Regulatory Impact Statement: Reintroducing interest deductibility on residential investment property

Coversheet

Purpose of Document	
Decision sought:	*Agree to phase the ability to claim interest deductions for residential investment property back in over three years.*
Advising agencies:	*Inland Revenue*
Proposing Ministers:	*Minister of Finance* *Minister of Revenue*
Date finalised:	*8 December 2023*

Problem Definition
The Government's objective in reintroducing interest deductibility for residential investment land is to reduce upward pressure on rents, and to tax landlords on rental profit by allowing deductions for all costs.

Executive Summary
The Government intends to phase back in the ability to claim interest deductions over three years, with the intention of reducing upward pressure on rents. Tax settings generally allow deductions to be claimed against income so that overall taxation is imposed on a net profit basis. However, the interest limitation settings applicable to residential investment property do not allow interest to be claimed as a deduction for tax purposes. All else being equal, this impacts on the attractiveness of residential property as an investment. This can reduce new construction and, in the longer-run, put upward pressure on rents. This issue is likely to grow over time as a smaller number of new builds can lead to a proportionately large change in the housing stock. Due to time constraints, only two options are considered. **Option 1** is the status quo. Under current settings, interest deductibility is denied for properties purchased on or after 27 March 2021. For other properties, interest deductibility is phasing out such that 50% of interest costs may be deducted in the 2023–24 (tax) year, 25% in the 2024–25 year, and 0% in the 2025–26 and later years. **Option 2** is for interest deductibility to be restored via phasing back in over three years: for 50% deductibility in the 2023–24 (tax) year, 80% in the 2024–25 year, and 100% in 2025–26 and later years.

For an income tax to be based on ability to pay, there needs to be a deduction for the costs of producing the income[1]. Compared to the status quo, Option 2 will support income being used as a measure of a taxpayer's ability to pay tax.

Inland Revenue's recommended option is Option 2. Option 2 means that income will be a better measure of ability to pay than would have been true under Option 1. It also means that tax will be less of a barrier to people making efficient commercial decisions. Finally, Inland Revenue is concerned that the denial of interest deductions is likely to make investment in rental housing an unattractive proposition for many investors. Over time, this is likely to reduce the supply of housing and rental housing (relative to what would be the case if interest expense was deductible). This would place upward pressure on rents, which would increase housing costs for tenants and decrease the equity with the tax treatment of other investments that are taxed on a net basis.

Views of stakeholders

The Treasury

Treasury agrees that allowing deductions for costs incurred in deriving income ensures that income tax reflects ability to pay and that restoring interest deductions will make the income tax system more consistent and coherent.

Treasury considers it unlikely that landlords will pass on the tax change through lower rents in the short run. Research by the Housing Technical Working Group, a cross-agency group of housing experts, found that the main drivers of rents over the past twenty years have been household income growth and the physical supply of rental housing relative to demand. The Treasury therefore expects that restoring interest deductibility would not significantly impact rents in the short run, as the stock of housing supply is fixed.

In the longer term, the change could result in some increase to rental housing supply, thereby putting downward pressure on rents. This will depend on the degree of flexibility in urban land supply and/or opportunities to intensify existing land. As a result, the impact of interest deductibility in the long term will depend on future policy. Supporting the flexibility of urban land supply will make it more likely that restoring interest deductibility increases the supply of housing in the long run rather than primarily raising house prices.

Ministry of Housing and Urban Development – Te Tūāpapa Kura Kāinga (HUD)

HUD agrees with Inland Revenue's assessment of the impact on supply, house prices, and rents. Based on research by the Housing Technical Working Group, a cross-agency group of housing experts, showing rents are primarily driven by household incomes and the relative supply and demand for housing, HUD believes the impact on rent prices in the short term will be negligible. In the long term, reinstatement should make rents under Option 2 less than under Option 1, with the magnitude of that contingent on any improvements to overall efficiency of urban land supply response.

General public

There was a wide range of views expressed when the current interest limitation rules were introduced, and there is likely to be that same wide range of views expressed as those

[1] It has been common for people to argue that tax should be levied on the basis of ability to pay, i.e. that those with greater ability to pay should pay more tax. If income is used to measure ability to pay, this means that those with greater incomes should pay more tax. In this context income is a net concept, after accounting for expenses incurred in earning that income, like interest.

limitation rules are effectively reversed. While some people are of the opinion that business expenses should always be allowable as deductions against business income, there are also people who believe that not having a comprehensive capital gains tax was justification for removing the ability to deduct interest on residential land. However, interest expense is allowed as a deduction in other areas where an investment partly financed with borrowed funds generates taxable income. This is the case even if the investments generate non-taxable capital gains (for example, a commercial rental property or a farm). Also under Option 1, interest deductions are being denied for residential rental properties even if the property does not generate a capital gain.

Limitations and Constraints on Analysis

The key limitations and constraints applying to this analysis are as follows:

1. Single option analysis: As the coalition Government has already announced its intention to reintroduce interest deductibility for residential investment properties, this analysis is focused solely on the implementation of that option, rather than any other option to address the Government's objective to reduce upward pressure on rents.

2. Time constraints: Policy advice is being prepared within the timeframes required to progress decisions on this proposal in December 2023. Accordingly, this analysis has been prepared within tight time constraints.

3. Consultation: While views were previously expressed during the development of the original interest limitation rules, officials were not able to directly consult on the current proposal.

Responsible Manager

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Chief Economist

Policy and Regulatory Stewardship

Inland Revenue

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8 December 2023

Quality Assurance

Reviewing Agency:	IRD
Panel Assessment & Comment:	The Quality Assurance panel at Inland Revenue has reviewed the regulatory impact statement (RIS) prepared by Inland Revenue. The panel considers that information and analysis summarised in the RIS: *Reintroducing interest deductibility on residential investment property parti*ally meets the quality assurance criteria. The proposal being considered by Cabinet supports a broader tax reform package developed in response to the coalition agreements of the government. As such, the options under

	consideration were limited to the status quo and reintroduction of interest deductibility. Time constraints also applied to the policy development of the proposal and has not permitted consultation on the various options, or refinement of the preferred option.

Section 1: Diagnosing the policy problem

What is the context behind the policy problem and how is the status quo expected to develop?

The rental market

1. Upward pressure on rents can be driven by many factors that influence the supply of rental properties. These factors may be related or unrelated to tax settings.

2. However, restoring interest deductibility could have a long-term effect on reducing the cost of housing for tenants by incentivising new construction with this putting downward pressure on rents. This is even true under the status quo with a new build exemption from the rules that deny interest deductions if it creates incentives for an important group of investors to pull back from investing in the housing market.

3. Rental affordability is a significant issue in New Zealand. Based on Household Economic Survey data for the year ended June 2022, a quarter of renting households were spending over 40% of their disposable income on housing costs, and rents have risen faster than mortgage payments. Renters also have higher rates of reporting housing issues like dampness, mould, and heating.[2]

4. While rental affordability (measured by the ratio of changes in rent prices to changes in incomes) has been mostly constant over the past decade,[3] New Zealand has not fared favourably in international comparisons. The proportion of low-income households (the lowest income quintile) in New Zealand spending over 40% of their income on rent was the highest in the OECD in 2018 data at 61%.[4] The same analysis for households of all incomes finds New Zealand is also near the top of OECD countries for the proportion of renters spending over 40% of their income on housing costs (24%),[5] and for median spend on housing costs by renting households (28% of household income).[6] The latter measure of median spend increases to 41% for low-income households.[7]

Interest limitation rules

5. The interest limitation rules for residential investment property were originally introduced to address housing affordability.[8] The aim of the rules was to reduce demand for residential property by preventing investors from deducting interest expenditure for tax purposes.

6. The interest limitation rules were introduced in 2021 and deny a deduction for interest incurred for residential investment property. For property acquired on or after 27 March

[2] https://www.stats.govt.nz/news/housing-affordability-more-challenging-for-renters-than-homeowners/

[3] https://www.hud.govt.nz/assets/Uploads/Documents/Methods-Nov-2022.pdf

[4] International comparisons of housing affordability for renters and owners, p. 18.

[5] International comparisons of housing affordability for renters and owners, p. 20

[6] International comparisons of housing affordability for renters and owners, p. 22.

[7] International comparisons of housing affordability for renters and owners, p. 23

[8] The regulatory impact statement published for the introduction of these rules is available here.

2021, interest deductions have been denied in full since 1 October 2021. For property acquired before 27 March 2021, and borrowings drawn down before 27 March 2021, the ability to claim interest deductions is being phased out as follows:

Period that interest is incurred	Percentage of interest deductions allowed
1 April 2021–30 September 2021	100%
1 October 2021–31 March 2022	75%
1 April 2022–31 Mach 2023	75%
1 April 2023–31 March 2024	50%
1 April 2024–31 March 2025	25%
On and after 1 April 2025	0%

7. Interest is still deductible in some situations. For example, an exemption from interest limitation is allowed for properties defined as new builds (defined as land that has a self-contained residence or abode that received a Code Compliance Certificate (CCC) on or after 27 March 2020), for a period of 20 years after the CCC is issued. There are also exemptions for property developers, and for land used for social, emergency or council housing.

8. The Government has agreed, as part of its coalition agreements, that it will phase back in the ability to claim interest deductions over three years, with the intention of reducing upward pressure on rents. The Government has also signalled that it will make other changes to the taxation of property, including changes to the bright-line test and to non-residential building depreciation.

What is the policy problem or opportunity?

9. There are good reasons for allowing interest deductibility, including the following:

    a. To allow deductions for costs of earning income so that income tax reflects ability to pay.

    b. Concerns about longer-term impacts of the lack of interest deductibility on rents.

Income tax based on ability to pay

10. For an income tax to be based on ability to pay, deductions must be allowed for the costs of producing the income. For example, if a landlord earns $30,000 of rental income and incurs no costs of doing so, other things being equal, that increases their ability to pay by $30,000. If, instead, the landlord earns $30,000 but interest and other costs amount to $25,000, other things being equal, the landlord's ability to pay has increased by $5,000, not $30,000.

11. Denying deductions for interest expenses moves away from taxing income based on ability to pay. Restoring interest deductions is an important step to make the income tax more consistent and coherent. Interest expense is allowed as a deduction in other areas of the tax system where investment partly financed with borrowed funds generates

taxable income. Deductions are generally allowed whether or not assets generate non-taxable gains as well as taxable income.

Impact of deductibility settings on rents

12. In addition, denial of interest deductions may be reducing new construction and the supply of dwellings below the level that would have arisen if interest continued to be deductible. Over time, this could put upward pressure on rents and gradually make rental properties less affordable for tenants. A healthy housing market requires a good supply of housing for both tenants and owner-occupiers.

13. The reintroduction of the ability to claim interest deductions for residential investment properties would reduce pressure on landlords which, in the longer run, should have a flow-on effect in reducing rents for tenants.

What objectives are sought in relation to the policy problem?

14. The Government's objective in reintroducing interest deductibility for residential investment land is to reduce upward pressure on rents.

15. In addition, restoring interest deductions is an important step to make the income tax system more consistent and coherent by ensuring tax is based on ability to pay.

Section 2: Deciding upon an option to address the policy problem

What criteria will be used to compare options to the status quo?

16. The likely impact of the options will be assessed against the status quo under the Government's objective of reducing upward pressure on rents and improving housing affordability in the rental market.

17. The options will also be evaluated against the traditional tax policy criteria of efficiency, equity, integrity, fiscal impact, compliance and administration costs, and coherence. These are described below:

    a. **Efficiency:** Taxes should be, to the extent possible, efficient and minimise (as much as possible) impediments to economic growth. That is, the tax system should avoid unnecessarily distorting the use of resources (e.g., causing biases toward one form of investment versus another) and imposing heavy costs on individuals and firms.

    b. **Equity:** The tax system should promote fairness. The burden of taxes differs across individuals and businesses depending on which bases and rates are adopted. Assessment of both vertical equity (the appropriate treatment of those on different income levels or in different circumstances) and horizontal equity (the consistent treatment of those at similar income levels, or similar circumstances) is important.

    c. **Revenue integrity:** The tax system should be sustainable over time and minimise opportunities for tax avoidance and arbitrage.

    d. **Fiscal impact:** Tax reforms need to be affordable given fiscal constraints, and the system must raise sufficient revenue to support the Government's fiscal strategy.

    e. **Compliance and administration costs:** The tax system should be as simple and low cost as possible for taxpayers to comply with and for Inland Revenue to administer.

    f. **Coherence:** Individual reform options should make sense in the context of the entire tax system. While a particular measure may seem sensible when viewed in isolation, implementing the proposal may not be desirable given the tax system as a whole.

What scope will options be considered within?

Government commitments

18. The Government has already announced its intention to phase the ability to claim interest deductions for residential investment properties back in with the phasing and timing specified described in Option 2 below.

19. Ministers have directed officials to provide advice on this policy within the timeframes required for decisions in December 2023. Therefore, the scope of feasible options is limited.

Limitations on consultation

20. Formal stakeholder engagement following the Generic Tax Policy Process has not been possible in the time allowed for preparation of this advice. The risks of a lack of formal consultation include the potential for unintended consequences arising from the policy change. Consultation also enables a more rigorous understanding of trade-offs when making policy changes. This is pertinent for a proposal like reintroducing interest deductions, which could have impacts on the rental property market and the housing system more generally with respect to prices, rents, and the supply of housing.

21. The intention to change the interest limitation rules was signalled in the pre-election manifestos of the parties that have formed the Government.

What options are being considered?

Option 1: Retain the status quo

22. Option 1 is to retain the status quo. Under the status quo, the ability to claim interest deductions for residential investment properties will continue to be denied entirely for properties purchased on or after 27 March 2021. For properties acquired before 27 March 2021 (and lending drawn down before that date), the ability to claim interest deductions will continue to be phased out, with a deduction for 50% of the interest being allowed in the current income year (2023/24), a deduction for 25% of the interest being allowed in the next income year (2024/25), and no deductions for interest being allowed in all subsequent income years.

Option 2: Reintroduce interest deductibility

23. Option 2 is to phase back in the ability to claim interest deductions for residential investment properties. The option would allow a deduction for 50% of the interest in the current income year (2023/24), a deduction for 80% of the interest in the next income year (2024/25), and full deductions for interest in all subsequent income years. Although the percentage of deductions allowed for the 2023/24 income year does not change from the status quo above, it will apply for all property owners unlike the status quo, so there is some retrospective effect.

Options analysis

24. Option 2 is assessed relative to Option 1 (the status quo) against the Government's objective of reducing upward pressure on rents as well as the tax policy criteria listed above.

25. **Reducing upward pressure on rents:** Option 2 will remove a tax bias that is discouraging debt-financed investors from acquiring rental properties. This makes it less likely that leveraged investors will withdraw from the property market. This can increase the construction of new dwellings and, over time, reduce upward pressure on rents.

26. **Efficiency:** Restoring deductions for the costs of earning income will tend to promote economic efficiency. If someone discovered a profitable venture where they could earn revenue of $30,000 by incurring costs of $25,000, this would be a worthwhile venture in

the absence of tax because of the $5,000 of net income it generates. If a taxpayer faced an income tax rate of 30%, the venture would still be worthwhile to undertake so long as expenses are deductible. In that case the taxpayer would pay tax of $1,500 on the $5,000 of profit and earn an after-tax income of $3,500.

27. However, if the revenue is taxed but the expense is not deductible, the taxpayer would pay tax of $9,000 on the gross revenue of $30,000, and make a loss of $4,000. Failing to allow deductions for the costs of earning income can create a penalty standing in the way of people making decisions which would be sensible in the absence of tax. By doing so, this will tend to reduce economic efficiency.

28. Denying deductions for interest can also reduce economic efficiency by encouraging investment to be undertaken with a landlord's own funds rather than through using borrowed funds. Investment in rental property that is debt-financed can be double taxed. If investment in rental property is financed with a landlord's own funds, rental income will be taxed in the landlord's hands. But suppose, instead, that the investment in a rental property is financed by borrowing from another New Zealander. The rental income will be taxed in the landlord's hands in the same way as if the investment were equity financed. There will be no deduction for interest, but the lender of the funds will also be taxed on the interest stream. This creates a tax bias discouraging the debt finance of residential rental property.

29. The current 20-year exemption from the interest limitation rules for new builds can also increase economic inefficiencies by encouraging leveraged landlords to invest in new residential rental properties ahead of existing properties. This biases the stock of rental and owner-occupied housing by encouraging landlords to hold a greater fraction of new builds in their portfolios, and owner-occupiers to hold a smaller fraction of new builds than would be the case under more neutral tax settings.

30. **Equity:** Denying interest deductions for residential rental property can also reduce horizontal equity. Suppose that A earns $30,000 of residential rental income with no interest expense, B earns $30,000 of residential rental income with $25,000 of interest expense and C earns $30,000 of rental income from a commercial (non-residential) property with $25,000 of interest expense.

	A (residential rental with no interest)	B (residential rental with interest)	C (commercial rental with interest)
Rental income	$30,000	$30,000	$30,000
Interest expense	$0	$25,000	$25,000
Rental profit	$30,000	$5,000	$5,000
Taxable income if interest is denied for residential rental	$30,000	$30,000	$5,000

31. In reality, A has $30,000 of income while B and C have $5,000 of income. C is taxed on their $5,000 of income because their investment is in a commercial property. However, B is taxed on $30,000 as though they were in the same position as A while, in reality, B

has only earned $5,000 just like C. If taxes are not horizontally equitable, they will not be vertically equitable because income becomes a poor measure of ability to pay.

32. As has been noted, some might argue that denying B an interest deduction may be an offset for the possibility that B might be generating untaxed capital gains. However, this is a weak rationale for denying interest deductions, given that A or C may also be generating untaxed capital gains.

33. There is another potential fairness issue. Under current settings where interest deductions are denied on rental property, there is a 20-year exemption for new builds. This means that someone who purchased a property that was a new build just before the new rules came into effect is having interest deductions phased out over 4 years while someone who purchased a property just after the new rules came into effect is allowed interest deductions for 20 years. This can be seen as unfair to leveraged investors with sunk investments who purchased a residential rental property shortly before the new rules came into force.

34. **Revenue integrity:** There are no revenue integrity impacts, other than compliance issues arising from the complex nature of the interest limitation rules.

35. **Fiscal impact:** The expected fiscal cost of Option 2 over the forecast period (to 2027/28) is estimated to be $2,920m.

36. **Compliance and administration costs**: Option 2 is likely to reduce ongoing administration and compliance costs. It will reduce the complexity of the rules for taxpayers; interest limitation sits alongside already complex rules for the taxation of investment property, including the bright-line test, loss ring-fencing and rules for mixed-use assets such as holiday homes. A reduction in complexity consequently leads to less customer contact for Inland Revenue in supporting the interest limitation rules. Restoring interest deductibility retrospectively (i.e., changing the proportion of allowed deductions for the 2023/24 income year for property owners currently being denied any deductions) will create some initial administrative work such as providing guidance and education campaigns (detailed in Section 3).

37. **Coherence:** Limiting interest deductions has reduced the coherence of the tax system. A principle underlying the tax system is that generally only the amount of income after deducting any associated costs is taxable. Denial of interest deductions was an exception to this rule. Restoring interest deductions would therefore increase coherence.

Treasury assessment of the options

38. Treasury agrees that allowing deductions for costs incurred in deriving income ensures that income tax reflects ability to pay and that restoring interest deductions will make the income tax system more consistent and coherent.

39. In the short and medium term, the bulk of the impact from restoring interest deductibility is likely to be reflected in house prices, with minimal impacts on rents. House price impacts are highly uncertain and will depend on the final policy design and timing of the reintroduction of interest deductibility. The Treasury will analyse these potential impacts further and may adjust our house price forecasts to reflect them as part of the *Budget Economic and Fiscal Update*.

40. In the long run, tax changes could also impact the supply of housing by incentivising new construction, and could therefore have more significant impacts on rents. The long-run incidence on house prices and rents will depend on the flexibility of urban land supply and the availability of opportunities to intensify existing urban land:

    a. low flexibility of urban land supply and limited opportunities to intensify mean the policy will primarily raise house prices in the long run.

    b. high flexibility of urban land supply and significant opportunities to intensify mean the policy will primarily reduce rents in the long run.

41. Research by the Housing Technical Working Group, a cross-agency group of housing experts, suggests that rents are primarily driven by household incomes and the relative supply and demand for rental housing. The Treasury therefore expects that restoring interest deductibility would not significantly impact rents in the short run, as the stock of housing supply is fixed.

42. The Treasury's assessment of the evidence is that urban land supply has been highly restrictive over the last two decades, as demonstrated by the gradual fall in interest rates pushing up house prices rather than pushing down rents.

43. Recent policy changes (such as the Auckland Unitary Plan) appear to have improved the responsiveness of supply for higher-density housing. However, without further changes, housing supply may continue to be unresponsive to demand in the long term.

44. As a result, the impact of interest deductibility in the long term will depend on future policy. Supporting the flexibility of urban land supply will make it more likely that restoring interest deductibility increases the supply of housing in the long run rather than primarily raising house prices.

45. The Treasury recommends phasing the restoration and consideration of a cap on deductions (either as a maximum dollar amount or a fraction of interest expenses) to manage the large fiscal cost of restoring interest deductibility.

Ministry of Housing and Urban Development – Te Tūāpapa Kura Kāinga assessment of the options

46. HUD agrees with Inland Revenue's assessment of the impact on supply, house prices, and rents. Based on research by the Housing Technical Working Group, a cross-agency group of housing experts, showing rents are primarily driven by household incomes and the relative supply and demand for housing, HUD believes the impact on rent prices in the short term will be negligible. In the long term, reinstatement should make rents under Option 2 less than under Option 1, with the magnitude of that contingent on any improvements to overall efficiency of urban land supply response.

How do the options compare to the status quo/counterfactual?

	Option 1 Status quo	Option 2 Restoring interest deductions
Reducing upward pressure on rents	0	+
Efficiency	0	++
Equity	0	++
Revenue integrity	0	0
Fiscal impact	0	--
Compliance and administration cost	0	++
Coherence	0	++
Overall assessment	0	++

Example key for qualitative judgements:

++	much better than doing nothing/the status quo/counterfactual
+	better than doing nothing/the status quo/counterfactual
0	about the same as doing nothing/the status quo/counterfactual
-	worse than doing nothing/the status quo/counterfactual
- -	much worse than doing nothing/the status quo/counterfactual

What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

47. Inland Revenue considers that Option 2 is preferable to Option 1. While restoring interest deductibility has a significant fiscal cost, Inland Revenue considers that this cost is outweighed by the positive impacts on the rental market (less upward pressure on rents) and on the tax system (through improvements to the various criteria like efficiency, equity, and coherence, as discussed above).

48. Overall, restoring interest deductibility is most likely to meet the Government's objective of easing upward pressure on rents. Residential property investment will become more attractive, which may increase rental supply.

What are the marginal costs and benefits of the option?

Affected groups	Comment	Impact	Evidence Certainty
Additional costs of the preferred option compared to taking no action			
Other interested parties – first-home buyers	Restoring interest deductions for residential rental property is likely to put some upward pressure on property prices, making buying	House price impacts are highly uncertain and will depend on the final policy design and timing of the reintroduction of interest deductibility.	Low

	a first home somewhat less affordable.	The Treasury will analyse these potential impacts further and may adjust house price forecasts to reflect them as part of the *Budget Economic and Fiscal Update*.	
Regulators – wider government	Decreased revenue would be collected from the reintroduction of interest deductions for residential property investors.	The expected fiscal cost is $2,920m over the five years to 2027/28.	Low
Total monetised costs		The expected fiscal cost is $2,920m over the five years to 2027/28.	Low
Non-monetised costs	We do not have confidence in our ability to provide a total non-monetised cost.	Low	Low
Additional benefits of the preferred option compared to taking no action			
Regulated groups – residential property investors	Restoring interest deductions will reduce tax payments on residential property owners in the first instance. This group will also benefit from a decrease in compliance costs.	The reduced tax payments are estimated to be $2,920m over the five years to 2027/28.	Low
Regulators – Inland Revenue	Restoring interest deductions is likely to reduce ongoing administration costs for Inland Revenue, though with some initial implementation costs.	It is not possible in the time available to attempt to quantify this impact.	Low
Other interested parties – renters	Over time, additional supply of rental housing will tend to put downward pressure on rents.	It is not possible in the time available to attempt to quantify this impact.	Low
Non-monetised benefits	We do not have confidence in our ability to provide a	Low	Low

	non-monetised benefit.		

Section 3: Delivering an option

How will the new arrangements be implemented?

49. It is intended that the ability to deduct interest for residential investment properties will be reintroduced as follows, as per Option 2:

	Percentage of interest deductions allowed
1 April 2023–31 March 2024	50%
1 April 2024–31 March 2025	80%
On and after 1 April 2025	100%

50. Given the proposal is to start phasing back in interest deductibility in the current year, including for property owners currently being denied any deductions, this proposal will have retrospective effect. Consequently, some minor systems changes will be required to accommodate a retrospective change in deductibility, including the need to amend taxpayer guidance and communicating with taxpayers before they file their tax returns. Those changes can be accommodated, but need to be considered alongside any other changes the Government may require as part of its 100-day plan.

51. Taxpayers will have made decisions based on the current law at the beginning of the year. Therefore, a retrospective change of this nature will have an impact on them. While returns for the 2023/24 income year do not need to be filed until 7 July 2024 (or 31 March 2025 if the taxpayer has a tax agent), taxpayers will have made provisional tax payments throughout the year based on the current level of deductibility. Increasing interest deductions may mean they have overpaid their tax, however, most of these taxpayers will have the ability to correct this overpayment at their final instalment of provisional tax. Any overpaid tax will ultimately be refunded. Some taxpayers with early balance dates (i.e., balance dates between 1 October 2023 and 31 March 2024) may also file their tax returns before the changes are finalised, meaning their returns will need to be reassessed.

How will the new arrangements be monitored, evaluated, and reviewed?

52. Inland Revenue's initial focus will be on communication and education. Information will be provided to increase awareness of the new arrangements and support customers in getting their obligations right from the start.

53. Inland Revenue currently monitors work on compliance using a range of interventions, and so the proposed changes to interest limitation will be integrated into existing systems for the purposes of monitoring and evaluation. Guidance will be updated on Inland Revenue's website.