**Interest limitation – information sheet 5**

September 2021

How interest deductions are affected

This information sheet provides general information on the way that proposals the Government is introducing are likely to work.

The Government intends to limit the ability to deduct interest to make residential properties a less attractive investment option and thus level the playing field for first home buyers.

For property investors who borrowed to acquire residential property before 27 March 2021, interest deductions will be phased out between 1 October 2021 and 31 March 2025 as shown in the table. Residential property investors who borrow to acquire residential property on or after 27 March 2021 will not be allowed to deduct interest incurred after 1 October 2021 (unless an exception applies). Certain exemptions apply and certain property types are excluded.

This information sheet provides general information on what interest is proposed to be either phased out or become immediately non-deductible from 1 October 2021.

These proposals will be considered by Parliament and may change.

**Phasing out interest deductions for properties acquired before 27 March 2021**

| **Date interest incurred** | **Percentage of the interest that can be claimed** |
| --- | --- |
| 1 April 2020 to 31 March 2021 | 100% |
| 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% |

# Date property 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 can be found in QB 17/02 on [taxtechnical.ird.govt.nz](https://www.taxtechnical.ird.govt.nz/questions-we-ve-been-asked/2017/qb-1702-income-tax-date-of-acquisition-of-land-and-start-date-for-2-year-bright-line-test)

# Funds borrowed on or after 27 March 2021

If you borrowed funds on or after 27 March 2021 for your property, interest deductions will no longer be allowed from 1 October 2021 except if you used those funds to purchase property acquired:

* before 27 March 2021 (for example, you entered into an agreement but settlement was in May 2021), or
* as a result of an offer you made before 24 March 2021 that you weren’t permitted to withdraw before 27 March 2021 (for example, as part of the contractual terms and conditions in a tender process).

If either of these exceptions applies, your ability to deduct interest will be phased out according to the table above.

Note: If one of the exemptions for property development or new builds applies your interest deductions will not be limited under the proposed rules. For more information on this, see information sheet 4 – [Exemptions for property development and new builds](https://taxpolicy.ird.govt.nz/publications/2021/2021-other-interest-limitation/4-exemptions).

# Refinancing on or after 27 March 2021

Refinancing up to the level of the original loan will not affect the deductibility of your interest. If the original loan qualified for phasing out, then that treatment remains the same.

# Variable loans, such as a revolving credit or overdraft

Deductions for interest on a variable loan will also be phased out as per the table above. This is provided the amount outstanding (after subtracting any expenditure on deductible or private activities) is the same or lower than the amount that was outstanding on 27 March 2021.

If the amount outstanding is higher than the amount outstanding on 27 March 2021, only interest on the amount outstanding on 27 March 2021 will be deductible under the phased approach. Interest on the remainder of the amount outstanding will be non-deductible.

# Borrowing used for other purposes

The interest limitation rules will not affect borrowings for non-residential property purposes. For example, if you borrow against a residential property to buy a truck for a transport business, your interest deductions will not be affected.

If you took out a loan before 27 March 2021 and cannot work out how much of the loan was used for residential property and how much was used for other business property, a special transition rule will apply. Under that transition rule, the loan will be treated as being used to acquire your other business property first (based on the market value of that business property) and then the balance will be applied to the residential property.

# Property rented out and also used privately

The interest limitation rules will apply to interest relating to residential property that is rented out some of the time and used privately some of the time. This is the case with many holiday homes. Interest expenses for such properties will be entirely non-deductible from 1 October 2021 unless the interest qualifies for the phased approach because the loan is a pre-27 March 2021 loan (as discussed above).

The interest limitation rules will not apply if the interest relates to income you earn in your main home, for example, from a flatting or boarding situation. You will still be able to deduct some interest against that income.

# Changes in how property is held

Proposed rollover relief will allow you to change how you hold the property after 27 March 2021 but still allow you to deduct a portion of your interest expense during the interest phase-out period.

Relief will be provided for some transfers to family trusts and for transfers to or from look-through companies and partnerships. This is consistent with the relief proposed for the bright-line test. Specific relief is proposed for transfers of land subject to the Te Ture Whenua Māori Act 1993 and transfers to trusts as part of settling Treaty claims.

Relief will also be provided for relationship property settlements and transfers on death. This is in line with existing rollover relief provided under the bright-line test.

|  |
| --- |
| This information sheet provides a brief description of the Government’s proposals. It does not attempt to provide comprehensive coverage. For full details of the proposals refer to the Supplementary Order Paper. |