



## BIG TAX CHANGES FOR HOLIDAY HOME OWNERS

Topics covered in this issue include:

- [IF YOU HAVE A RENTED HOLIDAY HOME OR CHARTER YACHT YOU MUST READ THIS NEWSLETTER](#)
- [IF ANY OF THESE TESTS ARE BREACHED, ONLY EXPENDITURE RELATED TO THE TIME THAT THE PROPERTY WAS ACTUALLY RENTED WILL BE DEDUCTIBLE!](#)
- [CASE STUDY](#)
- [FLAWED THINKING ?](#)
- [FOCUS ON FINANCIAL OUTCOME MAY DELIVER FAIRER OUTCOME](#)
- [WHAT ABOUT SEASONAL AND GEOGRAPHIC IMPACTS ON USAGE ?](#)
- [ISSUES WITH RELATED PARTY TENNANTS](#)
- [ADVICE FROM WITHERS TSANG & CO LTD](#)
- [HELP US WITH YOUR INPUT INTO OUR SUBMISSION](#)

### **IF YOU HAVE A RENTED HOLIDAY HOME OR CHARTER YACHT YOU MUST READ THIS NEWSLETTER**

The government has recently released an Officials Issues paper calling for submissions on the tax treatment of mixed use assets. The proposed changes are specifically aimed at rented holiday homes, charter yachts and aeroplanes.

The focus of the paper is to more clearly define the rules surrounding the extent to which expenditure can be deducted where mixed use assets are used partially for deriving income and partially for domestic private use.

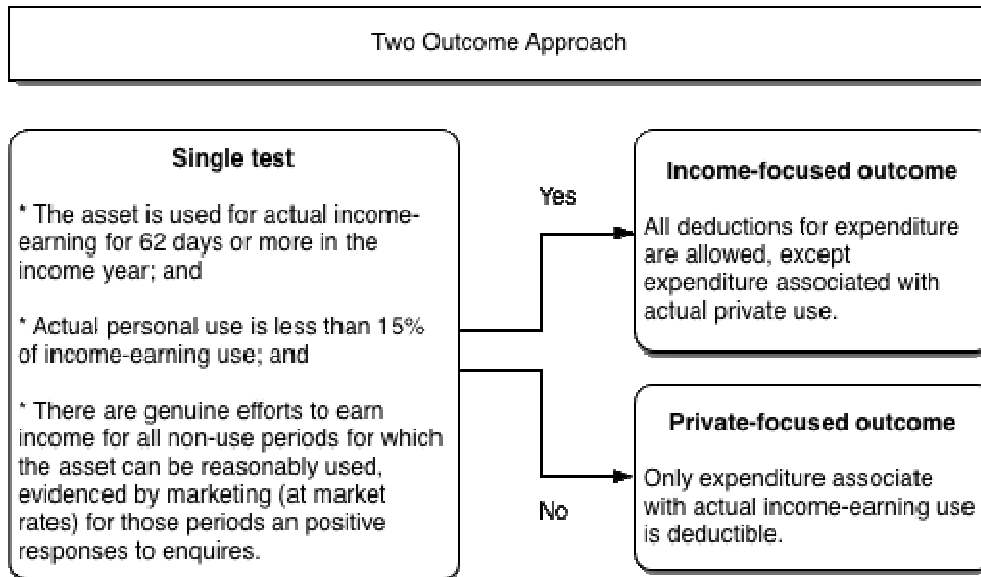
In the holiday home scenario this specifically deals with the tax payers expenditure for the time that the property is neither rented nor used privately but is available for rent.

For the time that the property is actually rented the expenditure remains deductible and for the time that the property is used privately the expenditure remains non deductible, the changes effect the time in the middle when the property is vacant but available to be rented.

The paper essentially offers up two options for public consultation.

The first option is referred to as the "Two Outcome Approach". Under this approach a tax payer's ability to claim expenditure for times when the property is available for rent will be tested based on the following criteria.

Firstly the property must actually have been rented for more than 62 days in the income year. Secondly there must be a genuine effort to advertise and market the property for rental and thirdly, the amount of the owner's personal use cannot exceed 15% of the rented days.

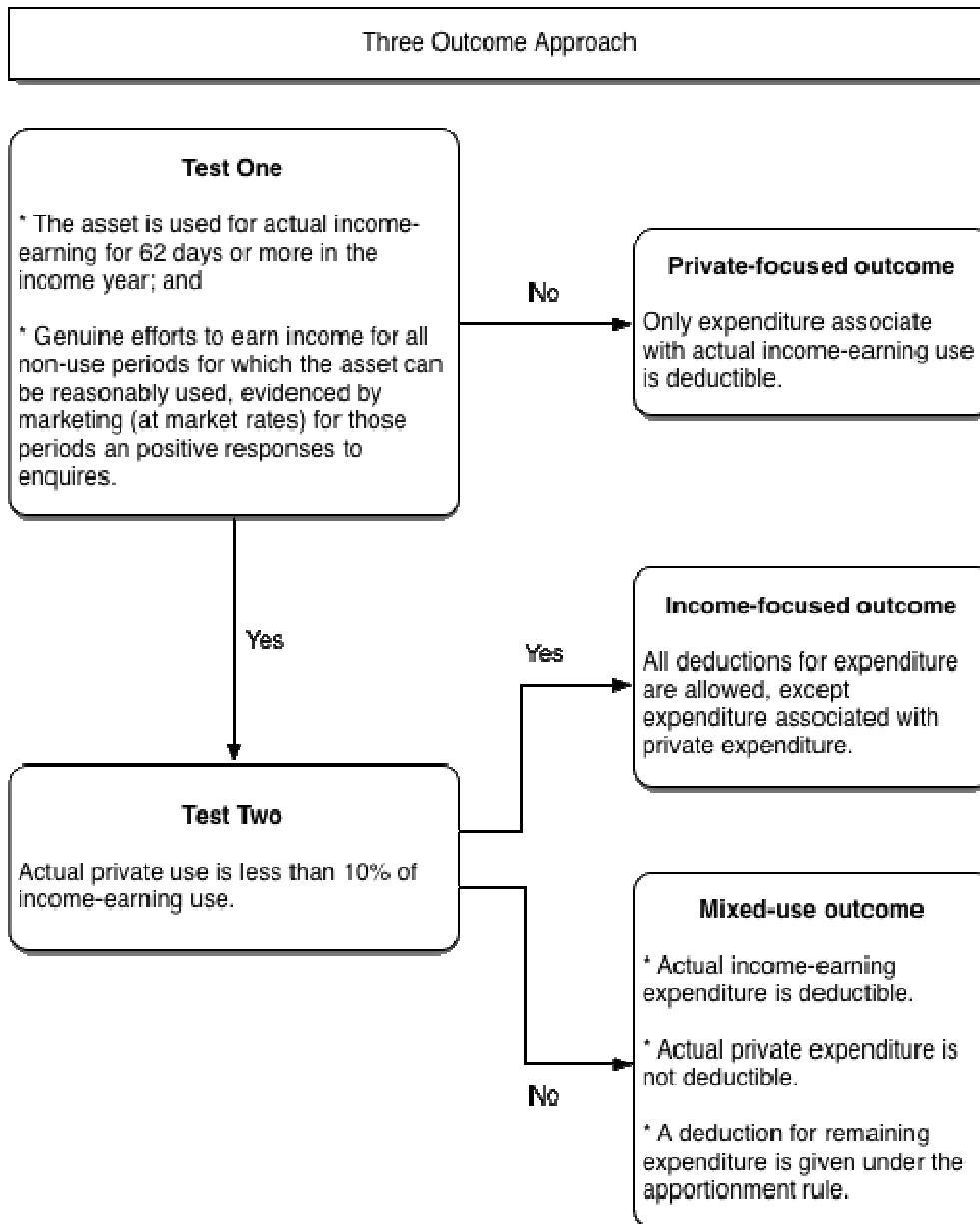


**IF ANY OF THESE TESTS ARE BREACHED, ONLY EXPENDITURE RELATED TO THE TIME THAT THE PROPERTY WAS ACTUALLY RENTED WILL BE DEDUCTIBLE!**

The second alternative is referred to as the “Three Outcome Approach”. Under this approach the same 62 days of rental test is applied along with the requirement for the property to be actively marketed. The third limb of the test is that the percentage of private use relative to rented days must not exceed 10%.

However, if the owners domestic use is greater than 10% of the rented use the outcome is softened by the ability to apportion the expenditure for the unrented days in the ratio of domestic use to rented use, ie a portion of the expenditure for this time will remain deductible but this will reduce as the private use increases.

If an owner has used the property for less than 10% of the rented use all the expenditure will remain deductible.



Of the two methods on offer the “Three Outcome Approach” is more complex to calculate as it requires the apportionment of the costs associated with the available but unrented days. However the outcome with the “Two Outcome Approach” is much more black and white, expenditure will either be allowed or disallowed depending on whether the domestic use exceeds the 15% threshold.

## CASE STUDY

To put this in perspective, if an owner rents his holiday home for 62 days of rental for the year under the “Two Outcome Approach” he will only be able to use the property himself for domestic use for 9 days before losing the opportunity to deduct any of the expenditure associated with the time that the property was vacant but available for rent. This means that if he uses the property for 10 days rather than 9 he loses the deductibility of 83% of his annual expenditure.

That 10th day would have been a very expensive day at the beach !

This outcome would seem to be overly harsh and punitive.

Under the three outcome approach his allowable domestic use if rented days were 62 would only be 6 days before he would be required to calculate an apportionment of the costs for available days using the ratio of private use over total rented days.

## **FLAWED THINKING ?**

The government's approach with these proposed changes is to try to split holiday home owners into two categories, those that were motivated to purchase the holiday home primarily for rental and those that were motivated by a domestic agenda and the rental of the property is a secondary activity to their own personal domestic use.

I believe this approach to be fundamentally flawed. In reality I believe very few holiday home owners are actually motivated by the opportunity to derive rent. The yields on holiday homes are simply too low for them to ever be a viable economic proposition from a rental perspective.

People are generally motivated by the lifestyle associated with having a holiday home and their motivation to rent it out is typically dictated by the size of the debt they must service.

I believe the government's move to set the ratio of private use verses rented use at only 15% and 10% under the two outcome and three outcome approaches respectively fails to recognize the reality of this type of investment and will lead to some unduly harsh tax outcomes particularly if the two outcome approach is adopted in favor of the three outcome approach and the allowable percentages of domestic use remain as low as has been suggested.

## **FOCUS ON FINANCIAL OUTCOME MAY DELIVER FAIRER OUTCOME**

My personal view is that a fairer approach to the whole question of deductibility of this type of expenditure would be to target the actual financial outcomes that the holiday home achieves.

If for example an owner can demonstrate that by renting the house on a night by night basis he has achieved a greater gross rental income than he would have achieved if he rented the property permanently with a standard residential tenancy arrangement, I see no reason why he should not be entitled to deduct all the costs associated with vacant days and rented days. At the end of the day he is still left paying more tax than he would have if he had let the property to a permanent tenant despite the vacant days.

If he fell short of achieving a holiday rental equivalent to a permanent tenancy it would then be appropriate to apportion the costs for the vacant days based on the ratio of actual rental earned over potential market rental.

Many holiday homes are in locations where the property values are high but there are often limited opportunities to offer the properties for permanent rental especially if they are true kiwi baches or cribs. Septic tank systems and tank water contribute to them being less than suitable as permanent rental properties.

In my experience many operators of holiday homes are able to derive more rent overall by letting the property for say \$200 - \$300 per night than they would if they were to permanently let it for say \$350 per week.

If the government's approach simply focused on the rent collected relative to an independent rent assessment for the property on a permanent basis a calculation like this would be far less subjective and

less likely to be manipulated than any test that requires the owner to keep an honest record of their personal domestic use of the property.

### **WHAT ABOUT SEASONAL AND GEOGRAPHIC IMPACTS ON USAGE ?**

The proposed approach from the government also seems to ignore the seasonality of holiday homes. Is it reasonable for example to expect the owner of a ski chalet in Ohakune to achieve 62 days of rental when the ski season may only be 90 days long?

The issues paper also calls for comment on this vexed question.

### **ISSUES WITH RELATED PARTY TENNANTS**

Another tricky question is the sensitive issue of rent paid by relatives, or associated parties as they are referred to in tax law.

The question here is whether a rent paid by a relative should be accepted as a "rented" day. On the face of it you might say yes but what if the holiday home is in the husband's name and he rents it to his wife to get his rented days over the threshold.

Where do you draw the line on this and should it really matter if he still pays tax on the rent?

I can see this being a real problem when different families have formed syndicates and perhaps structured the holiday home in a LTC. Many of these arrangements have shareholders agreements where the shareholders pay rent to the companies just as arms length guests do to maintain fairness in the syndicate if one family is getting more private use than another.

### **ADVICE FROM WITHERS TSANG & CO LTD**

Here at Withers Tsang we have many clients who include a holiday home in their investment property portfolio who will be directly affected by these changes. Those who have been a bit half hearted about the level of rent achieved who have none the less pushed for a full claim on costs for unrented days will be particularly hard hit. The issues paper also advises that the 62 day threshold has been determined by research gathered from commercial websites that owners use to promote holiday homes. It's therefore a fair bet that if you advertise on these sites you will be "on the radar" with IRD.

Regardless of which option the government selects this is a timely reminder of how vital it will be to keep a record of rented days and personal use days and how important it is to do everything you can think of to keep the rent ticking along for your holiday home.

Are you serious about doing everything you can to rent it?

What more could you be doing to promote it?

## HELP US WITH YOUR INPUT INTO OUR SUBMISSION

We will be putting in a submission on these changes and invite you to read the issues paper yourselves and either send us your thoughts for inclusion in our submission or better still, sit down and write your own submission on the proposed changes. The full Officials Issues paper is available from the IRD <http://taxpolicy.ird.govt.nz/publications/2011-ip-mixed-use-assets/overview>

Submissions must be in by 30 September.

Speak now or forever hold your peace !

## Withers Tsang & Co Ltd.

This email has been authorised by:

Withers Tsang & Co Ltd

24-26 Pollen Street

PO Box 47-145

Ponsonby

Auckland

phone: 64 9 376 8860

fax: 64 9 376 8861

email: [reception@wt.co.nz](mailto:reception@wt.co.nz)

web: [www.wt.co.nz](http://www.wt.co.nz)

Copyright ©2011 Withers Tsang & Co Ltd. All Rights Reserved.  
24-26 Pollen Street | Ponsonby | Auckland 1021

This email was sent to you at the following address: [mary@nzms.com.au](mailto:mary@nzms.com.au)  
[Click here to un-subscribe](#) from our mailing list