Tax Working Group Public Submissions Information Release

Release Document

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

30 April 2018

Tax Working Group Secretariat
PO Box 3724
Wellington 6140

By email: submissions@taxworkinggroup.govt.nz

TAX WORKING GROUP REQUEST FOR PUBLIC SUBMISSIONS

Please find attached the written response of the New Zealand Property Investors' Federation Inc to the Tax Working Groups request for information on their work into The Future of Tax.

The Federation is is happy to provide the Committee with any further information it may require and would welcome being heard in person before the group to answer any specific issues.

Yours sincerely

[1]

Andrew King
Executive Officer
NZ Property Investors' Federation

Submission to the

Tax Working Group

examining the

Future of Tax

30 April 2018

Andrew King
Executive Officer
New Zealand Property Investors' Federation Inc
PO Box 20039, Bishopdale
Christchurch

New Zealand Property Investors' Federation

This submission is prepared by the New Zealand Property Investors' Federation Inc (NZPIF) in response to the Tax Working Groups Background Paper the Future of Tax.

Established in 1983, the Federation has twenty affiliated local associations situated throughout New Zealand. It is the national body representing the interests of over 7,000 property investors on all matters affecting rental-housing.

If an opportunity is available, the NZPIF would like to appear before the Tax Working Group

Industry Background

To assist readers understand the extent of the economic and social importance of the private rental industry in New Zealand and the implications of residential tenancies legislation the following background points are offered.

What is the extent of the private rental industry?

There are approximately 270,000 landlords in New Zealand. There are no corporate or institutional residential landlords.
There are over 464,000 residential rental properties[1], housing over 600,000 tenants, and worth around $150 billion[2].

Private landlords are the largest providers of rental accommodation in New Zealand. Approximately 85% of tenants rent from a private landlord or trust[3].

Median weekly rent for all accommodation is $380[4]. The amount spent on rent each week is $64 million and annually this is $3.3 billion.

Most property investors (57%) have been engaged in the business for 10 or more years[5], which dispels the myth that people are investing in property to make a "quick buck". Instead, most property investors are using their rental income business as a mechanism for saving for retirement and are professional and committed long-term service/accommodation providers.

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[1] "Landlord group's code sets high standards" 5/9/08 NZ Herald

[2] NZ Herald 10/1/07

[3] 2013 Census

[4] Tenancy Bond Centre statistics

[5] ANZ NZPIF Annual Survey 2006

Introduction

The New Zealand Property Investors' Federation welcomes the opportunity to provide input into the Tax Working Groups work. The stated aim of ensuring the New Zealand tax system is fair, balanced and administered well is laudable.

We agree with the Government's starting position and guiding principle that tax should operate neutrally and as much in the background as possible.

Our submission is limited to our area of knowledge and expertise around housing and specifically rental housing. This is a critical area as the Group is to give special regard to housing affordability in their research and reporting.

The Group has been asked to report on whether the tax system promotes the right balance between supporting the productive economy and the speculative economy. It is critical that the Group correctly defines the productive economy as if done so then the provision of rental property to workers can only be seen as an essential part of the productive economy. The same cannot be said for buying and selling of shares.

Apart from providing accommodation for a third of all New Zealanders, the rental industry pays annual tax on a net rental income of around $1.5 billion, pays rates and supports many other industries such as insurance, property management and many trades.

The Group has been asked to consider whether taxing capital gains or land (except for the family home), or other housing tax measures would improve the tax system and make housing more affordable.

The NZPIF is concerned that the Group has received incorrect information that has lead you to state that "rental property is undertaxed relative to other assets". A report from Finance and Economic Consultants, Morgan Wallace, shows that rental property is in fact overtaxed compared to most other assets.

Other countries that have either a CGT or land tax have still seen large housing price rises, so tax is not a method to control house prices in New Zealand. In addition, increasing the cost or reducing the return of providing rental property has seen higher rental prices of the past seven years. This is leading to rental unaffordability and overcrowding, plus making it harder for aspiring first home buyers to save a deposit.

Housing has for many years been targeted to ensure that property speculators pay all the tax they should. This includes the IRD establishing the Property Compliance Team and the introduction of the two year Bright Line Test. The NZPIF has always supported measures to ensure property speculation is properly taxed, however the extension of the Bright Line Test to five years affects rental property purchases more than speculative property purchases. While the NZPIF promotes holding rental property for the long term, many things can happen over a five year period meaning that a property needs to be sold. The Bright Line Test therefore adds extra risk when buying and providing a rental property to tenants that does not apply to other assets. This is unfair and could lead to shortages in rental property supply.

If looking to introduce fairness to the tax system, the NZPIF believes that the Bright Line Test should apply to all assets, including shares and businesses. This could be a way to increase tax revenue.

DISCUSSION

Tax paid by rental property Industry

Regarding rental property, the current broad based system is working well despite there being a higher level of scrutiny towards property taxes than other taxes.

Contrary to public opinion, NZ Rental Property Owners do pay tax, and have paid tax on approximately $1.4b of rental income in each of the last five years. In addition, their spending on maintenance, upgrading their properties, insulation, insurance, rates and all the other costs they carry have resulted in substantial GST payments to Inland Revenue.

The current system is a good blend of encouraging investment in relatively low yielding property and providing relatively cheaper rental prices for tenants while still contributing significantly to New Zealand's taxation revenue requirements.

While many commentators continue to state that rental property has a tax advantage, the IRD have continually advised that housing is not tax advantaged in New Zealand. A recent report into Marginal Effective Tax Rates by Finance and Economic Consultancy, Morgan Wallace, confirms the IRD position.

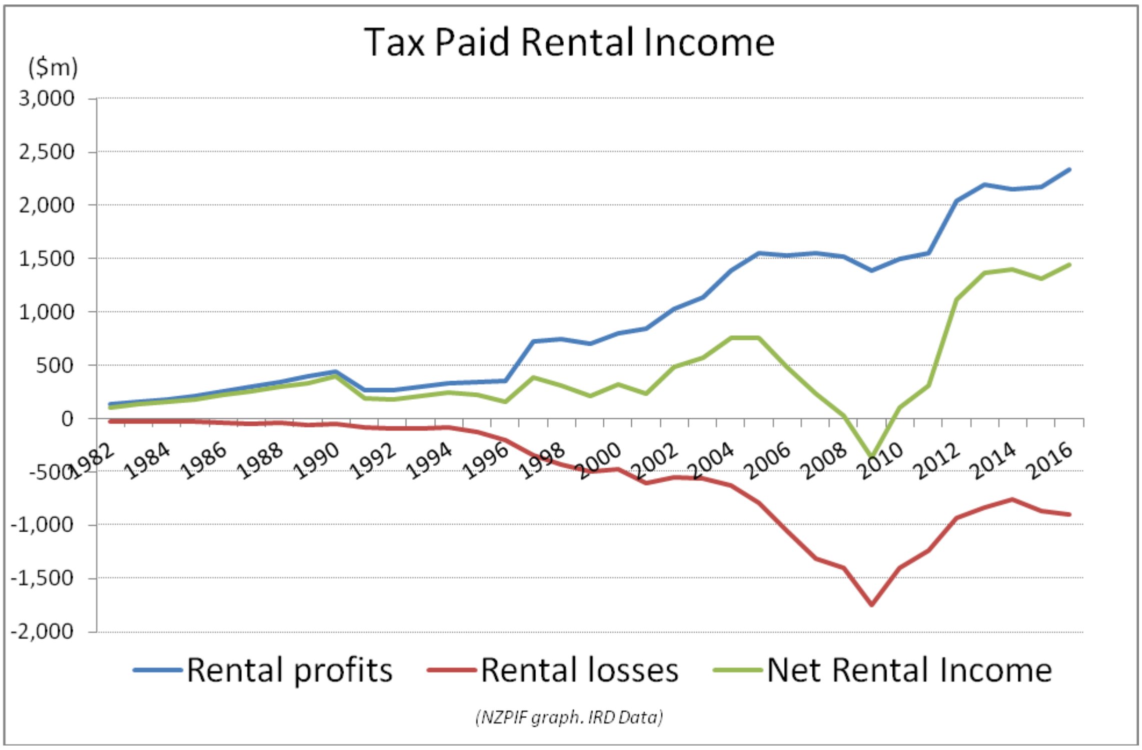
The 2010 Tax Working Group claimed that rental property lost $500m a year and therefore was a net tax taker rather than a tax payer. This was repeated so often that it is still believed to be true by many.

However the 2010 TWG's own information showed that rental property only made a loss in two of the past 27 years. Updated IRD information shows that the rental property industry actually only made a loss in one year since their records started in 1981.

The reason for the loss was a peak in mortgage interest rates during 2008 which could not be passed onto tenants through higher rents. This demonstrates that rental property owners protect tenants from interest rate fluctuations.

The following graph 1 is an update of the 2010 TWG's graph, showing that the rental property industry pays tax on approximately $1.4 billion of rental income a year.

As such the rental property industry pays a considerable amount of tax, with the level of tax appearing to be increasing.



Graph 1

Balancing the productive and speculation sectors

Rental property is a major part of the New Zealand economy, not only providing shelter for a third of the population while also paying tax and supporting many other industries.

The rental property industry employs lawyers, accountants, property managers and various trades people. The industry spends money on rates, insurance, repairs and maintenance, all of which attract GST.

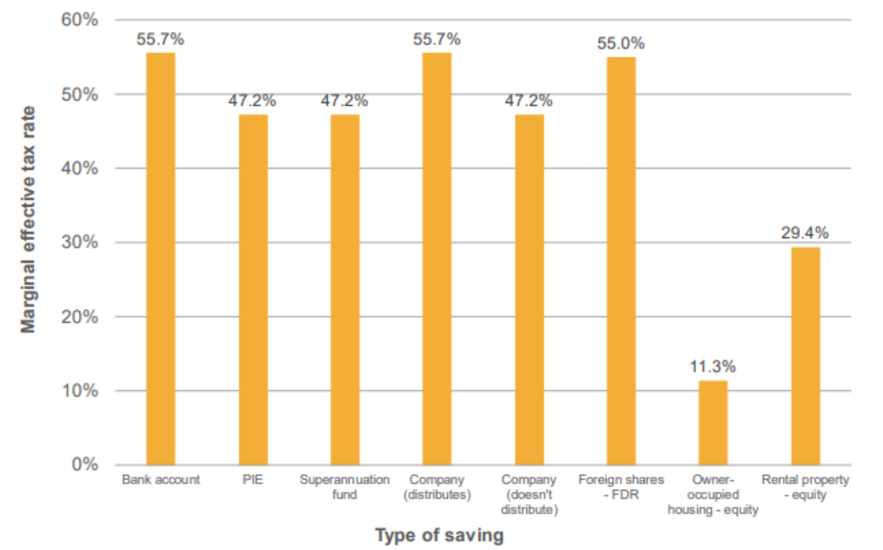
The rental property industry is definitely part of the productive economy and not the speculative economy as appears to be assumed.

Marginal Effective Tax Rates

The following graph is taken from the Tax Working Group's background paper the Future of Tax. It purports to show the marginal effective tax rates for a variety of assets.

Apart from rental property, other assets METR ranges from 47.2% to 55.7%.

Figure 21: Marginal effective tax rates on savings



Source: Treasury/IRD analysis

This information led the Tax Working Group to conclude that "owner occupied and rental housing is undertaxed relative to other assets."

However there are some major errors with this study, as pointed out in a report by finance and economic consultants, Morgan Wallace. (Attached)

A key error is that while PIE funds, Superannuation funds and companies have a capital growth element to them, this has not been accounted for in the study. Only property has capital growth as a factor, which is the prime reason why the stated METR is so low.

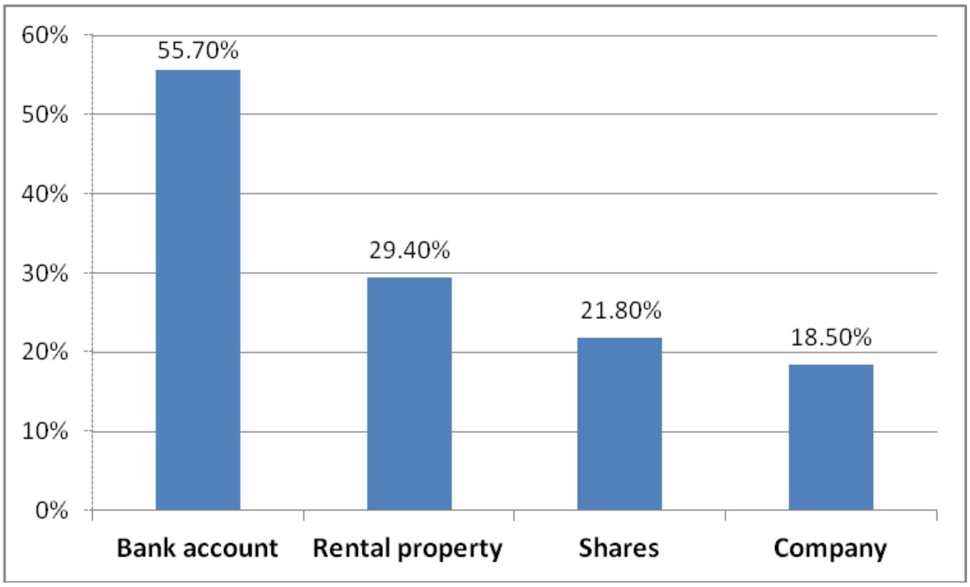
More than this, the study treats PIE Funds, superannuation and companies like bank deposits, not only assuming they don't increase in value, but that they actually lose value due to the effects of inflation. This incorrectly increases their METR.

Another point is that the study omits to include shares as an asset. Clearly share prices are a key part of share investment, which is why the changing price of shares is promoted on a daily basis by the finance industry. Morgan Wallace said that "If this asset class were to be included, it would have a lower METR than rental property under the TWG Paper framework."

Morgan Wallace state that the study "cannot therefore be accepted at face value. If a capital return component were to be included for PIE, superannuation and company investments, then all three would have lower METR than presented in the TWG research paper."

If the study included shares and correctly treated companies the same as rental property, then rental property has a higher METR than shares or companies.

The following graph shows the METR for these assets when capital return is included in all assets that have a capital growth component.



The TWG background paper says that "there may be room for improvement to make our current system more consistent". The clear implication of this (using incorrect information) is that rental property should be taxed more than other assets to increase its METR. Clearly this would be a mistake and distortionary.

Fairness and balance

The TWG asks "does the tax system strike the right balance between supporting the productive economy and the speculative economy".

Although the financial services industry frequently says otherwise, rental properties are a substantial part of the productive economy.

The current tax system appears to be reasonably balanced, however there is a case towards better implementation of tax policy.

While there is a property compliance team within the IRD to ensure property traders pay their fair share of tax, no such division exists for share traders.

Similarly, while there is a Bright Line Test for property, no such test exists for shares.

Tax revenue could be increased by implementing a bright line test for shares which could then be used to reduce income tax for companies so they are more in line with other countries.

Can tax make housing more affordable

Some believe that taxing rental property will make housing more affordable by discouraging rental property purchases and thereby reducing demand for property overall. This is not correct.

It is already difficult to purchase and provide a rental property to a tenant. Table 1 below is a budget for buying and renting the average New Zealand home to a tenant. It also compares the cost of renting the average NZ home to owning it.

This example allows for a 10% cash deposit of $53,000 (meaning the other 25% must come from equity in other assets) and yet the rent does not cover outgoings.

New Ring Fencing laws already encourage higher rental prices. To break even, the weekly rent would need to be $760pw or the deposit would need to be $185,000.

Even without a first home owner paying off any mortgage principle, it is still $79 per week cheaper to rent than own the average NZ home. This indicates that rental property is good value but also that there is room for rental prices to increase.

Increasing rental property tax will lead to higher rental prices. If it doesn't initially, then it will lead to a reduction in supply of rental properties which ultimately will lead to higher rental prices.

Saving a deposit is the hardest part for first home owners. Rent is often the most significant cost for those saving for a home of their own, so higher rental prices will make this task even harder.

Tax rules for rental property are not the cause of any housing unaffordability, therefore increasing property taxes will not help affordability.

Countries with extra housing taxes compared to New Zealand have also had high house price increases. If tax does not stop property price increases in these countries, tax will not stop property price increases in New Zealand.

Table 1. Cost of providing the average NZ home as a rental plus cost comparison between renting and owning the average NZ home

NZPIF Study, December 2017

		Rental Owner			Home Owner
Property Value (REINZ NZ Median house price)		**$530,000**			$530,000
Chattels value	4%	$21,200			
Deposit / Investment	10.00%	$53,000		15.00%	$79,500
Mortgage		$477,000			$450,500
Mortgage Interest rate (Average of the four main banks floating rates)		5.86%			5.86%
Weekly Rent (national upper quartile rental price)		**$560**			
Annual rent		$29,120			
Annual Expenses				Term of mortgage	
Mortgage	Interest only	$27,952		25	$34,370
Insurance		$1,000			$1,000
Rates		$3,000			$3,000
Property Manager (incl gst)	8.0%	$2,330			
Other		$500			$500
Maintenance as % of rent	8.0%	$2,330			$2,330
2 week vacancy provision		$1,120			
Total expenses		$38,231			$41,199
Chattels depreciation claim at	10.0%	$2,120			
Tax Refund/Payable	33.0%	-$3,706			
Landlords cost before Ring Fencing		-$5,405			
Landlords cost post Ring Fencing		-$9,111			
Homeowners cost above renting				Annual	$12,079
				Weekly	$232
Homeowners cost above renting with no principle repayments				Annual	$4,109
				Weekly	$79

Capital Gains Tax

New Zealand should not introduce a Capital Gains Tax (CGT). Our economic system is based on capital gains not being taxed and the introduction of such a tax would have a significant negative effect on the economy. We need to encourage people to save in a variety of ways rather than spend all their their income. A CGT would have the opposite effect.

A CGT has not stopped property price escalation in countries that have such a policy and there is no evidence that New Zealand will be any different.

Research suggests that it is relatively difficult to administer and does not raise significant tax revenues. Such a tax can also have a negative effect on the volatility of tax revenue, with people generally not selling during economic slowdowns thereby reducing CGT revenues.

The two year Bright Line Test was introduced to ensure property speculators and traders paid their fair share of tax. The NZPIF reluctantly accepted this, despite the policies additional effect on rental property providers. However the extension of the test to five years directly affects rental property providers and in effect has become a pseudo CGT just for rental property. Without any hardship clauses, this is very unfair as a lot can happen over a five year period.

Excluding primary residents would greatly reduce the potential tax revenue from a CGT. In addition, excluding primary residents would discourage investment in other assets whose capital increases were taxed, in favour of overcapitalising their own homes.

New Zealand currently has an undersupply of rental property that has led tenants to comment about lack of choice and high rental prices. A CGT would reduce the return on all rental property and raise rental prices. A CGT would discourage the provision of rental property when we need more of it.

Rental price increases have been higher than general inflation for a number of years. This is due to previously introduced and adverse legislation such as removing depreciation allowances, LVR restrictions and minimum standards plus two High Court rulings and cost increases for insurance, rates, repairs and maintenance. A CGT would add to the difficulty that many are having in providing homes to people.

Land Tax

A land tax excluding the family home would be distortionary and should not be introduced. It would encourage homes with large plots of land which would not be in the best interest of many areas in New Zealand, but particularly in areas like Auckland.

A land tax would increase business costs which would increase the price of all goods and services to all New Zealanders.

It would be complicated for mixed use premises, such as home and incomes, mixed-use commercial/residential properties and farms. It would also be difficult for properties that move into and out of being taxed due to their changing use.

A land tax would increase the cost of providing rental property leading to either a reduction in supply, an increase in price, an increase in overcrowding or a likely combination of all three.

A land tax would be hardest on tenants making it harder for them to save a deposit and become homeowners.

Because it would not apply to all assets, a land tax would be distortionary to property investments.

Conclusion

Our broad based taxation system works well, providing tax revenue to pay for essential services that our country needs.

The provision of rental property contributes to the productive economy and pays a fair share of tax. Increasing property tax would not be equitable and the burden would mostly fall on tenants.

A case could be made to ensure share traders pay their fair share of tax by including shares in the Bright Line Test and introducing a share traders compliance unit within the Inland Revenue Department.

The introduction of a CGT or Land Tax would not make housing more affordable, but it would make rental property more difficult to provide at a time when we need more of it. Rising rental prices through higher costs and taxes would make it harder for tenants to save a home deposit, thereby making housing less affordable.