Inland Revenue
Te Tari Taake

March 2021

Interest deductions on residential property income - Proposed changes

This is a summary of changes the Government has announced it intends to introduce to the tax treatment of interest on loans for residential property.

The current law

Currently when owners of residential investment property calculate their taxable income they can subtract the interest on loans that relate to the properties from the income that comes from those properties (claimed as an expense). This reduces their net income from their property and therefore the tax they need to pay on it.

What the proposed change is

The Government is proposing to not allow property owners to claim interest on loans used to earn income from residential properties as an expense against their income from those properties.

This change is expected to become law in 2022 when legislation is passed. However, it will apply retrospectively from 1 October 2021 for all properties acquired on or after 27 March 2021.

Interest on loans for properties acquired before 27 March 2021 can still be claimed as an expense. However, the amount you can claim will be reduced over the next 4 income years until it is completely phased out, as shown in the table on the following page. This means that in the 2025–26 and later income years, you will not be able to claim any interest expense as deductions against your income.

If money is borrowed on or after 27 March 2021 to maintain or improve property acquired before 27 March 2021, it will be treated the same as a loan against a property acquired on or after 27 March 2021. Interest on it will not be able to be claimed as an expense from 1 October 2021.

Property developers (who pay tax on the sale of property) will not be affected by this change. They will still be able to claim interest as an expense.

When a property is acquired

For tax purposes, a property is generally acquired on the date a binding sale and purchase agreement is entered into (even if some conditions still need to be met).

Full information on when a property is acquired is found in **QB 17/02** on **taxtechnical.ird.govt.nz**

For the purposes of the changes outlined on this factsheet, a property acquired on or after 27 March 2021, but where the purchase was the result of an offer the purchaser made on or before 23 March 2021 that cannot be withdrawn before 27 March 2021, will be treated as having been acquired before 27 March 2021.

Consultation

The Government is consulting on further details of the rules, including whether newly built homes should be given some form this exemption, and whether all people who are taxed on the sale of a property (for example under the bright-line tests) should be able to deduct their interest cost at the time of the sale.

More information can be found at **taxpolicy.ird.govt.nz**

What the proposed change means for you

Property acquired before 27 March 2021

If you acquired a property before 27 March 2021, you can still claim interest (for loans that already existed for that property) as an expense against your residential property income, but this amount will reduce by 25% each income year until the ability to deduct the interest is completely phased-out in the 2025–26 income year. If you have a standard balance date, the proposed change will be phased in as follows.

Tax year	Percent of interest you can claim
1 April 2020 to 31 March 2021	100%
1 April 2021 to 31 March 2022 (transitional year)	1 April 2021 to 30 September 2021 - 100% 1 October 2021 to 31 March 2022 - 75%
1 April 2022 to 31 March 2023	75%
1 April 2023 to 31 March 2024	50%
1 April 2024 to 31 March 2025	25%
From 1 April 2026 onwards	0%

Example

Ana acquired a rental property in 2017. Ana is charged $1,250 interest each month on her mortgage ($7,500 every 6 months). Ana has a standard balance date, ending 31 March.

For the 2021–22 income year Ana claims 100% of the interest charged between 1 April 2021 and 30 September 2021, which is $7,500. Between 1 October 2021 and 31 March 2022 Ana is charged $7,500 interest but can only claim 75%, which is $5,625. The total interest Ana claims for 2021–22 is $13,125.

For the 2022–23 income year Ana claims $11,250 interest charged as an expense (75% of $15,000). For the 2023–24 income year she claims $7,500 interest charged as an expense (50% of $15,000). In 2025 she claims $3,750 (25% of $15,000). From the 2025–26 income year onwards Ana is no longer able to claim any interest against her rental income.

Property acquired on or after 27 March 2021

If you acquire a residential property on or after 27 March 2021 and take a loan out to acquire it, you cannot claim interest on that loan as an expense against your property income from 1 October 2021 onwards. This means you'll pay more tax on any property income you receive.

You can still claim other expenses such as the cost of insurance and rates.

Example

Afu took out a loan to acquire a rental property on 1 April 2021. He can deduct the interest he's been charged from 1 April 2021 to 30 September 2021 against his rental income. Because he acquired the property after 27 March 2021, he cannot deduct any interest charged from 1 October 2021 onwards.

Afu has an interest-only mortgage of $500,000, at a fixed rate of 3% per year.

During Afu's 2021-22 income year (1 April 2021 to 31 March 2022), Afu:

- received $40,000 from rental income
- paid $5,000 for insurance and rates
- paid $15,000 in mortgage interest.

For the 2021–22 income year, Afu can claim $7,500 of mortgage interest as an expense against his income (the interest charged from 1 April 2021 to 30 September 2021). He can also claim his insurance and rates. His net rental income for 2021–22 is $27,500 and he pays tax on this amount.

If Afu receives and pays the same amounts for the 2022–23 income year, he can claim the insurance and rates as an expense against his rental income, but can no longer claim any interest. His net rental income will be $35,000.

Offer made before, but property acquired after, 27 March 2021

If you've made an offer on a property on or before 23 March 2021, but the offer is accepted after 27 March 2021, and you could not withdraw the offer before 27 March 2021, your property will be treated as if it was acquired before 27 March 2021, meaning you can claim interest as an expense until the ability to deduct it is completely phased-out.

Example

Ted made an offer to purchase a property through a tender process that closed on 22 March 2021, but the offer was not accepted until 27 March 2021. Because the terms of the tender meant he could not withdraw the offer until 28 March, Ted will still be able to claim interest as if the property was acquired before 27 March.

Borrowing on or after 27 March 2021

If you acquire a property before 27 March 2021, the interest on any borrowings for the property will generally be able to be claimed as an expense in a phased-out manner over the next fourincome years. This includes the situation where the settlement doesn't take place (and therefore the loan isn't drawn down) until after 27 March 2021.

However, if you incur additional debt (from drawing on the same loan or taking a new loan) on or after 27 March 2021, and the use of the loan relates to the investment property, interest on that portion of the loan will not be able to be claimed as an expense from 1 October 2021 onwards.

Example

Petra acquired a property in February 2021, but settlement did not take place until April 2021, when she drew down a $400,000 loan to complete the purchase. The interest on the loan was $1,000 per month. Despite the loan being drawn down after 27 March 2021, Petra is able to claim the interest as an expense in a phased-out manner for the next four income years as shown in the table on page 2 of this fact sheet.

In May, Petra draws down an additional $100,000 against the same property in order to add an extra floor onto the house, paying interest of $250 per month. Because this wasn't part of the loan to complete the terms of the purchase agreement signed prior to 27 March 2021, Petra cannot claim the $250 per month interest as an expense from 1 October 2021 onwards.

Loans for business use secured against residential property

The Government's intention is that the rule change will not apply to loans for non-housing business purposes. However, this is a complex issue and needs to be consulted on prior to the rule coming into effect.

Example

Maia owns a rental property valued at $500,000. She secures a $200,000 loan against her rental property to buy a food truck and other equipment to start a business.

Maia should be allowed to claim interest charged as an expense on her $200,000 business loan. How this will work is yet to be confirmed.