**[Jonathan Milne](https://www.newsroom.co.nz/profile/jonathanmilne2020/posts)**

Jonathan Milne is the managing editor for Newsroom Pro.

**COMMENTS BY** John Trezise, Richard Milne, Patricia Smith, Charmaine Pountney

**HOUSING**

**House prices: All is calm, all is bright-line this Christmas**

***ANALYSIS: The Reserve Bank now admits bringing back loan-to-value mortgage restrictions won't rein in galloping housing prices – so is the answer, instead, a merry and bright-line Christmas?***

If you want any convincing that the bright-line test for taxing residential property gains is really just a capital gains tax, listen to the cries of dismay from property investors.

Finance Minister Grant Robertson has asked for advice from Treasury before Christmas, on extending the bright-line test. “I expect to receive that advice towards the end of the year, and will discuss it with Cabinet as soon as possible after that,” he says.

Mortgage advisers responded quickly: extending the test would be a broken election promise that would not solve New Zealand's chronic undersupply problem, said one; the move would be foolish, said another. Richard Brown of FCH Ltd told Good Returns: "The ones who make the most noise, the Greens, some Labour supporters and the irrational envy crowd, fail to understand that any costs that befall investors, owners, businesses, all get passed on – usually to those who can’t afford to pay them, and then end up worse off."

**The Prime Minister and Finance Minister have promised to not set in place a capital gains tax or extend the bright-line test on property gains. Should they break their promise?**[**Click here to comment.**](https://www.newsroom.co.nz/all-is-calm-all-is-bright-line#comment-container)

They'll get little sympathy. Robertson is now able to move towards a capital gains tax – or something very closely resembling it – with the NZ First handbrake removed.

Winston Peters had been quick to claim credit for blocking such a tax when the Cullen Tax Working Group recommended it in 2018. Among NZ First's supporters were property companies like Conrad Properties, who [**reportedly donated $55,000 to the controversial NZ First Foundation in 2018/19**](https://www.rnz.co.nz/news/in-depth/409752/nz-first-foundation-trustee-was-lobbying-for-donor).

Conrad, which says it is New Zealand's biggest apartment developer, opposed its Chinese and Indonesian investors being exposed to tax through the bright-line test.

**"There will obviously be significant resistance if unit purchasers are forced to sell within the 'bright-line' tax periods. This forces long term investors to be taxed as speculators; surely making them reluctant to reinvest."
– Conrad Properties**

Directors Jamie Hutchens and Ben Dearlove made a select committee submission on overseas investment restrictions in 2018, arguing their foreign property investors were no difference to share market investors.

"Our overseas investors pay tax on rents and GST on purchases and furniture. There will obviously be significant resistance if unit purchasers are forced to sell within the 'bright-line' tax periods. This forces long term investors to be taxed as speculators; surely making them reluctant to reinvest."

If they didn't like the bright-line test then, they'll hate it now. Treasury is expected to advise the Government whether the bright-line test (which initially taxed anyone who flipped a property within two years, later extended to five years) should be extended again to 10 years.

Opponents fear that would have the same impact as a capital gains tax, scaring off those foreign investors whose deposits were funding the construction of apartment blocks.

Conrad Properties, for instance, told the select committee it had developed more than 4,300 residences and retail spaces. "Since 2017, we have pre-sold over 1,685 dwellings across 8 developments – 728 of which were sold to offshore investors."

Terry Baucher, the director of Auckland-based tax consultancy firm Baucher Consulting, says the concern is that if these offshore investors don't pay for the apartment blocks, then nobody will, and much-needed new housing won't get built.

"As for any investor, if tax becomes a consideration then they have to factor it into their financial returns, and make a call."

**So, is the bright-line test the same as a capital gains tax?**

Insofar as our purpose is to rein in housing prices, yes it is.

"In a nutshell, you’re right," says CoreLogic senior property economist Kelvin Davidson: "The bright-line test is essentially a capital gains tax (taxed at your rate of income tax) if you buy and sell an investment property within five years – and actually sell it for a price higher than what you paid. No gain means no tax."

Last year's Cullen Tax Working Group wasn't able to agree on whether New Zealand should have a capital gains tax on assets like shares – but all 11 members did agree there should be one on residential property, as long as that excluded the family home.

That call hasn't gone away: the Greens and many Labour MPs are still in favour, and a month ago University of Auckland postgraduate student Connor Sharp launched a petition calling on Parliament to implement a capital gains tax on residential property.

And on Tuesday, an ANZ research report said broadening the tax system with tools like capital gains, wealth or inheritance taxes were "real possibilities" over the longer run.

"If income earners end up doing the heavy lifting of fiscal consolidation while houses remains unattainable to them – even to those earning an average wage – then surely it’s just a matter of time before the tax system is changed to make it fairer for them. The political appetite obviously isn’t there right now, but the debate won’t go away."

Despite all this, officially we still don't have a capital gains tax - but we do have something that looks startlingly similar: the bright-line test, a test that decides whether a home-owner should be liable to pay income tax on the capitals gains on residential property.

**The only difference: A timeframe**

The bright-line test was introduced by the John Key Government in 2015, to get around a problem in the existing law that said residential property owners were liable for tax on gains when they sold the property, if their intention in buying the property had been to resell it at a profit.

The problem was, the intention test was inherently subjective – who can a tax official knows what is in our minds? So that made it difficult for Inland Revenue to enforce in practice.

The bright-line test was intended to be unambiguous and objective: if you bought and sold a residential property (other than your family home) within two years, then you were liable to pay income tax on the gains. You intent was deemed to be to make money on the resale.

So that was the difference: a capital gains tax like that proposed by the Tax Working Group could be applied if you resold a property 10, 20, 50, even 100 years after buying it. But to be liable under the bright-line test, you had to resell within two years.

Jacinda Ardern's Labour-NZ First Government was formed in late 2017, on a campaign trail assurance that it would *not* set in place a capital gains tax that term. So instead, in almost its first action on returning to the Treasury benches at the start of 2018, it announced it would extend the bright-line test period from two years to five years.

**"A capital gains tax is an envy tax and is a tax on those who have worked hard and saved."
– Tax Working Group submission**

Last year, she ruled out a capital gains tax any time while she was leader. No way, no sir. Instead, her deputy Grant Robertson has asked Treasury to review the bright-line test again – and tax experts like Terry Baucher argue the most obvious extension is to 10 years to align it with other tax clauses.

Kelvin Davidson says: "An extension of bright-line would just be inching it ever closer to basically being a capital gains tax by another name."

Certainly, Robertson needs to do something to address out-of-control house prices. And just this week, in a consultation paper, the Reserve Bank acknowledged reinstating loan-to-value mortgage restrictions wouldn't do the trick. So he has to go back to his original playbook.

**What was wrong with introducing a capital gains tax?**

Ardern and her coalition government surprised pretty much everyone in April last year, by rejecting the Tax Working Group's recommendation for a capital gains tax. Behind the scenes, there had been intense lobbying from opponents – like Conrad Properties, mentioned earlier.

"A capital gains tax is an envy tax and is a tax on those who have worked hard and saved," opponents argued in their submissions.

Some of the opponents were community groups like the Child Poverty Action Group and the Salvation Army that supported more significant tax reform. But many were big property interests.

Among those to oppose a capital gains tax were Foodstuffs, DairyNZ, Federated Farmers, the Employers and Manufacturers Association (Northern), the Institute of Directors, Kiwi Property Group, Property Investors’ Federation, the Property Institute, Retail NZ, the Retirement Villages Association, and a number of iwi property holding companies.

"A capital gains tax would discourage investment, stifling wage growth and distorting the economy. It would also cause a ‘lock-in’ effect, meaning investors would be discouraged from shifting capital out of unproductive investment," opponents argued.

"A capital gains tax would discourage landlords from investing in rental property and many would leave the rental market, causing supply issues."

**"Compliance with the bright-line test is low, so benefits of a capital gains tax are likely overstated."**

Winston Peters himself claimed NZ First had stopped the tax. He put out a tweet, saying: "We've heard, listened, and acted: No Capital Gains Tax."

The thing is, the same criticism directed at a capital gains tax could equally be directed at an extended bright-line test. "One potentially perverse effect of extending the bright-line might be that some people choose not to sell, in order to avoid the tax," Davidson argues. "And that wouldn’t be particularly welcome in the current environment of low listings."

And opponents of a capital gains tax made one argument that is very material, as Grant Robertson contemplates reining in housing prices by extending the bright-line test. "Compliance with the bright-line test is low, so benefits of a capital gains tax are likely overstated," they said.

**What more can officials do to crack down on those flipping property for profit?**

As many as one in four residential property sellers didn’t pay the tax they owed on properties flipped last year, IRD figures reveal. Of the 1701 property sales subject to the bright-line test in 2019 (mostly the two-year test), just 1285 paid up.

So now, Inland Revenue is cracking down on those property investors. The department is matching tax returns with property transactions and is contacting who might be affected and asking tax advisers to do the same. It is a "direct, planned, and coordinated" campaign with all tax advisers being warned, [**says KPMG tax partner Paul McPadden**](https://www.rnz.co.nz/news/national/431804/ird-cracks-down-on-residential-property-investors-shirking-bright-line).

If that doesn't make much difference, Inland Revenue can go all the way back to section CB6 of the Income Tax Act which (as we discussed) requires that those who buy property, intending to sell it, should be liable for income tax if they make a profit on that sale.

**"The only rhyme or reason you would invest in property is you are hoping to get some sort of payout at the end."
– Michael Rehm**

A new University of Auckland research paper, by Michael Rehm and Yang Yang, argues skyrocketing house prices emphasise the importance of enforcing all available taxes on property speculation.

It comes as Auckland's median sales prices top $1 million for the first time, and the Real Estate Institute reports national prices have also ballooned to a new high.

Rehm said his decade-long analysis of Auckland rental home purchases showed nearly all made initial losses and relied on a profit at resale to be considered wise financial investments.

"These things on a cashflow basis are complete dogs," he told *NZ Herald*. "The only rhyme or reason you would invest in property is you are hoping to get some sort of payout at the end."

**"I think if you asked people now, you'd get a majority supporting a capital gains tax. I think many of us would prefer a comprehensive capital gains tax to a 39c income tax rate."
– Geof Nightingale**

That meant investors could safely be said to have purchased the properties in the hope house prices would continue to rise, and intending to sale – satisfying the intent test in the Income Tax Act.

Tax consultant Terry Baucher says that opens the door to Inland Revenue to also crack down on tax owed by investors under section CB6 of the Income Tax Act.

**Fairness for those excluded from the housing market**

An extension to the bright-line test may be a way the Government can effectively implement a capital gains tax on residential property without coming under quite so much fire for breaking its promise. Not on my watch, Ardern had said last year.

None of this may do much to rein in those galloping housing prices. That's acknowledged even by supporters of an extended bright-line test or a capital gains tax on residential property.

"Extending the bright-line test is just another sticking plaster on a mishmash of messy tax policy," says Geof Nightingale, a corporate tax partner at PwC who was a member of the Tax Working Group. "People will just hold onto their properties for longer, to avoid the tax – it's a poor substitute for a broad-based, properly-founded capital gains tax."

But, supporters say, even if it didn't fix the problem of house prices, introducing a comprehensive capital gains tax would make the tax system much fairer.

Baucher and Nightingale both argue that is the real reason one would introduce a capital gains tax.

At present, Nightingale explains, those who work hard for their money are taxed on their earnings – but those who sit back and make profits off the soaring values of their rental properties aren't taxed on those gains.

"I think if you asked people now, you'd get a majority supporting a capital gains tax. I think many of us would prefer a comprehensive capital gains tax to a 39c income tax rate."