Tax Working Group Public Submissions Information Release

Release Document

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Submission to the Tax Working Group

From: Peter Lewis, [1]
Residential Landlord
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Taxation and Residential Investment Property:

There is much confusion, both in the public mind and the political sphere, between the role of a property speculator and that of a property investor. Many commentators use the terms interchangeably and without distinction, attacking all property people as speculators who they then blame for many of the ills of society.

Landlords are seldom speculators. People who run bookshops do not buy and sell their shops. Similarly, Landlords seldom trade in property. What Landlords do is rent out accommodation. If they do ever sell, they obviously cannot run their accommodation business. Those people who do trade in property are traders, developers or renovators - not landlords, and are taxed on an entirely different basis. I have been a landlord since 1992, and over that 26 years I have never sold an investment property.

Landlords seek to make a profit by renting out a property. Their income is the rent they charge, and like any other business they can then legally deduct the costs involved in running their business before paying tax on that net income. There are frequent demands for the tax loopholes that landlords enjoy to be removed. This never happens - for the simple reason that there aren’t any.

Back in 2007, at a Parliamentary Select Committee hearing, Deputy IRD Commissioner Robin Oliver was asked why people had the impression that there was some tax advantage in investments in rental housing. His reply was blunt: "The short answer is there are none." Yet this myth remains popular and is frequently quoted by those who should know better.
I personally have paid tax every year on the income I derive from my rental properties.

Public perception is that residential landlords are wealthy individuals who dress like the Monopoly Man and drive around in expensive limousines. Wrong. Over 90% of NZ landlords own just one or two rental properties. Thus when people attack and condemn landlords they are not attacking Google or Apple, they are actually criticising their next door neighbour, their plumber or their local school teacher.

The man on the top of the mountain did not fall there. Hardly any of today’s Landlords woke up one morning to find – surprise surprise - that they had got a rental or two overnight without any effort. Acquiring an investment property and then renting it out is, for those of us who don’t win Lotto, a long hard self-sacrificing slog. Landlords, generally speaking, are hardworking, thrifty and goal orientated. These are people that any sane society should cherish and reward, not vilify and punish.

Most tenants have never owned property. They firmly believe that the rent they pay goes entirely into the Landlords pocket and then is spent on overseas trips and flash cars. However, when you do own your own home, you then appreciate that the price of the house is actually only the down payment. Even without any mortgage burden the constant stream of bills for rates, insurance, water, and household services add up to a substantial and unavoidable sum each and every year. All of these costs also add to the tax take by virtue of the GST added to each and every item.

Every Government action creates two after-effects. Costs go up and people alter their behaviour to avoid or minimise the effects of that action. Already, the recent demands put upon rental housing has removed from the market those many houses rented out by owner-occupiers who are off overseas for just a year or two. The expense of making the house compliant now exceed the return. Overtime, if the current trends continue, more and more landlords will sell up and retire. Any tax imposition on and restricted to residential rentals alone will only serve to reinforce this trend.

Bias Against Residential Property Investors:

From the briefing papers supplied, would appear that the researchers have an agenda against rental property. This was the case with the last TWG in 2010 which claimed that rental property took $200m a year out of the tax take when this had only happened once, due to high mortgage interest rates, over a 27 year period.
It will surprise many to learn that according to the latest IRD data, rental property owners have paid tax on rental property income of between $1.3 and $1.5 billion dollars in each of the five years to 2016.

In their background paper "Future of Tax" the TWG say that "property remains under taxed compared to other investments. For instance, any profits from the sale of a long term property investment generally isn't taxed." This is misleading as the IRD has confirmed that similar profits from the sale of shares, farms, businesses and other assets that grow in value are also untaxed. We have had a number high-profile sales of New Zealand companies (such as TradeMe, Icebreaker and 42 Below) to overseas investors with their founders being rewarded to the tune of many millions of dollars. These pay-outs, which massively dwarf any profits that could possibly be made from the sale of a residential investment property, are also entirely tax-free under the current law.

Of most importance is that the TWG uses a study into Marginal Effective Tax Rates (METR) on savings to claim that "Owner occupied and rental housing is undertaxed relative to other assets."

However a just released report by Morgan Wallace, a financial economics consultancy, has uncovered serious flaws with the TWG's study, leading them to conclude that apart from bank deposits, rental property is actually taxed at a higher rate than other asset classes.
A key flaw in the TWG study is that they assume capital growth for property but not for other

capital growth assets. They treat 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.

Morgan Wallace state that "the TWG paper 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."

The TWG also didn't include a key asset class, being direct share investments. Morgan Wallace said that "If this asset class were to be included, it would also have a lower METR than rental property under the TWG Paper framework."

Capital Taxes:

Taxing capital gains is invariably a complicated and expensive exercise. Before implementing the tax you need firstly to determine the types of assets to be taxed and when it will be payable. What real property and when? How about shares, sales of businesses, kiwisaver portfolios, collectable art items, vintage cars? All these hair-splitting decisions would require considerable thought and negotiation, much legal and accounting argument on both sides, and an incredibly complex rulebook.

The likelihood then is that such a tax would be restricted to real property, and with the required exemption of the owner-occupied family home, it would become a punitive tax rather than a means of raising considerable revenue. Such a restricted CGT would never be more than a tiny fraction of total tax receipts and also tend to restrain the movement of both assets and capital around the economy.

Many people have promoted the idea of a CGT as a way of controlling housing costs. Quite why they would expect that putting a tax on something would reduce its price they have always failed to explain. This argument also fails when you consider the rampant housing market in cities such as Sydney, London and San Francisco – all located in countries where a CGT is imposed. Where a CGT exists but owner-occupied homes have been exempt, housing prices have risen rapidly as people have responded by spending the money they would previously have invested elsewhere on renovating and improving their own homes, secure in the knowledge that when they do sell that particular asset there will be no tax to pay.

Obvious Income Tax Avoidance:

There are however some taxpayers who currently appear to be paying less tax than other similar entities for purely historical reasons. These companies compete commercially with other, less tax-favoured entities and thus enjoy an unearned advantage.

Companies owned by charities and Maori Authorities have a tax advantage over their competitors which the Tax Working Group should recommend be closed.

Under the current law companies owned by registered charities are liable to pay zero income tax, even if only a portion (or none) of their income is distributed to the parent charity and the business' activity has no connection to the charitable purpose.

How to Collect a Tax on Capital Transactions:

Many of the tax change suggestions being made are designed to close real or perceived loopholes or minimize avoidance, typically by adjusting or extending the existing system. But there is an idea for something new: a very small tax on monetary flows, also known as a Financial Transactions Tax.

Because the daily flow of money through the banking system is so vast - many millions of dollars every day—a tiny FTT, say, just a few hundredths of a percent, could raise significant money for the Government. Because the FTT would be carried out within the existing banking system, once set up this would require minimal ongoing overhead.

Thus a FTT fulfils the requirements for a highly efficient tax collection system:
- it would be broad-based
- it would be neutral, affecting all taxpayers equally
- it would be convenient and difficult to avoid
- it would be simple to understand
- it would be economic to collect.

This FTT would also capture the sale and purchase of capital assets without the high associated administrative cost of valuing each and every transaction in a similar way that the existing GST impacts on the sale of goods and services. If a property or other asset is sold, the money is banked and the FTT is collected. If a property or other asset is bought the money moves from the purchasers account and FTT collected. Easily implemented, easily collected and the tax on each individual transaction would be so minor that it would probably not even be noticed by the taxpayer.

As an additional benefit, such a transaction tax would also capture monetary flows to international entities that currently largely escape the NZ tax system, such as Google, Facebook and other internet-based traders.

Summary:

Current proposals to shift a substantial part of the tax burden on to capital holdings would be controversial, complicated, and carry high compliance costs.
Politically, such taxes would require substantial parts of the economy to be exempt (e.g. owner-occupied housing).
Existing historic exemptions should be removed.
A Financial Transactions Tax should be introduced that collects from all monetary flows around the banking system as an efficient and cost-effective alternative to Capital Gains or

Wealth taxes.

I would welcome the opportunity to appear in person to be heard before the group to discuss my proposals.

You may contact me to discuss.

Peter Lewis.

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