Report of the Petitions Committee

Petition of Connor Sharp: Implement a capital gains tax on residential property

May 2022

Contents

Hon Jacqui Dean
Chairperson

Petition of Connor Sharp

Recommendation
The Petitions Committee has considered the petition of Connor Sharp—Implement a capital gains tax on residential properties—and recommends that the House take note of its report.

Request for a capital gains tax on residential properties

The petition was presented to the House on 1 July 2021. It requests:

> That the House of Representatives implement a capital gains tax on residential property in New Zealand.

We received evidence from the petitioner, Treasury—Te Tai Ōhanga, and Inland Revenue—Te Tari Tāke.

The petitioner argues "a buck is a buck" however it is earned

Mr Sharp's central argument is that the lack of taxation on profit made from house sales is fundamentally unfair: "…no matter how someone earns their money, they should pay their fair share". The petitioner believes that the lack of a capital gains tax (CGT) on housing makes it a very appealing investment, increasing demand for properties, preventing first home buyers from entering the market, and driving up rental prices. Mr Sharp worries about the growing waiting list for public housing, and the increase in homelessness as more people are shut out of housing.

The petitioner is concerned that New Zealand's high house prices are discouraging his friends, co-workers, and fellow students from staying in New Zealand.

> The only ones who remain…will be the beneficiaries of a flawed and unfair system inheriting wealth from parents, also untaxed, and becoming part of a new "landed gentry".

He acknowledged that "there are many forms of taxation that may be appropriate for this but I chose a CGT". The petitioner did not explain why he had chosen the CGT.

Mr Sharp referred to international organisations that have advocated for the New Zealand Government to correct the housing market. They include the International Monetary Fund, the United Nations, and the OECD.

What is a capital gains tax?

Capital gain is defined as the profit earned on the sale of an asset which has increased in value over the holding period. New Zealand is one of only a few OECD countries without a comprehensive capital gains tax.

The nature of capital gains taxes, and their rates, vary between those countries that have implemented a CGT. Some, like the United States of America, differentiate between short-term capital gains and long-term capital gains. In the USA, individuals and organisations alike must pay federal income tax on the net total of all their capital gains. CGT in the United Kingdom targets business owners, investors, and employee share scheme participants. The Australian CGT is applied to the capital gain on the disposal of any asset with a few exemptions, such as the family home.

Comparison with other OECD countries

We are aware that 32 of the OECD's 38 member countries have a capital gains tax on residential rental properties. Thirteen members also charge CGT on owner-occupied residential property. New Zealand is one of five OECD members that do not tax capital gains on residential property bought with the intention to let.[1] However, since October 2015, New Zealand has had the bright-line test on the sale of residential property (excluding the main home) if sold within a specified period. The bright-line test is discussed later in this report.

In nearly all OECD countries, inflation over the period during which the property was owned is not taken into account. In most countries where capital gains on rented property are taxed, the level of tax depends on a minimum holding period. This is akin to the bright-line test.[2] If the property qualifies for that holding period, a concessionary or zero tax rate applies.[3]

We note that house prices in New Zealand have experienced one of the largest increases in the OECD over the last 15 years. The OECD's most recent data shows that New Zealand has the third-highest price-to-income ratio for housing.[4]

Current New Zealand tax rules for residential property

Inland Revenue—Te Tari Tāke explained that "the cornerstone of New Zealand's tax system is its 'broad base, low rate' approach". This means that the tax bases for income tax and goods and services tax (GST) are broad, with few exemptions.

Purpose or intention of resale

Although New Zealand does not have a "capital gains tax" per se, Inland Revenue told us that people who purchase items with the intention of reselling them, or are in the business of selling items, are taxed on any capital gains. However, housing is an exception, as is any item that is held over a longer period and appreciates in value, such as shares.

Inland Revenue explained that the existing tax rules mean that sales of land by land developers, dealers, and builders are taxed. The "intention test" also taxes the sale of land that has been acquired for the purpose of disposal, with certain exemptions. In most cases, New Zealanders do not have to pay tax when selling their main home, or a property that has been a long-term rental investment.

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1 The other OECD member countries that do not charge CGT on rented residential property are Chile, the Netherlands, Slovakia, and Turkey.

2 A holding period is the amount of time between the purchase and sale of an asset, and is used to determine the taxes on capital gains or losses.

3 A zero tax rate is a 0 percent tax on capital gains, in this context, from the sale of property.

4 OECD Data: Housing prices.

However, if a person has a pattern of buying and selling the home they live in, the intention test can apply. There is no set number of properties a person can buy and sell before they may have to pay tax on the sale profit.

The bright-line property test

Inland Revenue explained that New Zealand's bright-line test was introduced in 2015 with the aim of strengthening the intention test, described above. It taxes gains from residential land (and the homes on that land) sold within a specified period after its acquisition. The length of the bright-line period depends on when the land was bought.

The tax applies regardless of the person's intention, or their history of buying and selling property. However, there are exclusions for main homes, inherited property, and land transferred under settlements of relationship property.

As of March 2022, section CB 6A of the Taxation (Annual Rates for 2021/22, GST, and Remedial Matters) Act 2022 lengthened the bright-line period. If the sale and purchase agreement for the property became binding on or after 27 March 2021, the bright-line period is five years for certain new build land, and 10 years for all other residential land. Previously, for sale agreements between 29 March 2018 and 26 March 2021, the bright-line period was five years.

Owner-occupied main home

Inland Revenue told us that capital gains on the sales of owner-occupied main homes are not taxed, with two exceptions. Firstly, the "main home" exclusion from the bright-line test can only be used twice in a two-year period. Also, owner-occupiers with a regular pattern of buying and selling residential land cannot use the "main home" exclusion for the land sale rules, including the bright-line test.

Limiting interest on profits gained from residential property

Inland Revenue also explained that any payments an investment property owner receives as rent are considered to be taxable income. However, property owners can deduct some rental expenses from their gross income when assessing how much tax they must pay. Deductible expenses include maintenance and administrative costs associated with the rental property.

Until new legislation took effect in October 2021, interest incurred on any mortgage against the rental property was also considered a deductible expense.[5] If a residential property investor has a gross rental income of $10,000 per year, and their maintenance costs are $3,000, with interest on their mortgage at $5,000, their taxable income under the previous rules was $10,000 – ($3,000 + $5,000) = $2,000. Under the new legislation, their taxable income is $7,000, because interest is no longer deductible.

Interest deductions for residential investment property bought on or after 27 March 2021 ceased immediately. Interest deductions for residential investment property acquired before 27 March 2021 are being gradually phased out until 31 March 2025. Inland Revenue told us that this change is one of the Government's initiatives to address housing affordability.

5 Subpart DH of the Income Tax Act 2007.

Exemptions for new builds and property development

Section DH 4 of the Income Tax Act 2007 provides that interest on land for a new property is deductible for 20 years, after which it becomes non-deductible.[6]

2018/19 Tax Working Group—Te Awheawhe Tāke

Inland Revenue told us that in 2018/19, the Tax Working Group—Te Awheawhe Tāke reviewed the New Zealand tax system, its structure, fairness, and balance.

Most members of the working group agreed that there should be an extension of the taxation of capital gains from residential rental investment properties. It recommended taxing gains and most losses from all types of land and improvements (except the family home and other personal-use assets), as well as shares, intangible property, and business assets.

The Treasury told us that the working group identified that extending capital gains taxation would:

- enhance fiscal sustainability by broadening the tax base
- enhance the tax system's flexibility by allowing for greater future divergence between the company rate and the top personal income rate
- be a source of revenue for additional public services and/or tax reform
- enhance horizontal equity through greater consistency in how income is treated, whether income is from capital gains or labour[7]
- enhance vertical equity (in general, wealthier people earn income from capital gains)[8]
- reduce opportunities for tax avoidance and evasion
- improve the allocation of investment by reducing the tax bias on investment decisions.

The group identified that extending the capital gains tax system could also disadvantage New Zealand because:

- higher capital taxation could discourage some savings and investment
- of inefficiencies associated with a new tax
- greater complexity would produce higher administration and compliance costs.

The Government decided not to adopt the Tax Working Group's recommendation on capital gains taxation.

[6] Section 75 of the Taxation (Annual Rates for 2021/22, GST, and Remedial Matters) Act 2022 inserted subpart DH into the Income Tax Act 2007. Subpart DH relates to interest incurred in relation to land, and applies to interest incurred on or after 1 October 2022 (s DH 2). Due to publishing delays, subpart DH was not yet (as of 6 April 2022) incorporated into the online version of the Income Tax Act 2007, available through legislation.govt.nz.

[7] Horizontal equity is a principle of income tax collection that argues that everyone earning the same income should be subject to the same rate of taxation.

[8] Vertical equity is a method of collecting income tax in which taxes increase with the amount of earned income. The principle behind vertical equity is that those who can pay more taxes should contribute more than those who are less able to pay taxes.

Our response to the petition

We thank the petitioner for raising this matter. We acknowledge his disquiet over younger generations being unable to afford a home. We note that house prices are starting to trend downwards.

We note that the Government hopes that the recent legislation extending the bright-line test and limiting interest deductions for rental properties will enable more first-home buyers to enter the market.

We encourage the Government to keep monitoring housing affordability, and to continue to review the effects of the recent changes on housing affordability.

Appendix

Committee procedure

The petition was referred to us on 1 July 2021. We met between 12 August 2021 and 12 May 2022 to consider it. We received written submissions from Connor Sharp, the Treasury—Te Tai Ōhanga, and Inland Revenue—Te Tari Tāke. We received advice from the Parliamentary Library.

Committee members

Hon Jacqui Dean (Chairperson)
Rachel Boyack
Dr Liz Craig (until 4 May 2022)
Shanan Halbert
Nicole McKee
Todd Muller
Sarah Pallett (from 4 May 2022)
Teanau Tuiono

Evidence received

The documents we received as evidence in relation to this petition are available on the Parliament website.