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# RING FENCING OF RENTAL LOSSES



Written by Rory Noorland, Director

Originally signalled in March 2018, in a discussion document, draft legislation to introduce the ring fencing of rental losses has been released just in time for Christmas. The rules that are proposed will bring to an end the ability for taxpayers to offset losses from a rental property against their other sources of income. The ability to do this has been perceived as an unfair tax advantage to rental property investors and coupled with other recent changes will further discourage involvement in being a land lord.

As background, where a rental property was in a loss making position (often due to interest costs) those losses were able to be offset against other sources of income. This was often structured to allow individuals to utilise the tax loss against

their salary and wage income to receive a tax refund. The loss incurred by the taxpayer in this situation was real and the offsetting of the loss against other sources of income consistent with the principles of the tax system. The removal of the ability to offset rental losses against other sources of income will instead mean that those losses must be 'ring fenced' and carried forward to be offset against future rental profits or income from the taxable sale of land, i.e. under the bright-line test or the subdivision rules.

## Application date

These rules will apply for the 2019/2020 income tax year, for most taxpayers this will mean an application date of 1 April 2019.

## Features

Some of the key features of the proposed rules are:

- It will apply to "residential land" by utilising the definition from the previously enacted bright-line test.
- Much like the bright-line test there will be an exemption for properties used as a main home, properties classed as farm land, land used predominantly as a business premises and certain employee accommodation. There will also be further exemptions for properties that fall under the mixed-use asset rules i.e. holiday homes.
- The rules will apply on a portfolio basis allowing losses from one rental property to be offset against income from another profitable rental property owned within a portfolio.
- Losses that are ring fenced will be carried forward to be used against residential rental income in future years or income from the

taxable sale of land. Any unused losses will remain ring fenced.

- The use of companies or other entities to try and achieve a deduction that would be otherwise ring fenced will be prevented.

## Potential issues

With the legislation being a first draft there is still opportunity for the detail to change but some of the issues that will require consideration are;

- Tracking of losses, will Inland Revenues new system handle this or will it be a taxpayer requirement to maintain a record of the amount of ring fenced loss.
- Ensuring that the rules cope with the complexity of ownership structures for farms such that farm houses provided to employees are not inadvertently captured.
- The possibility that some rental losses may be ring fenced forever if a taxpayer exits ownership of rental properties and never derives future rental income.

## Opportunities

There appears to be very little opportunity between now and the application of the rules. However consideration should be given to bringing forward any repair and maintenance work or deductible expenditure that would otherwise form a future ring fenced loss and claim a deduction in the current income tax year.

If you have any questions or wish to discuss this further, please contact our team at CooperAitken.



We were delighted to be part of the **Morrinsville Christmas Parade** again this year as their major sponsor. The parade is always such a fun afternoon and an awesome community event to be part of. We were lucky enough to have Winnie the Pooh join us this year!

Our team donated and delivered a car load of toys to **The Hits Toy Run** bus that was in town earlier this month. All toy donations gifted to The Hits will then be passed onto St Vincent de Paul to gift to kids in need before Christmas.



## Payday Filing events coming...

We have two upcoming seminars with Inland Revenue on payday filing.

If these might be of interest to you, pop these dates in your calendar and keep a look out for an invitation in January with more details.

**Tues 12 Feb - Morrinsville**

**Wed 13 Feb - Thames**

