Inland Revenue
Te Tari Taake

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Special report on build-to-rent exclusion from interest limitation rules

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This special report provides early information on the build-to-rent exclusion from the interest limitation rules included in the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Act 2023 ahead of an upcoming edition of the *Tax Information Bulletin*.

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Build-to-rent exclusion from interest limitation rules

Section YA 1 and schedule 15 of the Income Tax Act 2007

Amendments enacted in the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Act 2023 provide for an in-perpetuity exclusion from the interest limitation rules for build-to-rent land that meets the asset class definition.

Background

The interest limitation rules in subpart DH of the Income Tax Act 2007 (ITA) took effect on 1 October 2021 and are aimed at tilting the playing field for existing residential property away from investors and towards first home buyers and owner-occupiers. The rules deny an interest deduction for interest incurred for disallowed residential property on or after 1 October 2021. However, the rules do not apply to interest incurred for "excepted residential land" as listed in schedule 15 of the ITA.

Exemptions, such as the new build exemption, were included to ensure the interest limitation rules do not have a negative impact on new housing supply. Build-to-rent assets have now been added to the list of excepted residential land to ensure the rules do not negatively impact the supply of this type of large-scale rental property specifically.

Key features

"Build-to-rent land" has been added to the list of excepted residential land in schedule 15. This means the interest limitation rules do not apply to deny deductions for interest incurred for property that the Commissioner of Inland Revenue has received notice has met the asset class definition and been approved as build-to-rent land by Te Tūāpapa Kura Kāinga – Ministry of Housing and Urban Development. However, if the land at any later point fails to meet the asset class definition, taxpayers will no longer be able to rely on the build-to-rent exclusion to prevent the interest limitation rules from applying to deny interest deductions for that residential rental property.

"Build-to-rent land" definition

The new definition of "build-to-rent land" in section YA 1 of the ITA provides that build-to-rent land is, for a person, land that they own and that is described in section CB 12(1)(a) to (e) or section CB 13 (1)(a) and (b) to the extent to which:

- it is or was part of one project of 20 or more dwellings, and
- it is currently one of 20 or more dwellings used, available for use, or being prepared or restored for use, as a rental property to which the Residential Tenancies Act 1986 (RTA) applies,

if—

- every residential tenancy has the option of a fixed term of at least 10 years, with the ability for the tenant to give 56 days' notice of termination, and
- every tenancy agreement includes a personalisation policy in line with sections 42, 42A and 42B of the RTA.

It does not include land that, at any time after it first meets the above requirements, fails to meet those requirements.

Existing dwellings must meet definition by 1 July 2023

Existing build-to-rent assets have until 1 July 2023 to comply with the tenure and personalisation policy requirements included in the definition of "build-to-rent land". The policy is intended to apply to new and existing build-to-rent developments, however, it is highly unlikely any existing developments will have offered 10-year tenancies to all tenants.

Effective date

The amendments take effect on 1 October 2021 to align with the introduction of the interest limitation rules.

Detailed Analysis

Land is excluded from the interest limitation rules in perpetuity for as long as it meets the definition of "build-to-rent land". The definition contains several elements, which are discussed below.

Land described in sections CB 12(1)(a) to (e) or CB 13(1)(a) and (b)

Land described in sections CB 12 and CB 13 is land where an undertaking or scheme involves the development or division of the land. Indications that land is part of a particular development could include records of title, consent applications, development/subdivision plans or other materials, such as a prospectus for investors.

Land described in sections CB 12 and CB 13 can include land that is in separate adjacent blocks or held on different records of title. This allows for flexibility in the configuration of build-to-rent land if it includes commercial premises or dwellings that do not meet the build-to-rent requirements. In these instances, apportionment will be required (see discussion under the "'To the extent' test" heading below). It also does not preclude land that is not contiguous, for example, if there is a road between pieces of land.

This requirement ensures (in conjunction with the single owner requirement) that the build-to-rent land is part of one cohesive project, even where it spans multiple blocks of land. While flexibility is allowed for in the configuration, it must still be part of the same project. For example, it would not be possible to claim that ten dwellings on a block of land in Thorndon, Wellington and ten dwellings on a block of land in Newtown, Wellington could comprise a single build-to-rent development.

Configuration of development

A build-to-rent development must always have no less than 20 dwellings that satisfy the requirements to qualify as "build-to-rent land".

The dwellings can be held in one or more titles and can be on adjoining parcels of land. The development can include commercial premises or other dwellings (that do not meet build-to-rent requirements) that do not form part of the build-to-rent development. For example, there may be owner-occupied dwellings or rental dwellings that do not offer 10-year tenancies or personalisation policies. In these instances, apportionment will be required.

Including commercial premises within build-to-rent developments enables community amenities to be provided and allows for alternative revenue streams for the development. Including other dwellings supports developments that want to mix tenure types, which may be needed to make developments viable, particularly in regional centres.

'To the extent' test

A dwelling will qualify for the exclusion "to the extent" to which it meets the definition requirements. This means each individual dwelling must meet the definition, as well as the overall development, for interest not to be subject to the interest limitation rules. Only interest relating to the portion of the development that meets the definition of "build-to-rent land" will not be denied the deductions under the rules. This includes the portion of shared amenities made available to build-to-rent tenants.

Example 1: 'To the extent' to which it meets the definition

Te Awhi Co. completed a 35-apartment development in 2024 that also has a block of commercial shops on the ground floor. Of the 35 apartments, 10 are sold to owner-occupiers and 25 are retained by Te Awhi Co. to rent out under the build-to-rent model.

Assuming the 25 apartments meet the other requirements of build-to-rent land (that is, they are rented out under the RTA, tenants have been offered a 10-year tenancy agreement and personalisation policies have been included), these 25 apartments will qualify as build-to-rent land. Any interest relating to these 25 apartments will therefore not be denied a deduction under the interest limitation rules. Assuming existing tax rules are satisfied, interest incurred for these 25 apartments will be deductible.

Having commercial premises and dwellings that do not meet the "build-to-rent land" definition in the same development does not stop those units that do meet the definition from qualifying for the exclusion.

If, instead of being owner-occupied, the remaining 10 apartments were rented out (as a residential rental property that did not qualify as build-to-rent land), they may still be eligible for the new build exemption for a period of 20 years from the date the code compliance certificate was issued.

Same person

Build-to-rent land must be owned by the same person to qualify for the exclusion. "Same person" can include any natural person or legal entity (for example, a company, limited partnership or joint venture).

Continuous use requirement

A unit must continually meet the requirements of the "build-to-rent land" definition to qualify for the exclusion.

If, after first meeting the requirements, a unit fails at any point to meet the definition, even if the unit again meets the requirements in the future, it can never again qualify as "build-to-rent land".

Existing build-to-rent developments must meet all requirements by 1 July 2023 and continue to do so at all times after that date. All new developments completed after 1 July 2023 must always comply.

Used, available for use, or being prepared or restored for use

A dwelling must be used, available for use or being prepared or restored for use as a build-to-rent dwelling to qualify for the exclusion. The wording "available for use" is intended to cover situations where dwellings are not currently occupied but are being advertised on the market as available for rent. "Being prepared or restored for use" covers scenarios where a dwelling is not currently available for use but is undergoing work to be suitable for use as a rental property. For example, between tenancies a unit may be renovated to replace an outdated kitchen. The dwelling would still qualify during this period even though it is not occupied.

Tenure length requirement

Tenants of a build-to-rent dwelling must be offered a fixed term tenancy of at least 10 years, which is terminable by 56 days' notice under section 58A of the RTA, including at times of tenancy renewal and renegotiation.

This does not mean the tenant has to accept this offer. They may agree to, or request, a different tenancy offer.

Existing build-to-rent developments will have until 1 July 2023 to offer all existing tenants a 10-year contract and must offer all new tenants a 10-year contract from that date. Any build-to-rent development completed after 1 July 2023 will have to meet this requirement immediately.

Personalisation policies

The definition of "build-to-rent land" requires that explicit personalisation policies are offered by build-to-rent providers to their tenants that are in line with sections 42, 42A and 42B of the RTA. Under the RTA, a tenant can ask a landlord if they can make a change (for example, attach a fixture or make an alteration) to the property. The landlord must not unreasonably withhold consent to the change and may impose reasonable conditions. At the end of the tenancy, tenants will be required to 'make good' on any personalisations made during the tenancy, as set out by the RTA.

Personalisation policies are not intended to pre-authorise the personalisations featured in the policies, rather they are intended to make clear to tenants upfront what personalisations the build-to-rent provider is happy for the tenant to make.

This requirement may take the form of a build-to-rent provider including a clause in associated tenancy agreements or producing a document, offered to all tenants within the

build-to-rent development, that explicitly outlines how tenants can personalise their dwellings. Providers must include their position on the keeping of pets.

The intention of this requirement is to make lifestyle issues, like pets and home-making, more transparent to prospective tenants.

Existing build-to-rent developments have until 1 July 2023 to provide personalisation policies to all current tenants. Any build-to-rent developments completed after 1 July 2023 will have to comply with this requirement immediately.

When the exclusion applies

To qualify for the exclusion, the Chief Executive of the department responsible for the administration of the Residential Tenancies Act 1986 must be satisfied that the development meets the definition of build-to-rent land. Currently, this approval would be granted by the Chief Executive of Te Tūāpapa Kura Kāinga – Ministry of Housing and Urban Development (HUD). The asset will then be recorded on a register of assets that is then shared with Inland Revenue. The exclusion will continue for as long as the development meets the definition requirements.

Taxpayers with existing build-to-rent developments will be eligible for the exclusion from 1 October 2021 if they meet the definition requirements before 1 July 2023 and are approved by HUD. The exclusion for existing developments applies from 1 October 2021 to align with the introduction of the interest limitation rules. New build-to-rent developments can apply the exclusion from the date of application if they meet the definition requirements and are approved by HUD.

Existing build-to-rent developments completed before 1 July 2023 will have until that date to meet the definition requirements and apply for registration. If a development does not do so by 1 July 2023, it will never be able to qualify for the exclusion. New build-to-rent developments will need to comply with the requirements immediately and will be eligible for the exclusion from the date they apply for the exclusion, provided they meet the requirements and are approved by HUD.

Effect of exclusion

The effect of the build-to-rent exclusion is that the interest limitation rules in subpart DH of the ITA would not apply to deny interest deductions. However, interest would still have to be deductible under existing tax rules.

Provided a deduction is allowed under existing tax rules, the interest that may be deducted if the exclusion applies would include interest on loans to:

- acquire the land a build-to-rent development is on,
- construct or install a build-to-rent development on the land,
- pay for things like insurance and rates, and
- renovate, maintain, or repair a build-to-rent dwelling.

When the exclusion ceases

A dwelling will cease to qualify immediately if it fails to meet the definition of "build-to-rent land". If a dwelling in a development no longer meets the requirements, for example, if it is not rented out under the RTA, interest relating to that dwelling will no longer be excluded from the interest limitation rules. If, when that dwelling ceases to qualify, this results in the development having less than 20 qualifying dwellings, the exclusion will cease to apply to the entire development.

Example 2: When a unit ceases to qualify

Assuming the same facts as in example 1, Te Awhi Co. is currently deducting interest relating to the 25 qualifying units in their development. In February 2025, four of these units are sold, so interest is only deductible for the remaining 21 units.

In May 2025, two units are rented out to new tenants who are only offered three-year contracts. This does not meet the requirement of offering a fixed-term tenancy of at least 10 years. As such, the two units no longer qualify for the build-to-rent exclusion. As only 19 units now meet the requirements in the build-to-rent land definition, the build-to-rent exclusion from the interest limitation rules will cease to apply for the entire development. The new build exemption may apply to the property for a period of 20 years from the date the property received its code compliance certificate.

In situations where an inadvertent breach of the "build-to-rent land" definition occurs, for example, a genuine administrative error sees a tenant in one of 20 dwellings not provided an explicit personalisation policy, Te Tūāpapa Kura Kāinga - Ministry of Housing and Urban Development will work with taxpayers to assist them in meeting compliance.

Interaction with the new build exemption

The new build exemption currently applies to exempt new builds from the interest limitation rules for a period of 20 years. A new build is a self-contained dwelling that has received its code compliance certificate on or after 27 March 2020.

A build-to-rent development is not barred from accessing the new build exemption. However, a development would still have to meet the build-to-rent land requirements—either from 1 July 2023 if it is an existing build, or immediately for new build-to-rent developments—to be able to access the exclusion at any time in the future (for example, once the 20-year new build exemption ceases).

Further information

More information about the build-to-rent exclusion is available at Te Tūāpapa Kura Kāinga – Ministry of Housing and Urban Development's website: www.hud.govt.nz/our-work/build-to-rent.

About this document

Special reports are published shortly after new legislation is enacted or Orders in Council are made to help affected taxpayers and their advisors understand the consequences of the changes. These are published in advance of an article in the *Tax Information Bulletin*.