Inland Revenue
Te Tari Taake

Te Tūāpapa Kura Kāinga
Ministry of Housing and Urban Development

TE TAI ŌHANGA
THE TREASURY

POLICY AND REGULATORY STEWARDSHIP

Tax policy report: **Cabinet Paper – Taxation of Housing: Limiting Interest Deductions for Residential Property and Changes Related to the Bright-Line Extension**

Date:	9 September 2021	**Priority:**	High
Security level:	In Confidence	**Report number:**	IR2021/382 T2021/2316 BRF21/22091096

Action sought

	Action sought	Deadline
Minister of Finance	**Sign** the attached Cabinet paper **Refer** the attached Cabinet paper to the Cabinet Economic Development Committee	15 September 2021 10am Thursday 16 September 2021
Minister of Revenue	**Sign** the attached Cabinet paper	15 September 2021
Minister of Housing	**Sign** the attached Cabinet paper	15 September 2021

Contact for telephone discussion (if required)

Name	Position	Telephone
Stephen Bond	Acting Manager, The Treasury	s 9(2)(a)
Chris Gillion	Policy Lead, Inland Revenue	
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9 September 2021

Minister of Finance
Minister of Revenue
Minister of Housing

Cabinet Paper – Taxation of Housing: Limiting Interest Deductions for Residential Property and Changes Related to the Bright-Line Extension

Purpose

1. The attached paper is for the Cabinet Economic Development Committee to consider at its meeting on Wednesday 22 September 2021. The paper needs to be referred to the Cabinet Office by 10am on Thursday 16 September 2021.

2. In March 2021, Cabinet agreed to extend the bright-line test from 5 years to 10 years (CAB-21-MIN-0070 refers). Cabinet also agreed in-principle to limit interest deductions for residential property and to some of its key features (CAB-21-Min-0045 refers). Cabinet directed officials to consult on the detail of the proposal, with decisions to be confirmed by Cabinet following consultation.

3. The attached paper seeks Cabinet's:

   3.1 confirmation of its earlier in-principle decisions;

   3.2 agreement to key aspects of the interest limitation proposal;

   3.3 agreement to some changes relating to the bright-line test extension;

   3.4 approval of changes to appropriations to give effect to the tax reforms;

   3.5 agreement to delegate authority to the Minister of Finance and Minister of Revenue to make additional joint decisions on any policy and drafting issues arising in consultation with the Minister of Housing or Minister for Land Information as appropriate;

   3.6 agreement to delegate authority to the Minister of Revenue, in consultation with the Leader of the House, to release a Supplementary Order Paper (SOP) containing the interest limitation and bright-line measures at the Finance and Expenditure Committee stage of the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Bill.

Key points in Cabinet Paper

4. The attached paper provides an overview of the interest limitation proposal and changes associated with the bright-line test extension. It outlines, at a high level, what the interest limitation proposal is and what it will and will not apply to.

5. The main areas to be aware of in advance of the Cabinet meeting are:

   5.1 Purpose-built rentals (also known as "build-to-rent");

   5.2 Public, council, emergency and transitional housing; and

   5.3 New build exemption.

Purpose-built rentals

6. There is likely to be discussion over whether purpose-built rentals (PBRs) should be excluded from the interest limitation proposal.

7. s 9(2)(f)(iv)

8. s 9(2)(f)(iv)

Public, council, emergency and transitional housing

9. The Cabinet paper proposes an exclusion for this type of housing to eliminate the risk of a reduction in supply. Previously, the Minister of Finance, Minister of Housing and Minister of Revenue had agreed to exclude this housing (IR2021/325; T2021/1935 refers). However, we understand that the Minister of Finance’s and Minister of Revenue’s support for the exclusion was based on the inclusion of a sunset provision for public housing properties leased from the private market.

10. On 26 August HUD provided a briefing to the Minister of Housing on whether to have a sunset provision for leased properties, and if so, how to design it (BRF21/22081081). This briefing recommended against having a sunset provision for leased properties. Continuing to provide the exclusion to leased properties would not hinder efforts by the Government to progressively decrease the proportion of public housing properties leased from the private market. A sunset provision for leased properties would also increase the complexity for Inland Revenue in administering the rules.

11. The Cabinet paper does not currently propose a sunset provision for leased properties. However, a sunset provision for leased properties can be added into the Cabinet paper at Ministers’ direction.

New build exemption

12. In March 2021, Cabinet directed officials to consult on three options for the design and duration of the new build exemption. The new build exemption balances trade-offs between maximising the impact of interest limitation on house prices (suggesting a shorter exemption) and minimising impacts on housing supply (suggesting a longer exemption).

13. Following consultation, you agreed that the new build exemption should apply to both initial and subsequent purchasers for 20 years after a code compliance certificate (CCC) is issued (IR2021/325; T2021/1935 refers).

Financial implications

14. The estimated revenue gain from the interest limitation proposal is **$1.12 billion** over the forecast period.

	$ millions - increase/(decrease)			
Vote Revenue Minister of Revenue	**2021/22**	**2022/23**	**2023/24**	**2024/25**
Tax revenue: Income tax	80.000	200.000	350.000	490.000

15. The revenue will decline from 2026 as investment is increasingly reallocated towards new builds.

16. This estimate is highly uncertain due to the assumptions and projections involved.

17. Implementation and administration of the reforms will increase the outreach, assistance, compliance and policy work expected of Inland Revenue over an extended period of time, especially while different rules apply during the phase-out period.

18. The complexity of the new rules, added to others for taxing property, means the resulting work items are not simple or quick to manage. The likely enactment date and the application dates also add pressure in what is a very busy period for Inland Revenue. There is a compressed impact in the final 2021/22 quarter peak for supporting customers and delivery partners to understand the immediate impact on their return filing and provisional tax payment obligations, particularly for customers without tax agents. While 82% of rental property owners have tax agents, only 52% of the customers who have interest expenses have tax agents.

19. Given the immediate effect of the rules from 1 October 2021, Inland Revenue will initially focus on providing customers and third parties with clear information and assistance to support accurate self-assessments and payments return filing. Automated analytic and intervention capabilities will be deployed, with follow-up activity for cases of obvious deliberate non-compliance. Inland Revenue expects increased customer contacts in particular following the introduction of the SOP and enactment and estimates an expected response rate of the affected customer base of 15% initially, reducing to 2% over 10 years. Additional Inland Revenue services include outbound letter campaign, marketing campaign to support customers and increase voluntary compliance, seminars and 1:1 advisory visits to present the legislative changes, proactive (compliance) actions, audit activities, technical and legal support to Inland Revenue staff, technical publications to provide certainty to customers, and delivering analytics and reporting capability to monitor and support the intelligence lead compliance approach.

20. Inland Revenue is seeking funding totalling $19.38 million over the forecast period to help meet additional administration and implementation costs of the reforms. Inland Revenue considers this amount sufficient to support the forecast revenue gain. A one-off amount is also sought in the 2022-23 fiscal year for policy work on new boundaries, definitions within the legislation and areas identified for further policy development. Some remedial legislation is expected to be required.

21. Inland Revenue will report to the Minister of Finance and Minister of Revenue annually on the effect of this funding on taxpayers' compliance with the interest limitation rules and the changes to the bright-line rules.

22. While funding is sought in the draft Cabinet paper over the forecast period only, Inland Revenue thinks there is significant compliance work required beyond the forecast period. This is particularly because the phase-out period over four years

means the first "standard" year when the ability to deduct interest is completely phased-out is the 2025–26 income year.

23. A summary of the estimated incremental administrative costs over 10 years are provided in the table below:

	$m – increase/(decrease)										
Vote Revenue Minister of Revenue	**2020/21**	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27**	**2027/28**	**2028/29**	**2029/30**	**2030/31**
Capital	**-**	**1.400**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Operating	-	3.580	5.920	5.260	4.620	3.090	2.570	1.950	1.780	1.650	1.520
Depreciation & Capital Charge	-	0.050	0.200	0.200	0.200	0.200	0.200	0.200	0.200	0.200	0.200
Total operating	**-**	**3.630**	**6.120**	**5.460**	**4.820**	**3.290**	**2.770**	**2.150**	**1.980**	**1.850**	**1.720**

24. Inland Revenue intends to raise out-year and on-going cost as part of future budget discussions, by which time more certainty will exist.

Next steps

25. The attached Cabinet paper will be considered by the Cabinet Economic Development Committee on Wednesday 22 September, and by Cabinet on Monday 27 September.

26. The measures outlined in the Cabinet paper will be included in an SOP to the Taxation (Annual Rates for 2021-22, GST, and Remedial Matters) Bill, which was introduced on 8 September. The SOP will be released on 28 September and the Finance and Expenditure Committee will be invited by the Minister of Revenue to consider the SOP and call for submissions on it.

27. Bill commentary for the SOP will not be published when the SOP is released, but shortly afterwards. Fact sheets and questions and answers will be provided on the SOP's release to help those affected understand the legislation.

Recommended action

We recommend that you:

28. **sign** the attached paper to the Cabinet Economic Development Committee;

Signed Signed Signed

29. **refer** the attached paper to the Cabinet Economic Development Committee.

Referred

s 9(2)(a)

[redacted]

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Hon Grant Robertson
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Hon Dr Megan Woods
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