residential) buildings on the same title

we support an apportionment approach, rather than a predominant use (i.e. "more than 50%" business or residential purpose) test. This should be based on existing apportionment principles (i.e. based on time and space).

Employee accommodation

We agree this should be excluded from scope having regard to the public policy objective underlying this change. Employers providing their employees with accommodation, particularly in critical industries, should be a supported outcome. (There is no tax advantage to the employer or employee as the provision of accommodation, other than in specific circumstances, is taxable).

Student accommodation

We support an exclusion designed around the requirements outlined in sections 5(1)(h) and 5B of the Residential Tenancies Act 1986. The additional requirements imposed under that Act, including the need for accommodation providers to implement, and tenants to abide by, "house rules", should be sufficient to mitigate risk of substitution.

Short-stay accommodation

Any carve-out for short-stay accommodation should be based on objective criteria, such as features of a dwelling/premises that would make it difficult to substitute for long term residential accommodation. This may include features such as lack of standalone amenities (such as a fully functional kitchen) or private living areas (e.g. if such spaces are largely communal).

Serviced apartments

Similar to short stay accommodation, a carve-out should be based on features that make it difficult to substitute for longer-term accommodation. Where a serviced apartment is otherwise contained in a "commercial dwelling", such as where the space is predominantly used for hotel operations, this may also warrant the application of the carve-out. While there may be a degree of substitutability, the type of building structure and its overall use, suggests to us that a serviced apartment in such a setting is unlikely to be a good substitute for long term accommodation.

Māori collectively-owned land

We broadly agree that a carve out for rented papakāinga housing may be appropriate on the basis that papakāinga housing does not compete with owner-occupied housing.

In terms of identifying and defining papakāinga housing, an option may be to limit papakāinga to that on Māori land or Māori freehold land, identified through land records in the Te Kooti Whenua Māori (Māori Land Courts).

Our understanding is that papakāinga housing is often funded by Kainga Whenua Loans. We also understand that it is not uncommon for papakāinga housing to be held in, for instance, company structures alongside other non-residential property assets. As such, in the absence of a full exemption for papakāinga housing there is a potential for tracing to be required. It is possible that papakāinga may be structured in other ways, and further consultation with Te Puna Kokiri and Māori around the structure of papakāinga may be appropriate.

Chapter 3 – Entities affected by interest limitations

Chapter 3 proposes that the interest limitation rule should apply to companies that currently receive an automatic deduction for interest under section DB 7, provided they are either "close companies" or "residential investment property-rich" companies.

Residential investment property-rich company definition

Where a company holds an ownership interest in a residential investment property-rich company, the discussion document proposes that the ownership interest is treated as a "residential investment property" for the purposes of the threshold. We consider that the rules should allow this approach at a taxpayer's option, rather than making it compulsory. Where a taxpayer does not apply this rule, direct tracing for interest would be required.

Valuation considerations

Determining whether a company is residential investment property-rich requires the company to determine the value of its residential investment properties and compare this to the value of its total assets. The discussion document proposes applying the rules in existing section EL 19 to determine the relevant percentage.

While we agree that adopting the existing test in section EL 19 for this purpose is likely to be sensible given that taxpayers and their agents are likely to have some familiarity with the test, we note that any test requiring taxpayers to determine valuations for assets is likely to create compliance difficulties (and additional costs) for taxpayers.

Allowing taxpayers to apply the annual valuations set by local authorities is therefore support to reduce compliance costs. We also support the proposal to allow taxpayers to optionally use accounting or tax book values, rather than market values, for other property.

We note that under section EL 19, assets values are tested at the end of the taxpayer's income year. This creates a risk that a company acquiring land at the end of the income year may technically breach the test even if for most of the year it held no residential property assets. An option that allows taxpayers to test the percentage on an averaged quarterly basis, as is available in the thin capitalisation rules, may be preferable in this regard.

To reduce compliance costs, we submit that taxpayers should be allowed the option of using their accounting book values, as in most cases this should result in lower asset values (as typically, for accounting purposes, depreciation will be at a higher rate than for tax purposes).

Single company test for applying the test

The discussion document proposes that the "residential investment property-rich" test should apply on a company-by-company basis. The exception is for tax consolidated groups, where the test can be applied on a whole of group basis (i.e. treating the group as a "single company").

Requiring taxpayers to form a tax consolidated group in order simply to measure their "residential investment property-rich" percentage as a single company does not seem reasonable. We recommend that any "group of companies" (as defined in section IC 3 of the Act) should have the option of applying the test on a single company basis, by consolidating all companies in the New Zealand group (similar to the test used for thin capitalisation).

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Chapter 4 – Interest limitation

Our basic propositions for determining what interest should be subject to the proposed limitation rule is:

- The existing rules are used to calculate the amount of interest, for tax purposes. This means either the financial arrangement or the cash basis persons rules will apply to determine the amount of interest potentially subject to the rules;
- This interest is allocated to private or taxable purposes as currently; and
- Interest incurred for taxable purposes is allocated to:
  - Residential property covered by the new interest limitation rule:
  - Other taxable income purposes (fully tax deductible).

Interest expenditure

We see no need to amend the current rules on how interest expenditure is calculated. This includes non-New Zealand dollar borrowing – the net expense (including foreign exchange gains and losses) should be the object of the rules. We note that interest is deducted first against any foreign exchange gains under this treatment. This is consistent with the current approach of the Act to determining interest expenditure.

Private interest expenditure

For existing loans, private borrowings should already be determined. That allocation should continue to be the basis for applying the transitional phase down rules.

Once the interest limitation rules are enacted, we assume that the private/taxable purpose allocation will be done when money is borrowed. Private interest expenditure would continue to remain non-deductible.

Tracing for companies

For companies, as there should be no private borrowing there would be no requirement to trace. For existing borrowings, the rules that apply to establish the purpose to be used in the transitional phase down will determine how the borrowing is allocated.

New borrowing/acquisitions

We assume the allocation to residential property would be determined at the time of borrowing. Interest allocated to residential property would be non-deductible in the current year. This interest should be carried forward and potentially offset/deducted in the year of sale (if the sale is taxable) per our submissions on Chapter 5.

This means:

- If no residential property is acquired, there would be no non-deductible interest. That would appear to be the case whether or not residential property is subsequently acquired (as the money has already been borrowed for another purposes).
- If residential property is acquired, borrowing will need to be traced to that use and interest deductions will be denied accordingly.

Specific allocation rules proposed

Refinancing

We agree that refinancing of loans used to acquire property, subject to the phase out of interest deductibility, should still qualify for the transitional phase down rule.

However, we disagree with the proposed treatment for a loan refinanced in another currency. This is inconsistent with the Act's scheme to treat all loans as if they were NZD loans on an accrual basis. (This is the effect of the current rules dealing with foreign exchange gains and losses.) The answer is a simple application of current policy leaving commercial decisions on how best to borrow to taxpayers.

Non traced loans

We consider that option 1 (apportionment) is logical if the original borrowing is likely to be for the original cost of the relevant assets. However, this is less likely to be the case for revolving credit facilities and ignores the ability to restructure borrowings.

We therefore prefer option 2 (stacking), for simplicity. We note that there are likely to be winners and loser from this approach as it will depend on how market values have changed (compared to the original cost and amounts borrowed). However, as any restructuring of borrowings would also be market value based, option 2 provides an equivalent result.

From a pure policy perspective, option 1 is likely to raise the question of whether a specific anti-avoidance rule is required to prevent restructuring or whether section BG 1 may apply to restructuring. We consider that option 2 does not raise those questions.

Example 12 – revolving credit facility

Example 12 (on page 49) assumes that the loan amount subject to the transitional phase down rule should not be increased for any reason. This leads to the high water mark proposal.

We have difficulty seeing any policy problem illustrated in the example which requires a solution of this type.

In the example, the increases are due only to the timing of the receipt of rent and the payment of interest. On an end of the day basis, there is no increase in the amount borrowed. There should be no need to adjust the qualifying deductible borrowing.

We understand that some facilities could allow for additional borrowing. We submit that the approach should be:

- Additional borrowing for the purposes of the existing residential property activity should be deductible but subject to the transitional phase down rule.
- Additional borrowing for new residential property will be subject to the proposed rules (i.e. deducible for a new build and non-deductible for existing residential property).
- Additional borrowing for private or other taxable use, would be deductible or not based on the use of the funds.

This would allow a simple calculation of net borrowings for each purpose to be done annually to determine the proportion of interest subject to each rule.

This approach has simplicity as an advantage. It is justified on the basis that it is reasonably foreseeable that a taxpayer will incur further expenditure as a result of having acquired residential property. The interest is therefore properly attributed to the pre-change use.

Offset arrangements

We note the effect of an offset arrangement is that interest expenditure is "deducted" against interest income first (as the offset reduces interest paid to the taxpayer.) Accordingly, offset arrangements should only be within the rules if there is net interest expenditure.

Our suggested approach to revolving credit facilities could be applied to determine how much, if any, of this interest is subject to the residential property rules.

Foreign currency denominated loans and hedges

As above, we disagree with the proposed approach to foreign currency denominated loans and therefore foreign exchange hedges. In principle, there is no difference between New Zealand dollar denominated loans and foreign currency denominated loans. This is the approach taken by the Act which assumes an economic equivalence between the net result of a foreign currency denominated loan and New Zealand dollar borrowings.

On this approach, interest expenditure would be calculated as currently on a foreign currency loan and subject to the proposed rules accordingly.

If there are any foreign exchange hedge instruments, the result of the tax calculations for the foreign currency loan should be included in the net interest calculation for the loan.

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Chapter 5 – Disposal of property subject to interest limitation

Options for treatment of revenue account disposals

We do not favour Option A (deductions denied). Under Option A, investors could potentially face a tax liability where they have actually made an economic loss on disposal of residential property, or a tax liability that significantly exceeds that on other investments with an equivalent economic return. The clear fairness and coherence concerns with Option A are not outweighed by any housing affordability objectives.

We prefer Option B, as its effect is that interest deductions should be available where returns from holding the property are appropriately taxed. We do not favour Options C or D, which add additional complexity in order to address a perceived arbitrage risk (discussed further below) and will over-tax residential property as a result.

Options for treatment of capital account disposals

We favour Option F, which allows a deduction only to the extent that the interest expenditure exceeds the non-taxed gain on sale of the property.

In our view, Option F effectively recognises that the interest cost incurred relates to both the capital gain amount and the taxable income that has already been returned during the period of ownership.

Arbitrage considerations

From a tax policy perspective, we do not see any reason why anti-arbitrage rules are required.

To the extent that a policy decision has been made to tax residential land, all "economic income" (whether from holding for rents or capital gains) will be taxed and allowing deductions is consistent with taxing only the net economic return to an investor.

Setting aside the tax policy considerations, from a social policy view, we also do not see any justification for the suggested anti-arbitrage approach. To the extent a tax loss might arise due to allowing a deduction for capitalised interest on disposal, at the margin, this may encourage investor to sell rather than hold on to the property. To the extent this increases available supply, this could be expected to benefit owner-occupiers.

Chapter 6 – Development and related activities

KPMG supports the proposed exemption for development activity. Land developers are adding to the housing stock and should be entitled to a full interest deduction.

We also agree that the exemption should apply on a property by property basis rather than on a taxpayer basis.

KPMG does not agree with the comment at para 6.11 that almost everyone who develops residential property will hold the property on revenue account under section CB 7. Many taxpayers developing residential property will not be caught by section CB 7.

We therefore agree with the proposal that the developer exemption needs to be wider than just covering CB 7 to also capture one-off developments by people who are not in the business of developing land and also property development on land that is not captured by section CB 7.

Where land is not acquired for the purpose of development, but that intention is formed later, interest should be deductible from the time the intention to undertake a development is formed. The interest should be deductible on both the additional debt used to fund the development acquisitive and also on the debt used to acquire the property (for the time the intention to develop the property is formed).

We support an exemption to allow interest on debt funding for remediation work where the work is necessary to extend the life of a residential property, bring it to a more suitable standard for habitation (for example, remediation specifically to meet the 'healthy homes' standard to uplift the quality of New Zealand rental stock), or to convert a building from non-residential to residential use. We believe this is consistent with the wider policy objectives of the new build exemption.

Chapter 7 – Definition of "new build"

We agree that an exemption should be made for new builds in order to ensure new housing supply is not constrained, if the interest limitation proposal proceeds.

We agree with the proposed definition of new build.

We agree that, in principle, renovating an uninhabitable dwelling so that it becomes habitable should qualify for the new build exemption on the basis that this increases the total housing supply. Again, having regard to the Government's wider housing objectives, it seems counter-intuitive that these types of conversions should be excluded from the new build exemption. This would create an incentive to demolish rather than remediate, at the margin, for tax purposes

While we acknowledge the potential complexity from differentiating between renovating an uninhabitable dwelling and other renovations, we do not believe this would be insurmountable. And to our general comment, if the trade-off is between accuracy and simplicity/supporting the wider objectives, we would err on the latter.

Chapter 8 – New build exemption from interest limitation

Fixed new build exemption period supported

If the interest limitation proposal proceeds, we support the proposed new build exemption being available to both early owners of a new build, and to any subsequent purchasers of properties that qualify as a new build.

It is important that, for an initial owner looking to invest in new housing supply, there is a secondary market available on the eventual sale of properties and the tax system does not create uncertainty around valuation on sale.

Interest deductibility will be one of the variables that is taken into consideration when determining the pricing, and ultimately the feasibility, of a new build project. It is therefore important that investors have certainty over the period that they, and/or any future owners, will be entitled to claim an interest deduction at the time they make the investment decision.

We therefore support allowing interest deductibility for a fixed period for both early owners and subsequent purchasers.

It is important that the period of the new build exemption does not discourage the development of new housing stock. We suggest that the new build exemption should apply for a maximum period of 30 years. This includes for early owners who hold the property for more than 30 years (i.e. interest deductibility would cease after year 30 for them). We note that there is no exact science to picking the exemption period. One argument is to align the period with the Commissioner's estimated useful life for buildings – 50 years. However, an argument could be made that this is too generous. A 30 year period reflects, in our view, an appropriate balance between the need for certainty (which a fixed exemption period would provide) and a realistic total period for debt funding a new build (including where there may be multiple owners).

Continued investment rule not supported

We do not support the proposed continued investment rule, where a residential property that is subject to the new build exemption may be owner occupied.

It is simply not practical to require subsequent purchasers to undertake due diligence regarding use of the property by all earlier owners in order to confirm their eligibility to claim interest deductions (through continued application of the new build exemption). Further, the period being considered for the new build exemption will exceed the general record keeping period of 7 years. So, unless information on the applicability of the new build exemption is collected by Inland Revenue periodically (e.g. as part of the tax return), and is available to subsequent owners on acquisition, this will be a difficult rule to both comply with and enforce.

There will also be circumstances where an initial owner may need to temporarily move into a new build for a period of time before renting it out (for instance, if a person develops two properties at once, one to live in and the other to rent, and lives in the latter while the former is being completed) where the initial owner should not be precluded from applying the new build exemption.

Ultimately, we do not believe that the value of the continued investment rule in potentially creating more stock for first-home owners is justified for the additional complexity of the rule.

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

We support retention of a five year bright-line period for new builds.

We recognise the rationale for wanting to limit the benefit of the shorter bright-line to early owners only. However, consideration should be given to whether its application to subsequent purchasers as well may better support the Government's objective of encouraging new housing supply.

Chapter 10 Rollover relief

We support the availability of rollover relief for both interest deductibility (during the interest phase out period and under the new build exemption) and for a wider range of scenarios under the bright-line test.

Rollover relief under the new build exemption should apply regardless of the new build exemption option chosen.

From a policy perspective, rollover relief should not only be available if new build exemption is limited to early owners in perpetuity. If the new build exemption is time capped (i.e. applies for a total fixed period across both early owners and subsequent purchasers), rollover relief should still be available for designated events.

Scope of bright-line rollover relief for family arrangements.

Paragraphs 10.7 and 10.8 outline an increasingly common occurrence where parental support may be necessary for first home buyers to enter the housing market. The discussion document notes that such arrangements can give rise to adverse tax consequences under the bright-line test. We agree and note that these issues will be exacerbated with the extension of the bright-line period to 10 years. In particular, we are concerned that the bright-line test could apply if a person other than the principal borrower(s) must also be listed on the title for a residential property in order secure bank funding (i.e. effectively acting as the guarantor). We submit that these types of situations should be addressed as a matter of priority, rather than “work being undertaken at a later date”.

Application of full bright-line test rollover relief for settlements on a family trust.

We strongly support the extension of the bright-line test rollover relief to situations where residential land acquired prior to the bright-line test (or that was subject to the 2 or 5 year versions but following their expiry) is transferred to a trust.

However, the parameters for availability of such relief are not clear (for example, paragraph 10.31 suggests that rollover relief may be allowed where “a settlor settles land onto a trust in return for the trust providing the settlor the right to occupy the property free of charge (i.e. for natural love and affection)”.

We believe this should also be the case where pre-bright-line test residential property is gifted to a trust or the property is sold to a trust in exchange for a loan. In both cases, if the transferor is also the settlor and a beneficiary of the trust, there is no change in economic ownership of the property, so there is no reason why the bright-line test should apply when it did not originally (or the bright-line period has otherwise lapsed).

Chapter 11 – Interposed entities

These proposals contain the most difficult rules to apply in practice. The require serious simplification to allow them to be used.

Affected assets percentage and apportionment calculations – closely held and other interposed entities

Paragraphs 11.6 to 11.9 do not specify when the calculation is performed. However, paragraph 11.14 and subsequent imply that this could be a year end test or a daily test (or something in between). 11.16 states that a "daily calculation" does not require a calculation everyday but that a calculation must be done for every day.

A good dose of common sense is required.

The PIE rules require daily calculations and attributions of income and expenditure for each PIE. These calculations are carried out by systems developed and operated by sophisticated fund managers and administrators.

A full attribution regime for company income has not been implemented in larger part due to the difficulty of doing daily calculations and attributions.

In both cases, the calculations are those of the entity itself. For the interposed entity rule, the shareholder would be required to access information from the entity and calculate their own apportionment. The entity would have to be able to provide that information on a daily basis.

This is an onerous burden. We can only conclude, in the words of a former Minister of Revenue and Finance, that this is an "ideological burp" and not to be taken as a serious proposal.

Most companies will only prepare annual financial statements. That should be the starting point for what is possible and realistic for them to provide to shareholders.

This means that an avoidance rule should be considered. An appropriate rule could eb modified from the thin capitalization rules. We are not aware of any specific difficulties with applying these rules or that have not achieved their objective. On the latter, any uncertainty of application is likely to mean that changes in the ratios are most likely the result of commercial decisions. Further, any "asset stuffing" to increase the non-residential property proportion would need to be funded. Existing funds would not change the proportion (i.e. from cash to some other asset). Other increases would require either debt or equity funding. The terms of such funding would likely make it easier to determine whether the anti-avoidance rule should apply.

Trusts

We have referred to companies as an inter-posed entity as it is difficult to see how borrowing to fund an inter-posed trust would be effective. A taxpayer borrowing to provide equity to a trust would not normally be considered to be borrowing to produce assessable income. A trust is therefore most likely to be involved in the on-lending scenario covered at paragraphs 11.28 to 11.30 and considered below.

Widely held companies

If implementing the proposals will be difficult for close companies, it will be even more difficult for shareholders of widely held companies. Information is unlikely to be able to be provided on a timely basis. If the company is listed there will be insider trading and NZX rules which may limit the type and timing of information provided to shareholders.

The current interest deductibility rules provide some certainty of deductibility. For investments in widely held companies, the interest deduction and therefore the taxable income, may be volatile.

We consider that a widely held company rule may not be required. It is unlikely that borrowing to invest in affected companies will be done to allow deducible interest.

However, if the rule proceeds, then the apportionment should be based on the company's prior year balance sheet. This is likely to assist investors with estimating their current year tax and also would reduce delays in the provision of information required for an income tax return.

For example, the company would provide shareholders with its 31 March 2022 percentages to be applied to the calculation of 31 March 2023 tax position.

If this approach was taken, then an apportionment should be allowed.

Look though companies and partnerships

A clarifying provision to ensure that the debt is apportioned to the assets of the LTC or partnership seems reasonable. However:

Depending on how this is drafted, it may raise questions on the taxation of an LTC or partnership more generally. Those consequences should be considered and dealt with.

The shareholder or partners access to relevant information should be considered. As this rule would mean that loans are traced to assets consideration needs to be given to how the primary rules can be given effect for a taxpayer who is not the entity with the entity's access to information.

Existing interposed entities

Given that nothing in the proposed rules is simple, we disagree with the proposal for existing loans. If due to compliance costs a taxpayer chooses not to apply apportionment and tracing rules, that should be the taxpayer's choice. Other taxpayers should have the same ability as direct acquirers of residential property.

Disposal of interest in inter-posed entity

Our submission on existing interposed entity treatment suggests that denied interest should be allowed as a deduction if either the property asset or the sale of the shares in the interposed entity is taxable.

On-lending

We agree that in the example it is only an anti-avoidance rule which needs to be considered. We note that less than market interest on-lending would raise the possibility that BG 1 would apply. (However, we note the restricted transfer pricing rule is premised on related party borrowing making no or very little margin. This is contrary to the market value assumption that is implied as required by BG 1.)

We have considered an alternative example. Zeean lends to her Family Trust, at interest, which acquires shares in LandCo. The Family Trust would be subject to the interposed entity rule and its interest would be apportioned in accordance with those rules. The anti-avoidance considerations would still apply to the interest rate charged by Zeean to the Family Trust.

Chapter 12 – Implications for the loss ring-fencing rules

As an initial observation, on the basis that the Government proceeds with the interest limitation rule as proposed, it would seem that rental investment properties are very likely to produce taxable profits, with losses being expected only at the margins. This is particularly so given that depreciation deductions are no longer available for residential investment properties. On that basis, our preferred approach is that the existing rental loss ring-fencing rules are repealed.

We further observe that if the rental loss ring-fencing rules are not repealed, we would expect the interface between the proposed interest limitation and the existing rental loss ring-fencing rules to become exceedingly complex. This is likely to result in potential unintended consequences.

To the extent the Government is not prepared to repeal the existing residential loss ring-fencing rules, we support carve outs for new builds and development properties on the basis that doing so will encourage new supply to the market, with the objective of lowering prices for potential owner-occupiers.

For reasons given above we do not consider that anti-arbitrage rules should be required, and we would not favour such rules in any case as they will likely result in considerable complexity.

Chapter 14 - Administration

Chapter 14 considers the administrative aspects arising from the Government's proposal to limit interest deductions and extend the bright-line tests for residential investment properties. We comment specifically on the questions raised by officials below.

Adding a field to tax return

We do not consider that any particular issues should arise from adding a new field to the tax return to capture the amount of interest relating to residential investment property debt. To the extent that taxpayers have had to trace their borrowings to residential property and determine the interest subject to the proposed deduction denial, itemising that amount in their tax return should not be an onerous task.

Record keeping

In light of the proposed extension of the bright-line test to 10 years, Inland Revenue should provide further detail as to its expectations around record keeping. Under the current settings, taxpayers are expected to keep records for a period of seven years from the end of the year to which the records relate.

Because the proposed 10-year bright-line test could 'bite' between year seven and year 10 without the taxpayer anticipating a tax liability, there is a risk that taxpayers may have discarded records at year seven making it difficult or impossible to quantify any tax liability.

In a practical sense, the new bright-line test may now imply that records must be held for 10 years.

Code Compliance Certificates

The Discussion Document suggests that Code Compliance Certificates ("CCC") might be used to evidence that a property is a new build under the proposed test. We consider that this is likely to be a reasonable approach given that all new builds will have a CCC issued once they are constructed to a standard suitable for occupation. We are not aware of any integrity risks that could arise from this approach.

Subsequent purchasers

To the extent that subsequent purchasers are able to take advantage of the new build exemption, there is a potential commercial risk as to the information that the subsequent purchaser will need to establish that the exemption applies. Depending on the design of the subsequent purchaser rule, and whether the rule requires any form of disclosure by the vendor so that the purchaser can determine its tax obligations, there could be a potential contractual risk between vendor and purchaser (similar to the kinds of risks under the GST CZR rules). There may be value in consulting with ADLS as to whether any of the standard terms in the ADLS SPA require amendment, or whether a specific disclosure schedule is necessary.

From: s9(2) [redacted]
To: Policy Webmaster
Subject: REINZ SUPPLEMENTAL Submissions: Design of the interest limitation rule and additional bright-line rules
Date: Wednesday, 14 July 2021 7:26:41 PM
Attachments: image002.png
image003.png
image004.png
image005.png
REINZ Supplemental submissions 140721.pdf
Importance: High

Evening

Thank you for your email earlier today confirming receipt of the below.

Please find attached supplemental submissions on behalf of our members.

Kind regards

s9(2)(a) [redacted]

From: s9(2)(a) [redacted]
Sent: Monday, 12 July 2021 6:33 pm
To: xxxxxx.xxxxxxxxx@xxx.xxxx.xx
Subject: REINZ Submissions: Design of the interest limitation rule and additional bright-line rules
Importance: High

Good evening

Please see attached submissions.

Thank you for the opportunity to make submissions on behalf of our members.

Kind regards

s9(2)(a) [redacted]

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The voice of real estate

REINZ
REAL ESTATE INSTITUTE OF NEW ZEALAND

14 July 2021

Ministers of Finance & Revenue
Parliament Buildings
Wellington

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

Supplemental submissions: Design of the interest limitation rule and additional bright-line rules

We write further to our 12 July submissions.

These supplemental submissions collate feedback from managers at all levels, sales agents and property managers around New Zealand, including a range of experience levels and across a range of sectors, including Residential Sales, Residential Property Management and Commercial.

Consistent with our original 12 July submissions, all feedback received from members opposes these proposed tax changes.

The general consensus is that the proposed tax changes will have a detrimental impact as follows:

- The average rent will increase faster
- The supply of rental properties will decrease
- The changes will not impact inflation, and many members commented that you only need to look at Australia to see that a multitude of tax schemes have had no effect on inflation
- House prices will actually increase as it is a simple formula of supply and demand.

The overwhelming feedback received from members is that the solution is straightforward; the following two areas need to be addressed:

- More houses need to be built
- It needs to be easier for developers to build at scale, by addressing the RMA.

Feedback from members on 10 specific questions is included in the Schedule attached.

Thank you for the opportunity to make these supplemental submissions on behalf of our members. We wish to thank s9(2)(a) [redacted] considerable assistance in collating feedback from members.

If the Committee has any questions, please direct them to s9(2)(a)

Yours faithfully

s9(2)(a)

SCHEDULE: SPECIFIC FEEDBACK FROM MEMBERS

1. **Do you think that these changes will slow the rate of inflation and make properties more affordable?**

   Across the country, every member who provided feedback, regardless of their role or industry, considered the proposed changes would not slow the rate of inflation.

2. **Since the proposed changes were released in March, have you noticed any changes in your marketplace?**

   Specific feedback:

   a. *'Some owners have sold, and there is uncertainty of what's ahead with the number of changes over the last two years and the costs incurred costs. Now investors feel further disadvantaged with these latest changes. My portfolio comprises of owners with 1 or 2 properties, and they are just ordinary people trying to invest wisely, but it is getting more and more difficult for them.'*
   b. *'The supply of houses has decreased, some investors have moved out of housing into other investments, interest in commercial investment has increased, which is starting to push these prices up.'*
   c. *'There has been some put on the market but not a lot, but there has been a lot of conversation from owners wanting increased rents to help offset the loss of they will have.'*
   d. *'Fewer investors in the marketplace, although mostly the large portfolio people. Mum and Dad investors not so affected.'*
   e. *'Yes, I have noticed Landlords have decided to sell up and take the capital gain leaving even fewer rental properties in the marketplace, which in turn has pushed up the rental prices.'*
   f. *'Scared off 'mum and dad' investors.'*

3. **Do you think the ring-fencing of claiming the mortgage interest for investment properties is a fair and consistent way to slow inflation?**

   Across the country, every member who provided feedback, regardless of their role or industry, did not believe the proposed changes were fair or conducive to encouraging future development or investors.

4. **Based on your experience with investors (and many of you own your owner rental properties), what are your thoughts on extending the Brightline test from five to ten years?**

   Specific feedback:

   a. *'Some new property investors are concerned or put off buying as they are wary of the implications of the Brightline test others generally in a better financial situation are willing to take the risk or consider new builds to avoid this.'*
   b. *'It is a capital gains tax from a government that claimed they wouldn't introduce a capital gains tax'*
   c. *'I think this is unfair. People go into investment thinking long term, but life can throw you some curveballs and ten years is a long time. With the housing shortage, why would you want to hold up properties from entering the market for ten years if there is a chance they could become available sooner'*
   d. *'Problematic for many, especially the older NZers who are wanting to buy an income for their retirement. It gives them less choice.'*

e. *‘I think doubling that time is too harsh, and I know of several Landlords who this has caught out; in provincial NZ, the majority of Landlords are not speculators and have many varied reasons for renting out a property.’*
f. *‘It probably won't make a massive amount of difference, just inconvenience a lot of people.’*

5. **What do you think are the main reasons for the growth of house prices and rental prices in your area?**

   Specific feedback:

   a. *‘The growth of house and rental rates is purely based on demand and lack of stock, uncontrolled immigration and lack of supply’*
   b. *‘Rental rates have increased because of the removal of letting fees, the difficulty in ending tenancies, increased compliance costs, and increased insurances and rates. The majority of owners are Mum and Dad owners. They are already putting money in every week already to keep their investment afloat. They just can't hold on to all the extra costs, damages and risks. The tenancy tribunal being so pro-tenant and not looking at things without bias makes the risk so much higher’*
   c. *‘Lack of supply’*
   d. *‘Lack of land to build and with all the changes in the current RTA, many older Landlords are cashing up, and very few of these properties are coming back into the rental pool.’*
   e. *‘Shortage of housing stock due to people coming back to NZ.’*

6. **Based on properties you are selling (if you are a sales agent), roughly what percentage of these sold properties are purchased by; Owner-occupiers or investors**

   The overwhelming feedback from members indicated that 80-85% of the purchasers are owner-occupiers. This ratio also includes purchases of existing rental properties.

7. **Based on properties you are losing from the portfolio (if you are a property manager), roughly what percentage of these lost properties are going to; Owner-occupiers, investors or owners moving back in?**

   Specific feedback:

   a. *‘80%’*
   b. *‘80% - Owner occupiers / 20% - investors’*
   c. *‘Owner-occupiers maybe 1-2% of investors are still purchasing. Owners moving back has almost stopped now that we are out of the Covid lockdowns of 2020.’*

8. **Investors that owned properties before March 2021 have four years before the proposed interest changes commence – what do you think will happen to rental prices over this period as landlords prepare for the change?**

   Specific feedback:

   a. *‘Rental rates will increase to cover the fact they will lose this financial benefit.’*
   b. *‘Rental prices will increase if the lack of supply is not addressed.’*
   c. *‘Rents will increase. They are already talking to us about this as we can only increase rents annually. Any decrease in fund coming in on a rental need to be covered by the rent or the owner. The owners want to offset what they can.’*
   d. *‘They will increase, although they would probably have increased anyway.’*

e. *'They will increase to offset the loss.'*
f. *'Rents will definitely increase to cover the extra costs to landlords.'*

9. **Based on what you see and hear within the industry, what do you think would have the most significant impact on mitigating the rate of inflation across the sales and rental market?**

   Specific feedback:

   a. *'Increased stock.'*
   b. *'Address the supply problem.'*
   c. *'Build more. Maybe marketing to 1st home buyers about working their way up the property ladder. I know my first home was well under the level I wanted, and I have now, but you used to buy what you could afford and improve over time. Today's first home buyers want a high level of first home.'*
   d. *'Build more houses.'*
   e. *'Making more land available to build on.'*
   f. *'Make more residential land available in a timely manner and build more houses.'*

10. **Over the next 5-10 years, what do you think will happen to the affordability of housing and rental accommodation in New Zealand?**

    Specific feedback:

    a. *'Rates will continue to increase, but the speed and extent will depend on other factors such as migration post covid, interest rates etc.'*
    b. *'Prices will increase.'*
    c. *'Rents will continue to increase, and more and more people move into rental properties as owning will become unaffordable.'*
    d. *'It frightens me to think, as in most areas of NZ, rents and housing are unaffordable for your average family or first home buyers. How can you afford to save to buy a house when your rent is more than the average mortgage.'*
    e. *'Prices won't decrease overall, but increases will slow as more houses become available.'*

From: s9(2)(a) [redacted]
To: Policy Webmaster
Cc: s9(2)(a) [redacted]
Subject: Interest limitation rule submittal
Date: Friday, 16 July 2021 9:09:01 AM
Attachments: image001.png
CHA IRD Interest limitation rule July 2021 Submission.pdf

Tena kōe,

Please find attached comments from Community Housing Aotearoa regarding the interest limitation rules.

Ngā mihi,

s9(2)(a) [redacted] **Community Housing Aotearoa**

PO Box 11543, Wellington 6142, New Zealand | Level 11, Ranchhod Tower, 39 The Terrace, Wellington

[redacted] s9 | http://www.communityhousing.org.nz/

Hear firsthand how good, affordable homes give people hope, connection and stability:

- Alex https://www.youtube.com/watch?v=3ZiMialQR0Q&feature=youtu.be
- Joan https://www.youtube.com/watch?v=y6CtVoqoIL4&feature=youtu.be
- Mau and David https://www.youtube.com/watch?v=1Pm0Ff7hJ3g&feature=youtu.be
- Christine https://www.youtube.com/watch?v=wTFy79WgNWI&feature=youtu.be
- Rozeena https://www.youtube.com/watch?v=yuITXPshH0A&feature=youtu.be

***Community Housing Aotearoa** is a peak body for New Zealand's community housing sector. Our 90 provider members house approximately 35,000 people nationally across 18,520 homes. Our 19 partner members include developers, consultants and local councils.*

Community Housing
Nga Wharerau o Aotearoa

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16 July 2021

Design of the interest limitation rule and additional bright-line tests
C/- Deputy Commissioner, Policy and Regulatory Stewardship
Inland Revenue Department
P O Box 2198
Wellington 6140
By Email: policy.webmaster@ird.govt.nz

RE: Design of the interest limitation rule and additional bright-line rules

Thank you for the opportunity to offer our views on the "Design of the interest limitation rule and additional bright-line rules" discussion document.

1. Community Housing Aotearoa (CHA) is an Incorporated Society and a peak body for the community housing sector. In order to achieve our vision of 'all New Zealanders well-housed', we have a strategic focus on supporting a well-functioning housing system and working toward the progressive realisation of the right to housing. We are also mindful of the larger institutional and regulatory settings within which our members and other community organisations operate. We are keen to ensure these settings are aligned and not unduly burdensome.

2. Our 90 provider members provide homes for nearly 30,000 kiwis nationally across 18,000 homes, and our 19 partner members include developers, consultants and local councils. Community Housing Providers (CHPs) are primarily not for dividend entities that develop, own and manage social and affordable housing stock, with rental and progressive homeownership tenure offerings. We work closely with Te Matapihi, which represents Iwi-based and Māori community housing providers. More about us can be found here.

3. We agree with and support the reasons for introducing these changes to help achieve Government's housing objectives:

   - ensure that every New Zealander has a safe, warm, dry, and affordable home to call their own – whether they are renters or owners
   - support more sustainable house prices, including by dampening investor demand for existing housing stock, which would improve affordability for first-home buyers, and
   - 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.

4. Our comments below are regarding those areas of the discussion document which we feel are pertinent to the interests of our members in general and to registered Community Housing Providers in particular. The general intent of our comments are to ensure that these changes do not unintentionally constrain the ability of the non-governmental providers of social and affordable homes in the future. We wish to align the settings and future-proof them based on the increasing sophistication of the models of delivery in New Zealand and international examples of the diverse development activities of the sector.

Comments on the Discussion Document

5. Extend Kāinga Ora Exemption to CHPs:
   Refer: Chapter 3 (3.17 to 3.19) – also 1.18 Chapter 1.

   These sections propose the exemption of Kāinga Ora from the interest deductibility rules as it is not a registered Community Housing Provider covered under section CW 42B of the Income Tax Act and is not a registered charity. Section 3.18 rightfully identifies that many registered Community Housing Providers are charities and therefore exempt from income tax. However, under the Public and Community Housing Management Act 1992, this is not a requirement. We also acknowledge that other Community Housing Providers may be exempt under section CW 42B of the Income Tax Act 2007.

   Community Housing Aotearoa agrees with the proposed exemption of Kāinga Ora and its wholly-owned subsidiaries from the interest limitation rules. We request that this exemption also applies to registered Community Housing Providers. This is for the following reasons:

   - Registered Community Housing Providers (CHPs) currently supply the same public housing services as Kāinga Ora through provision of rental housing to applicants from the government's Public Housing Register. They also provide newly-developed properties for use as rental public housing, below-market rental housing and also Progressive Home Ownership through rent-to-buy and other models. As is the case for Kāinga Ora, CHPs are bound by agreements with government for the provision of these services. It is highly desirable to align treatment of entities undertaking the same role.

   - Both Kainga Ora and CHPs are engaged in housing development and can be involved in regeneration of existing neighbourhoods. This can result in some acquisition, development and provision of housing for people at slightly higher levels of income to create mixed-tenure, mixed-income communities. These communities help establish better education and services infrastructure to those that most need them and enable families of all income levels to live and work in the same communities. The income resulting from such development activities may breach the current thresholds for eligibility for Exempt Income in CW 42B of the Income Tax Act. It is desirable to at least enable interest deductibility so as to not further disincentivise these initiatives to improve social cohesion. Otherwise, the desired neighbourhood outcomes would require additional governmental expenditure to achieve.

- Overseas, and potentially in New Zealand in the future, mixed-income and mixed-tenure housing has also been financially beneficial as an enabler of more social housing through deliberate cost subsidy (either from market sales or market rentals to subsidise discounted rentals for disadvantaged household). There are good examples of this in Australia, the USA and Britain. An arrangement of cross subsidy to foster social benefit could also potentially place a CHP in excess of CW 42B thresholds. Again, it is desirable to enable interest deductibility so as to not further disincentivise innovative approaches to making more social housing financially viable at reduced cost to government.

We believe this exemption of CHPs is consistent with the Governments stated objectives. It also is consistent with the "things to bear in mind" in Section 1.5. Whilst the Charities Act and CW 42B may currently be adequate, ensuring the regulatory changes proposed will be future-proofed is desirable. We are concerned the market may shift faster than the adjustment of thresholds applying to CW 42B, and providing this exemption helps in future-proofing against the unfortunate consequences if this happens.

In addition, having a clear exemption here will promote efficiency and reduce complexity. We wish to avoid a situation where each CHP needs to work with their own legal/tax counsel and their lenders/financiers legal/tax counsel to determine they are exempt.

6. Short Stay Accommodation Carve-Outs to Include Emergency & Transitional Housing: Refer: Chapter 2: 2.82

Section 2.82 and the question box below it request feedback on the desirability for carve-outs for short term housing and on categories of short term housing that are not likely to subsequently become long term housing.

Community Housing Aotearoa believes it is desirable to treat short term housing separately from long term housing and agrees that this should only occur when substitutability is unlikely. In this context, it would seem reasonable to exclude emergency and transitional housing as defined in the Residential Tenancies Act 1986 in Section 5(1)(y).

It is acknowledged that, as discussed in the prior section, registered Charities and organisations eligible through CW 42B will likely have tax-free status as providers of emergency and transitional housing. However, the same logic applies to ensure future changes don't have unintended consequences, for efficiency and to reduce complexity.

7. New Build to Include Upgrade of Homes to Make Habitable:
   Refer: Chapter 7: Questions for submitters (p76)

   The discussions document asks whether there is 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?

   Community Housing Aotearoa believes it is desirable to include upgrading homes to make them habitable as part of the definition of new build, as it is effectively new supply. A suggested tool for this is compliance with the Housing Improvement Regulations 1947 which set some fundamental minimum standards for a dwelling. These include minimum room sizes, essential plumbing fittings etc.

In summary, we support the intent of the proposed changes to achieve the objectives. We encourage the IRD to consider our comments and focus on aligning exemptions across Kāinga Ora and registered Community Housing Providers, clearly address Transitional and Emergency Housing and ensure these changes remain fit-for-purchase into the future.

We are available to discuss any questions you may have regarding the above points.

Kind regards

s9(2)(a)