Inland Revenue
Te Tari Taake

17 June 2019

S Devoy
fyi-request-10329-499a4bf2@requests.fyi.org.nz

Dear S Devoy

Thank you for your request made under the Official Information Act 1982 (OIA), received on 17 May 2019. This request followed on from your previous request for information related to the value of tax losses per annum from residential rental properties owned by LAQC and LTC entities. You requested the following:

> *Please define what is meant by the terms "tax effects" and "flow through amounts".*
>
> *What were those "tax effects" in dollar amounts annually for the years 2003 through 2017?*

The phrases "tax effects" and "flow through amounts" were both used in a footnote to the table supplied in my response to your previous OIA request. The footnote stated:

> *"Only the net value of gains and losses are provided and not the tax effect. The tax effect can be calculated using a generic average tax rate of 29% for flow through amounts."*

The intent of the footnote was to make it clear that the numbers in the table related to the loss or gain from rental property, and not the impact that any loss or gain would have on a tax assessment.

As an example, the current company tax rate is a flat rate of 28%, which is paid on company profits. If a company received $100,000 of income throughout the year, but also incurred $30,000 of losses, the company would pay tax on the $70,000 profit, equating to $19,600. In this case, the effect the loss had on the tax assessment would be $8,400, being 28% of the $30,000 loss.

However, for LAQC's, tax losses could be passed through to the shareholders, meaning the shareholder could get the immediate tax benefit of the loss, rather than the LAQC. Generally, LAQC gains were kept in the company and attracted the company tax rate. If the company rate differed from the underlying shareholder rate, any over or under taxation of the gain was later addressed through the imputation credit system when dividends were paid to shareholders.

The "flow through amounts" for LAQC's were generally losses, being what flowed from the LAQC to the shareholder. The LAQC gains only became shareholder income once the company profits were distributed as dividends.

LTC's are different, in that both profits and losses immediately flow through to shareholders and are taxed directly in the shareholder's hands. The company itself does not pay any company tax.

Assuming a shareholder was an individual, as individuals are taxed using "progressive tax rates", rather than the flat company tax rate, calculating the "tax effect" referred to in the footnote will change depending on the income level (and therefore the tax rate) applied to each shareholder.

Your new request specifically asks that the tax effects for each year be supplied. To calculate the exact tax effect for each year would not be possible as the underlying shareholders of each LAQC or LTC would need to be identified. Inland Revenue would also need to know each shareholders' relative shareholding, and, in the case of LAQC's, whether a dividend had been paid to them, and when. This aspect of your request is therefore refused under section 18(g) of the OIA, as the information is not held by Inland Revenue.

However, we can supply an approximation to calculating the tax effect, as suggested to you in my response to your original request, where we recommended that 29% would be a good approximation to use to calculate the tax impact. This weighted average rate allows for shareholders to be on different personal tax rates.

For the income years 2011/12 onwards, we have used an average tax rate of 29%. The personal tax scale has changed in the period of interest, so we have used 31% for the 2010/11 year and 34% for earlier years. Implicit in the use of these average personal tax rates is an assumption that any LAQC gains were eventually passed through to shareholders as dividends.

The tables in appendix 1 (attached) show the number of LAQC's and LTC's with active income tax returns, the net rental profit and loss for those entity types, and the estimated tax effect of the rental profits and losses for the underlying shareholders.

Thank you for your request. I trust that the information provided is of assistance to you.

Yours sincerely

Sandra Watson

Sandra Watson
Manager, Forecasting, Revenue Forecasting

Appendix 1

Note:

- Since my previous response, we have updated the data relating to total net rental profit and loss for LAQC's. The updated data has been used to calculate the tax effects of rental profit and loss.

	Number of LAQC's/QC's with active returns			LAQC rental income $m			
Year ended 31 March	Number of returns with net rental profit	Number of returns with net rental loss	Total entities reporting rental income	Net rental profit $m	Tax effect of rental profit $m	Net rental loss $m	Tax effect of rental loss $m
2003	700	3,160	3,860	29	10	-47	-16
2004	840	5,460	6,300	39	13	-88	-30
2005	980	7,710	8,690	41	14	-145	-49
2006	1,140	10,490	11,630	50	17	-211	-72
2007	1,300	13,500	14,800	73	25	-289	-98
2008	1,410	15,900	17,310	70	24	-413	-141
2009	1,540	17,840	19,380	64	22	-510	-174
2010	1,950	19,200	21,150	86	29	-437	-149
2011	2,320	19,390	21,710	76	24	-395	-123
2012	3,670	5,160	8,830	118	34	-70	-20
2013	4,200	4,860	9,060	160	46	-57	-17
2014	4,610	4,580	9,190	149	43	-49	-14
2015	4,540	4,770	9,310	157	45	-58	-17
2016	4,810	5,060	9,870	184	53	-63	-18
2017	5,140	4,790	9,930	214	62	-56	-16

	Number of LTC's with active returns			LTC rental income $m			
Year ended 31 March	Number of returns with net rental profit	Number of returns with net rental loss	Total entities reporting rental income	Net rental profit $m	Tax effect of rental profit $m	Net rental loss $m	Tax effect of rental loss $m
2003	-	-	-	-	-	-	-
2004	-	-	-	-	-	-	-
2005	-	-	-	-	-	-	-
2006	-	-	-	-	-	-	-
2007	-	-	-	-	-	-	-
2008	-	-	-	-	-	-	-
2009	-	-	-	-	-	-	-
2010	-	-	-	-	-	-	-
2011	-	-	-	-	-	-	-
2012	1,080	11,860	12,940	10	4	-114	-33
2013	1,980	12,300	14,280	19	6	-107	-31
2014	2,860	12,370	15,230	28	10	-102	-29
2015	3,000	13,300	16,300	32	11	-120	-35
2016	3,600	13,940	17,540	40	14	-133	-38
2017	4,770	13,650	18,420	55	19	-122	-35