

Email to release

From: David Hargreaves
Sent: Tuesday, 24 March 2015 11:50 a.m.
To: Grant Spencer
Cc: Bernard Hodgetts; Chris Bloor; Sarah Drought
Subject: FW: housing and tax

Hi Grant

Bernard said you needed a bit of info on tax and housing for the speech. I put this together – happy to answer any further questions.

Cheers,
David

What has changed with tax policy on rental properties in last decade?

- Tougher depreciation rules reducing loss that can be claimed.
<http://www.winkerr.co.nz/pdf/taxation/Tax%20on%20Rental%20Properties.pdf>
- Switch from LAQC to LTC (impact of this is pretty limited as far as I understand it – not an effective ring fence).
<http://www.stuff.co.nz/business/small-business/4318735/How-to-hang-on-to-LAQC-tax-losses>

Does this address the fundamental issues?

- Investor housing is treated similarly to other investments like shares, but both are treated in a way that makes them more tax efficient than having cash in the bank, or borrowing to own an owner occupied property. It is easier to gear investor housing than shares so the tax benefits of housing are much more relevant for many investors.
- Owner occupied mortgage-free housing is also heavily tax favoured (relative to say renting and having a large fixed income portfolio).
- In other words, our concerns from blue sky period have not really been resolved. Similar concerns were aired by McLeod report and VUW tax working group.
- The productivity commission tended to de-emphasise tax changes as a solution to the housing market issues. It didn't really disagree with the points above, but considered it would be better to look at interest deductibility and income tax in a more fundamental way rather than put fixes in to address housing issues specifically.

Possible further options

- Ring fence losses from rental property ownership. This would eliminate a lot of the tax benefits for a heavily leveraged investor. However a debt free or low-debt investor (not making losses) would still be much better off from a tax perspective than someone with a term deposit. This is because their eventual capital gains on sale are not typically taxed. (Over say 20 years with positive inflation, there are likely

to be capital gains even if real house prices are flat or falling). Arguably second best relative to more fundamental changes, but common in other OECD countries.

- Fundamental changes in tax system. These are typically not seen as politically feasible, so perhaps not worth floating anything specific – might be better to generally cite VUW working group report suggestion that base should be broadened in some way.
 - institute comprehensive capital gains tax or land tax,
 - switch to risk-free return method taxation of property (or indeed all wealth – this was (part of) the Gareth Morgan “big Kahuna” idea).
 - Tax imputed rental income of owner occupiers
- Other possible incremental shifts
 - Stamp duty. This is quite distortionary particularly for owner-occupiers (but could be considered for investors only).
 - Revisit property rates. A larger rates impost effectively acts like a larger risk-free return tax on property. Could be used to fund some services currently provided by central government, facilitating cuts in other taxes. Favoured by productivity commission. Could potentially ‘target’ Auckland since Auckland has large planned infrastructure spend.

David Hargreaves
Manager, Macrofinancial Policy
Macrofinancial Department
Reserve Bank of New Zealand