Let’s Talk About About Ring-Fencing Rental Losses

Rules to “ring-fence” losses from residential properties came into effect from 1 April 2019.

The aim of the rules is to prevent the owners of residential properties offsetting losses from residential properties against other sources of income, e.g. wages and investment income.

The rules only apply to residential land, which is:

- Land that has a dwelling on it
- Bare land that may be used for erecting a dwelling under the relevant district plan.

Note that residential land is not limited to land in New Zealand. The ring-fencing rules also apply where a New Zealand tax resident owns residential rental properties overseas.

There are a number of exclusions:

- **Main home**
  The main home of the taxpayer is excluded from the definition of residential property, if it was used as the main home predominantly for most of the income year.

- **Business premises**

- **Farmland**
  The definition of residential land also excludes farmland. The definition of farmland is “land that is being worked (or capable of being worked) in the farming or agricultural business of the land’s owner.”

- **Mixed use asset**
  Properties which fall within the existing mixed-use asset rules will also be excluded from the ring-fencing rules. These tend to be holiday homes which are used both as short-term rentals and for private use by the owner.

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- **Employee accommodation**
  Many farms and other businesses require employees to live on site. These properties will usually be excluded from the ring-fencing rules, even when the tenant is paying rent for the use of the dwelling. However, the owner must show that the employee is required to occupy the accommodation, either because of the remoteness of the location, or because of the nature of the business.

- **Lifestyle blocks**
  Lifestyle blocks will generally not be farmland; however, there is no statutory definition as to what a lifestyle block is. Land that falls within the definition of residential land that is not considered farmland may be subject to the loss ring-fencing rules where the owner derives income and cannot rely on the main home exemption.

How do the rules work?

There are two methods:

- **Portfolio approach (the default approach), where losses from properties are offset against profits from other properties.** When the total deductions for the portfolio of residential properties exceed the total portfolio income, the excess deductions are ring-fenced and carried forward to the next income year to be offset against future income from the portfolio. When the entire portfolio of residential properties is sold, any remaining ring-fenced loss may, in very limited circumstances, be offset against the taxpayer's other income. Losses that are not released continue to be carried forward and can be offset against income from residential properties acquired in the future.

- **Property-by-property approach, where each property is looked at separately**. When the deductions for one property exceed the income from that property, the excess deductions cannot be offset against the income from another residential property and must be carried forward. In this case the property making a profit is taxed and the loss from the other property is carried forward to be used against future income from that property. This approach could be preferable where a taxpayer holds some land that will, or could, be taxable on disposal.

The method must be chosen during the 2019-2020 income year for all properties owned now, or within the first year of acquiring the property. Once the choice is made there is no ability to move between the two methods.

Special rules will also be introduced to ensure the ring-fencing rules cannot be avoided by using a trust, company, look-through company, or partnership.

To find out more about how ring-fencing might affect you, please contact your MCI advisor.

By Sharyne Wimsett, B.B.S., C.A. *Sharyne is an Associate with MCI & Associates. She grew up on a sheep and beef farm and is passionate about athletics. Sharyne knows that on the farm and on the track, we all benefit from someone encouraging us to achieve our goals. And that's what Sharyne loves about her job - helping her clients maximise their performance and reach their personal best.*