

Ring Fencing Basics and Eleven Examples



As many of you will know, Ring Fencing comes in from 1/4/19. This basically means that you cannot offset residential property losses against other income.

What does this really mean for a lot of property investors? If for the year ending 31/3/19, you had a rental property in your personal name or in an LTC where you own the shares. It incurred a loss for tax purposes of \$20,000, the loss would have offset your personal income from salary or wage. And, if your income was over \$70,000, you should have received a tax refund of approximately \$3,300. **FROM THE 1/4/19, OR FOR THE 31/3/20 FINANCIAL YEAR, IF YOU MAKE THE SAME LOSS IN THE SAME WAY, THERE WILL BE NO TAX REFUND.**

So when can you use the losses?

- Either they will carry forward, year after year, until you have some profits from residential rental properties,
- Or, if you have multiple residential rental properties, you might be able to offset the profit from one rental, against a loss from another. If you have these rentals in different structures, it is important that you understand and check that you can offset a profit against a loss.

Eleven Examples, all from 1/4/19 or for the 31/3/20 financial year or later;

1. You have two residential rental properties in an LTC. One makes a \$15,000 profit, one incurs a \$10,000 loss. If you use the portfolio method (default method) for Ring Fencing, you could offset the loss against the profit, and just pay tax on the \$5,000 overall profit. SUCCESSFUL OFFSET.

So if we have properties in one entity, we can offset? Not necessarily!

2. You have one commercial property in an LTC, making a profit of \$15,000, and one residential rental property in the same LTC incurring a \$10,000 loss. Can't offset, as commercial properties are not included in the rules. So, you can't offset the residential loss against the commercial property. There might be ways to improve this, so well worth a chat with Ross! FAILED, CAN'T OFFSET. Would pay tax on full \$15,000, and \$10,000 loss would carry forward.

3. Similar as point 2, but Holiday Home with some private use and some rental, making a \$15,000 profit and in the same LTC residential rental property incurring \$10,000 loss. Can't offset as Mixed Use properties are not included in the rules. So can't offset the residential loss against the mixed use/holiday home profit. There may be ways to improve this, so well worth a chat with Ross! FAILED, CAN'T OFFSET. Would pay tax on full \$15,000, and \$10,000 loss would carry forward.

4. Two entities? An LTC owns a residential rental, incurs a \$10,000 loss. Joe owns all the shares in the LTC, and also owns a residential rental in his personal name that makes a \$20,000 profit. We can offset, so would just pay tax on the \$10,000 overall profit. **SUCCESSFUL OFFSET.**

So all entities can offset? NO.

5. A Trust owns a residential rental and incurs a \$10,000 loss. One of the beneficiaries, Jane, owns a residential rental in her personal name that makes a \$20,000 profit. We can't offset, and under the old rules we couldn't offset either as a Trust cannot distribute a loss to beneficiaries. There may be ways to improve this, so well worth a chat with Ross! **FAILED, CAN'T OFFSET.** Would pay tax on full \$20,000, and \$10,000 loss would carry forward.

6. A Normal Company or QC (not an LTC) owns a residential rental and incurs a \$10,000 loss. One of the shareholders, Bob, owns a residential rental in his personal name that makes a \$20,000 profit. We can't offset, and under the old rules we couldn't offset either as a Normal Company cannot pass losses onto shareholders. There may be ways to improve this, so well worth a chat with Ross! **FAILED, CAN'T OFFSET.** Would pay tax on full \$20,000, and \$20,000 loss would carry forward.

More complicated examples:

7. LTC owned by Sally, incurs \$7,500 loss. Trust where Sally is a Beneficiary achieves a \$12,500 profit. If the Trust retained the profit, we couldn't offset. If the Trust allocated the \$7,500 or more of the rental income to Sally, Sally could then offset this against the LTC loss. So, overall just pay tax on the \$5,000 overall profit. **SUCCESSFUL OFFSET.**

UPDATED 19 FEBRUARY 2020 – IRD have changed their opinion. If Trust allocated the \$7,500 or more of rental income to Sally, Sally **CANNOT** then offset this against the LTC loss. **FAILED, CAN'T OFFSET.**

IF YOU HAVE AN LTC WITH RENTALS AND YOU ALREADY HAVE A TRUST, WHY NOT HAVE THE LTC OWNED BY THE TRUST? Gives asset protection and more flexibility with allocating profits to beneficiaries and can potentially save tax. In the past, the losses were stuck in the Trust. But now with Ring Fencing, they will be Ring Fenced anyway, so makes sense to look at your Trust owning your LTC shares.

Note: Make sure you get expert advice before doing any share transfers as you can end up with a taxable gain from Brightline rules or have other tax consequences!

8. Sue has flatmates in her personal house and achieves a profit of \$3,000. An LTC in which Sue owns all the shares, has a \$2,500 loss from residential rental. We can't offset as personal home is excluded from Ring Fencing rules. So, Sue would have to pay tax on the \$3,000 flatmate income, and the \$2,500 residential loss would be Ring Fenced and carry forward to next year. **FAILED, CAN'T OFFSET.**

9. Overseas property? Alan owns a residential rental in Australia that incurs a \$5,000 loss. This needs to be returned in New Zealand, in New Zealand dollars, and following NZ tax rules (watch depreciation especially). Alan only has income from Salary and Wages in New Zealand. The loss would be Ring Fenced, and the loss would carry forward.

10. Three Airbnb properties (not personal home or mixed use) rented for short term accommodation in an LTC, making a \$30,000 profit. Fiona owns all the shares in LTC and also owns three residential rental properties in her personal name, incurring an \$18,000 loss. IRD's response to this query was that the three Airbnb properties were excluded from Ring Fencing rules as business, therefore could not offset. I think there will be further debate on this concept and many tax experts have different opinions! **SO, FOR NOW, BE VERY CAREFUL ABOUT SHORT TERM ACCOMMODATION OFFSETTING RESIDENTIAL RENTAL LOSSES.** If you are in this situation, I would suggest a catch up with me, as it will be very fact dependent!

11. Profit from trading properties can offset losses from residential rental properties, but it is not that straightforward:

a) If trading and holding in same entity (never do this in practice as there will be other issues), then could offset profit against loss. SUCCESSFUL OFFSET.

b) If Jake trades through a normal company and makes a \$60,000 profit and pays himself a shareholder salary of \$60,000. If Jake also has a residential rental in his personal name, incurring a \$10,000 loss. We can't offset and Jake would still pay tax on the \$60,000 shareholder salary. FAILED, CAN'T OFFSET.

c) Two LTC's - one with \$60,000 trading profit, one with \$10,000 residential loss. If the LTC's are both owned by the same Trust (for example), then the Trust could offset the two and just pay tax on the \$50,000 overall profit. SUCCESSFUL OFFSET.

IN GENERAL - If you are using Normal Companies, it would be worth meeting with me, as there is most likely a better way to structure, can reduce tax, can give asset protection long term and can make it a lot easier to get capital gains out!

For more details about having a Property Advisory Meeting with me and/or to book a meeting, [click here](#).

Make sure you also check out my other blogs on Ring Fencing:

- [Ring Fencing Options](#)
- [Ring Fencing - Obtained Royal Assent 26/6/19](#)
- [Recent Changes and Updates, including Ring Fencing](#)
- [Ring Fencing and Special Tax Codes](#)

I hope you have found this information useful. If you are concerned about Ring Fencing, it is best to [book an appointment with me](#) to ensure you are still set up in the best way.

For existing Coombe Smith clients, we are likely to only need 30 mins or less, so the cost for structure advice will be less. If you only have one entity, you can [book a free 5-10 minute telephone chat](#) with me to quickly go over this. We also have discounted meetings for Coombe Smith clients after your Annual Financial Statements have been completed (unless you have already used this).

Kind regards

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