

Auckland Property Investors Association Incorporated

Submission on the Taxation (Annual Rates for 2022-23, Platform Economy, and Remedial Matters) Bill (No 2)

02 November 2022

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1. Recommendations

1.1. Auckland Property Investors Association Incorporated ("APIA") welcomes the opportunity to give feedback on the Taxation (Annual Rates for 2022-23, Platform Economy, and Remedial Matters) Bill (No 2) ("the Bill"). Our comments relate to clauses 98 and 100 of the Bill. We make the following recommendations to this committee:

- In the first instance, the Bill repeals interest deductibility limitation on residential land in its entirety.
- Alternatively, the Bill
 - broadens its definition for 'build-to-rent land' ("BTR") to capture more residential dwellings; and
 - creates a new category of excepted residential land that would restore perpetual interest deduction to any residential dwelling where the owner/manager offers at least ten years tenancy and personalisation options on the same terms as BTR.
- Insofar as aspects of the Bill relate to the Residential Tenancies Act 1986 ("the RTA"), it adopts languages consistent with the RTA.

2. Introduction

2.1. APIA is a non-profit advocate and education facilitator for Auckland residential property investors (landlords).

2.2. The rental sector is critical to New Zealand's housing story. At the time of the 2018 Census, over 1.4 million people were living in rental housing¹. The sector's significance in its size and scope necessitates a vision that it should be well-run, professional and a thriving environment for landlords and tenants. Since our inception in 1995, we have oriented our work around these goals.

2.3. We act as a collective voice for landlords who provide over 200,000 rental homes across Auckland. We connect over 7,000 residential property investors and represent the interest of over 700 members.

¹ Stats NZ (2020), 'Housing in Aotearoa: 2020' www.stats.govt.nz, New Zealand, 2021, 38. Accessed 02/11/2022

- 2.4. This document set forth our thoughts on the Taxation (Annual Rates for 2022-23, Platform Economy, and Remedial Matters) Bill (No 2). Comments and recommendations are provided on issues relevant to our members and based on results collected from a recent survey designed for this submission.
- 2.5. A summary of the survey results is set out in the accompanying appendix.

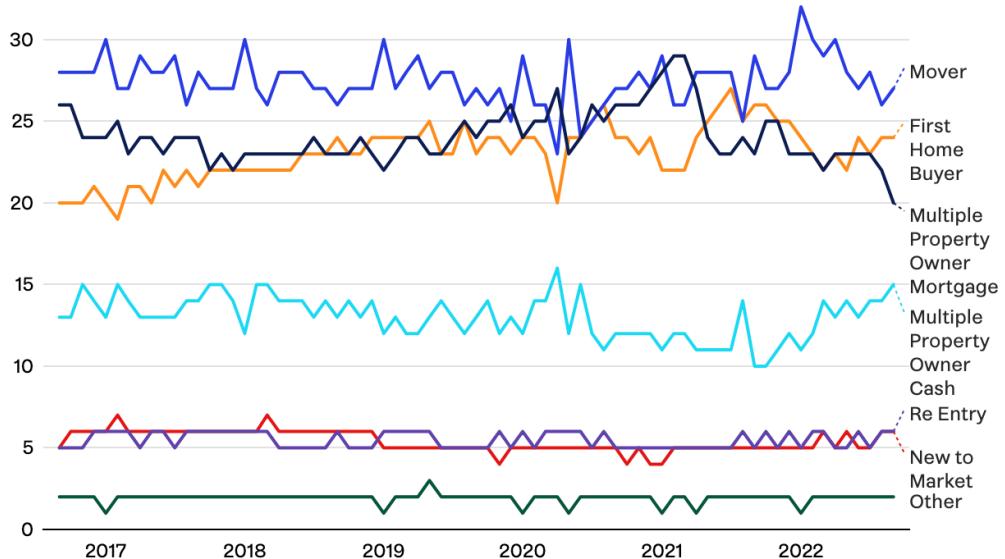
3. General Comments

3.1. Interest deductibility limitation is unprincipled, its economic basis outdated and should be repealed

- 3.1.1. APIA supports repealing the interest deductibility limitation rule for residential land. Our general position is that interest is a legitimate business expense irrespective of the nature of the business, and as such, deductibility should naturally follow.
- 3.1.2. Limiting interest deductibility reduces rental housing supply. The ensuing cost pressure on landlords will inevitably flow onto tenants through increased rents and/or compromised services (such as maintenance and repairs).
- 3.1.3. One of the stated objectives for interest deductibility limitation is to dampen investor demand for existing housing stock. The current economic conditions are no longer as they were in March 2021 when the rule was first introduced. Market forces and financing restrictions are already placing natural limits on investors' activities. To wit: Corelogic's latest buyer classification data shows mortgaged multiple property owners' activities to be at a 20 year low².

² Cann, Geraden. 'Investors requiring mortgages for next home least active in 20 years.' *Stuff*, 18 Oct. 2022, www.stuff.co.nz/business/property/130139857/investors-requiring-mortgages-for-next-home-least-active-in-20-years. Accessed 02 Nov. 2022.

Proportion of property purchases by different buyer groups



Source: CoreLogic buyer classification data

3.1.4. Arguably, there is no longer a policy basis for interest deductibility limitation, and the rule itself is outdated.

3.2. Disruption to rental housing supply should be kept at a minimum, and all developers appropriately incentivised

3.2.1. If the interest deductibility limitation rule is preserved, then we agree with the Government's position that it should not stymie rental housing supply. Overall, we support reasonable carve-outs to promote quality rental housing supply in New Zealand.

3.2.2. BTR developments are not the exclusive suppliers of quality rental housing. Smaller-scale developments and those under private ownership are equally capable of providing the same standard of housing. Accordingly, we believe that the Bill's carve-out should include all new rental housing stock providers, irrespective of the number of dwellings supplied.

3.2.3. Additionally, we concur with the IRD that '[t]here is nothing inherent in BTR that makes it different from other residential rental property,

apart from scale.¹³ BTRs should receive the same tax treatment as new build land. If perpetual interest deductibility is restored for BTR, so should it for new build land.

3.2.4. As things stand, BTRs (along with new build land) are already entitled to interest deductibility throughout their construction periods and 20 years after completion. Any further allowance for deduction after this 20-year period would unlikely yield additional incentive for BTR developers in a material way.

3.3. Tax rules should be simple, efficient and fair to promote compliance

3.3.1. The BTR carve-out, as provided by the Bill, creates tax complexity to the extent that it would diminish the overall level of compliance and create additional resource pressure on the IRD to maintain the integrity of our tax system.

3.3.2. As one of our survey respondents states, '... simple tax encourages compliance; complicated tax encourages non-compliance, either inadvertent or wilful.' We urge this committee to critique and improve the Bill through the lens of tax simplicity.

3.4. Restoring perpetual interest deduction to any owner who offers long fixed-term tenancy would go a long way to promote tenants' security of tenure

3.4.1. In a statement given on the 12th of August 2022, the Housing Minister, Hon Dr Megan Woods, outlined the critical nature of security of tenure and signalled that it would be bedded into the design of the BTR carve-out: "To qualify, developments need to offer tenants leases

¹³ Inland Revenue Department. 'Regulatory Impact Statement: Comparing options to support build-to rent.' IRD, 11 Aug. 2022, taxpolicy.ird.govt.nz/-/media/project/ir/tp/publications/2022/2022-ria-perm2-bill/2022-ria-7-optons-build-to-rent.pdf?modified=20220902032721. Accessed 02 Nov. 2022.

of at least 10 years... We believe the security of tenure is critical for people who are renting." ⁴

3.4.2. Security of tenure under the right circumstance is a benefit that goes both ways. Landlords also consider long-term tenancies to be critical and desirable. Though we support the Government's effort to promote security of tenure, we are also cognisant of the fact that most tenants in New Zealand do not currently live in BTR rentals. Protecting and preserving the security of tenure for the minority will have little or no effect on the majority's interests and, indeed, their outcome. As things stand, the Bill will unlikely achieve security of tenure for most tenants in a meaningful way for some years.

3.4.3. In the interim, security of tenure is no less critical for tenants and landlords. We think the more effective way to achieve security of tenure is to immediately restore perpetual interest deductibility to any owner who offers fixed-term tenancies of at least ten years with personalisation and early termination options for the tenant.

3.5. Maintaining a consistency of language across interrelating statutes will promote certainty and minimise disputes

3.5.1. We note that aspects of the Bill which relates to tenancy deviates from the language of the RTA.

3.5.2. To avoid confusion and promote consistent interpretation and compliance, we recommend that the language of the Bill mirror that of the RTA where appropriate.

4. Specific recommendations

4.1. That the interest deductibility limitation on residential land be repealed

⁴ "Tax incentives to boost long-term rental supply." Beehive, 12 Aug. 2022, www.beehive.govt.nz/release/tax-incentives-boost-long-term-rental-supply. Accessed 02 Nov. 2022

4.1.1. We recommend that this committee inserts into the Bill a clause that repeals subpart DH of the Income Tax Act 2007 to the effect that it would restore perpetual interest deduction to all residential land.

4.2. If interest deductibility limitation is preserved then the definition for BTR is broadened to capture more residential dwellings, and a new 'long-term tenancy land' asset class be created and added as excepted residential land

4.2.1. We recommend that clause 98(3)(a) be amended to read: "means land to the extent to which, together with any other contiguous land owned by the same person, has one or more dwellings used, available for use, or being prepared or restored for use, as dwellings occupied under a residential tenancy to which the Residential Tenancies Act 1986 applies or would apply, if -"

4.2.2. We recommend the creation of 'long-term tenancy land' as a new asset class under clause 98 and that it is inserted as item 12 under clause 100 which would effectively restore perpetual interest deduction to any residential land with one or more dwellings where the landlord or manager offers tenancies on the same terms as is required of BTRs per clauses 98(3)(a) and (b).

4.3. That the Bill adopts RTA phraseologies where appropriate

4.3.1. "We recommend that clauses 98(3)(a)(i)(C) and 98(3)(a)(ii)(C) be amended to read: "the tenancy provides that a tenant may terminate the tenancy by giving at least 56 days' notice, without penalty."

5. Conclusion

5.1. APIA is grateful for the opportunity to provide feedback on the Taxation (Annual Rates for 2022-23, Platform Economy, and Remedial Matters) Bill (No 2).

5.2. While we support the Bill's overall objective to mitigate the effects interest deductibility limitation has on rental housing supply, we urge this committee to

- (re)consider the (ongoing) relevance and validity limiting interest deductibility for residential land;
- take into account broader, more effective ways to incentivise rental housing supply and promote security of tenure; and
- maintain consistency of language across interrelating statutes to promote certainty and minimise potential disputes.

5.3. We wish to speak to our submission and look forward to interacting with this committee in due course.

Yours sincerely,
Sarina Gibbon, General Manager
Auckland Property Investors Association

Appendix: Summary of results from survey conducted between 1 October 2022 and 31 October 2022

Total survey respondents: 279

1. On the question of *Do you think providing 20 or more dwellings is a fair trade-off for build-to-rent land owners to be able to deduct interest in perpetuity?*

92.2% of survey respondents answered *No*

6.5% answered *I don't know/I don't feel strongly one way or another*

1.3% answered *Yes*

2. A selection of fairer trade-offs for perpetual interest deduction as suggested by our survey respondents include:

"Interest deductibility should be restored for all investors. Failing that, the threshold should be lowered to broaden the base of parties able to claim deductibility and thereby increase the potential supply of long term tenancies."

"It would be a fair trade-off to simply provide any rental property irrespective of whether it is an existing dwelling or newly built."

"What should number of properties have to do with it? How about exempting specific property types. Types of properties exist that cannot be occupied by owner occupiers, than can only be sold to investors. With no interest deductibility on these properties they are not useful to anyone. First home buyers (who this change is supposed to "help") will not buy them. The only impact is increasing costs on landlords and in turn, tenants."

"No, either all landlords should qualify for Interest deductibility or none. All other businesses can claim interest on their business lending but now we can't. We are professionals running a business providing rental accomodation for those who require it and the cost of interest is one of our expenses that should be deductible."

"Simply provide any number of rental properties (new or existing) but all to the Healthy Homes standard for the benefit of the tenant"

"Any rental property irrespective of whether it is an existing dwelling or newly built should qualify for interest deductibility, they need to be consistent with the tax on businesses deductibility across the board, being an investor who manages a property portfolio is a business, and you have the same expenses of operating any business interest deductions should have never been made exempt in the first place, which hunt for property investors, ridiculous."

"Any BTR property or existing that would not essentially fall under the First Home Buyer description should have interest deductibility in perpetuity. for example, blocks of flats or dual-key dwellings."

"A fair trade off is that if you provide the service of a residential dwelling under a residential rental agreement, this is a business activity and has become increasingly regulated as such. Therefore, these businesses should be taxed like any other business. The deductibility of interest is a fundamental principle of tax law and should not be limited to any particular landlord. These structures have been set up to provide long term stable homes for people needing rental accommodation, and the limitation of interest will only increase the cost and limit the supply of this accommodation. Limiting interest deductions will also disincentivise, larger improvements to these properties for the betterment on tenants and the wider community."

3. On the question of *What effect, if any, would interest deduction for build-to-rent land owners have on security of tenure?*

58.1% of survey respondents answered *No effect*

18.6% answered *Tenancies would become longer*

16.9% answered *I don't know*

6.5% answered *Tenancies would become shorter*

4. On the question *Instead of a myriad of exceptions and exemptions, do you agree that the interest limitation rule on residential property investors should be abolished/reversed altogether?*

100% of survey respondents answered Yes

5. A selection of additional comments from the survey respondents include:

"I'd be happy to offer 10yr tenancies too, but nobody has asked me to. If this govt was really all about security of tenure, why doesn't it offer interest deduction for any landlord offering 10yr tenancies?"

"Beggars belief that they 'close a loophole' only to open it to for a select few, including overseas investors. Thought they were all about equality. Distorting market values with division of properties into categories that either do or don't qualify for interest deductions. If introducing interest limitation should be for all properties purchased after the introduction date - that wouldn't have the same impact people who have made purchasing decisions based on old rules. Imagine someone who has to sell as can't afford to keep without interest deduction, forced by government policy to sell into a down market that's crashed due to government CCCFA legislation and overspending and RB ineptitude at managing OCR / inflation. Could easily be looking at a loss thanks essentially entirely due to government actions."

"Skewing the tax system in favour of institutional investors seems likely to achieve some of the government's objectives esp an increase in the supply of longer term tenancies but will make it harder for small investors to compete which could lead to small investors exiting the tenancy market (probably slowly over a long period as it will take time for the impact of the competitive advantage being given to institutional investors to be felt, many people will be caught by the bright line test and it also takes time for people to change long held patterns of investment and behaviour). The overall effect on the number of tenancies is anyones guess at the moment (has the government done any modelling or are they just hoping for the

best?) but could be negative if the number of units added by institutional investors does not exceed the number sold by small investors. Also, this is likely to change the mix of properties being offered with an increase in the supply of small dwellings such as newly built apartments being offered by institutional investors and a reduction in supply of large "existing" dwellings typically offered by small investors. That will make it harder for larger families."

"It has created a very unfair tax system that promotes further division of the wealthy & corporates (that can afford to do large developments) and smaller scale investors. This widens the wealth gap."

"Interest deductibility is not a loophole. It is a legitimate business expense. If the government genuinely thinks it is a loophole then why don't they make ALL interest for EVERY business in NZ non tax deductible. What do you think will happen to those businesses then? What do you think will happen to the prices that those businesses charge for their goods and services? If you guessed that they will pass those costs on to the consumer then you will be correct. I feel very sorry for my remaining tenants as I have been forced to put up my rents in order to pay a tax bill for making a loss - ... I have increased rent from \$385 to \$510 pw for one property and from \$410 to \$560 p/w on another property since Labour came to power in 2017 just to try and cover some of the cost increases they have burdened me with."

"All our properties are available longterm if required by tenants. Currently we have 2 tenancies that have been there over 12 years and rent well lower than the current market rent... and they can stay as long as they want going forward. Why should I not get my interest deductibility reinstated?"

"simple tax encourages compliance; complicated tax encourages non-compliance, either inadvertent or wilful. all business deduct interest, why is property investment (not trading) any different? us v them policies are divisive, new v existing doesn't matter to tenants, 21 v 19 is arbitrarily

irrelevant, 10yr v 1yr repeated ten times is the same, private landlords still provide the most tenancies in NZ all of these criteria artificially skew the market, in different but interrelated ways, and the cumulative effect will be to encourage less landlords, less owners, and higher rents”

“By including only those situations in which 20 or more houses can be built, the proposed change excludes most if not all small investors who wish to subdivide their land and install rentals. This would reduce the feasibility of increasing housing density in cities and encourage the changing of farm and garden land on the outskirts of cities to residential rental properties, thus increasing demand for food while reducing availability of close land to grow this food.”

“When interest rates were at 2% and we had runaway house prices, you could see some arguments for interest limitation. Now with interest rates back at or above ‘normal’ levels and house price decline, there is no argument for it. Abolish this law.”

“If interest limitation does not get abolished rental stock numbers will decrease and rents will increase. Marginal groups will find it more difficult to get housing. Government waiting lists for social housing have ballooned and will continue to increase. Private landlords are a key part of the housing solution - we are not the problem but have been demonised by the Labour Government who have run a narrative fueled by politics of envy.”