Inland Revenue
Te Tari Taake

IR264
March 2023

Rental income

Tax rules for people who rent out residential property and holiday homes

Introduction

Read this guide if you rent out residential property or holiday homes. It explains:

- what income to include in your tax return
- the expenses you can deduct from this income for tax purposes
- the limits on expenses you can claim if your residential rental property makes a loss
- the records you need to keep
- what to do if the property is owned by more than 1 person, and
- what happens if the property is sold.

This guide is meant for people who own 1 or 2 rental properties, and who are not in the business of providing residential rental accommodation or dealing in land or property.

If you have several rental properties or you're a commercial operator, we recommend you use a tax agent.

ird.govt.nz

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The information in this guide is based on current tax laws at the time of printing.

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Part 1 - General

Rental income - which income is taxable?

Normally income that you receive from renting out property will be liable for income tax, so you must include it in your tax return. This income could be from renting out land or buildings, or it could be income you earn by having private boarders or flatmates living with you. Our website **ird.govt.nz** has more information on private boarders and flatmates.

Note

The rules for income and expenses in this part apply to all rental properties. But if you rent your holiday home to the public for short-term stays, you may need to calculate the proportion of your expenses that you can deduct.

You'll find more information about holiday homes in Part 5 of this guide.

Note

If you earn income from renting out residential property, there may be a limit on the amount of expenses you can claim in an income year.

You'll find more information about the residential property deduction rules in Part 4 of this guide.

Rent in advance

Any rent paid to you in advance is taxable in the year you receive it. So if your tenant paid rent on 30 March 2020 for the next two weeks, you'd return this income in the income year 1 April 2019 to 31 March 2020 (if you have a standard 31 March balance date).

Tenancy bond

Amounts you receive for tenancy bond and pass on to the Ministry of Business, Innovation and Employment (MBIE) are not income.

Amounts out of a tenancy bond you receive from MBIE for payment of rent arrears, should be included as income.

Amounts out of a tenancy bond you receive because of damage to the property during the tenancy, are not income.

Expenses you can deduct from your rental income

When you own a rental property, you're likely to have maintenance and administrative costs. You can claim all or some of these costs depending on how the property is used and the nature of the work being done. If you use the property for both rental and private use then costs need to be apportioned. Go to Deducting your expenses on page 62 or 64, depending on your situation.

For properties subject to the residential property deduction rules (also known as ring-fencing rules), the amount of expenses you can claim as deductions each year generally cannot be more than your residential rental property income. There are no changes to what expenses you can claim, but there is a limit on the total amount of deductions that can be claimed for the year. Allowable deductions you cannot claim for the year are carried forward for use in a future year. Find out more in Part 4 - Residential property deduction rules.

Generally, you can only claim expenses relating to your rental income.

The following costs or expenses can be deducted from your rental income for tax purposes.

Rates and insurance

You can claim the rates and insurance on your rental property.

Interest

The interest limitation rules may mean you are unable to claim interest charged on the money you borrow to finance your rental property.

For properties purchased on or after 27 March 2021, interest is not deductible from 1 October 2021 unless an exclusion or exemption applies.

If your loan relates to the purchase of a property before 27 March 2021, you can deduct a certain percentage of your interest expense until 31 March 2025 (provided the loan was first drawn down before 27 March 2021 or was for the settlement of the property).

If you borrowed the money for another purpose as well as buying your rental property, you cannot claim all the interest as an expense.

Example

Your loan finances both your rental property and the house you live in. You can only claim the interest for the rental property and generally only if you purchased the rental property before 27 March 2021 and subject to the rules phasing out interest deductions.

For more information about interest see Part 3 of this guide.

Agent's fees and commission

If you use an agent to collect the rent and/or maintain the property, the cost of the agent's fees can be deducted. Any commission paid to an agent to find tenants for the property is also deductible.

Repairs and maintenance

The cost of repairs and maintenance you do, or pay someone else to do, on the rental property is normally deductible as an expense.

Examples of repairs and maintenance are:

- replacing a broken shower head
- plastering and painting a crack in the wall
- replacing a blown element in a hot water cylinder
- redecorating the property so that it's in the same condition it was in when you bought it to use as a rental property.

If you do the repairs yourself, you cannot claim your time as an expense, only the materials you purchase.

There are some circumstances when the cost of repairs cannot be deducted as an expense because they're considered a capital improvement, such as where you:

- buy a rundown property and spend large sums of money on it to significantly improve or alter it before renting it out.
- carry out work which significantly improves the property, for example you take down a badly deteriorated wall and put a conservatory in its place.

These are capital expenses and the cost of the work is depreciated.

In some situations it can be difficult to work out whether work done on the property is repairs and maintenance or capital improvements. If you're not sure, we recommend speaking with a tax agent.

Motor vehicle expenses

If you use your own vehicle in the course of renting out your property, for example travelling to inspect a property or to do some repairs, you may be able to claim some vehicle running costs as an expense against your income. There are two options for claiming motor vehicle expenses:

1. Use the Inland Revenue kilometre rates. These rates are based on the average cost to run a motor vehicle. They're available at **ird.govt.nz/vehicle-expenses**

   To claim kilometre rates you need to keep a vehicle logbook and record the date, distance travelled and reason for each trip related to your rental activity.

2. Claim a percentage of the total running costs such as petrol, oil, repairs, registration, insurance and depreciation. You need to keep records of the running costs. At the end of the year, add them all up and work out what percentage of these running costs and depreciation relates to your rental activity. To do this you'll need to keep an annual logbook and record the:

   - total mileage for the year
   - total distance travelled as part of your rental activity, with a breakdown of the date, distance and reason for each trip.

   Alternatively, you can keep a logbook for a test period of at least 3 months every 3 years that shows:

   - the odometer reading at the start of the test period
   - total distance travelled as part of your rental activity, with a breakdown of the date, distance and reason for each trip
   - the odometer reading at the end of the test period.

The test period must fairly represent your normal vehicle running conditions. Also, if you believe that the proportion of rental-related travel has changed by more than 20%, you must re-run your test period or keep an annual logbook.

If you do not maintain actual records or a logbook, then the default method applies to limit your motor vehicle expenses. This is the lesser of:

- the proportion of actual business travel of the vehicle
- 25% of total expenses.

Example

Nicole uses her own car for her rental activity. She's decided to keep a logbook for a three-month test period.

Vehicle logbook (3-month period) 1 February 2019 to 30 April 2019						Odometer reading (at start of period) 25,236	
Date	**Journey**		**Odometer reading**				
	From	**To**	**Start**	**Finish**	**Dist (km)**	**Reason for trip**	**Driver's signature**
1.2.19	Home	Ngaio	25,236	25,275	39	Property inspection	NG
5.2.19	Home	Petone	25,430	25,477	47	Pick up new shower head	NG
6.2.19	Home	Ngaio	25,503	25,542	39	Install shower head	NG
15.3.19	Home	Ngaio	27,342	27,381	39	Show prospective tenant	NG
20.3.19	Home	Ngaio	27,645	27,684	39	Property inspection	NG
18.4.19	Home	Ngaio	28,837	28,876	39	Property inspection	NG
Rental activity distance					**242**	**Reading at end of period**	**29,241**
Total distance travelled						**(29,241 - 25,236)**	**4,005**

Total distance travelled in three months: 4,005 km
Distance travelled for rental activity: 242 km

$$\frac{242}{4,005} = 6.04\%$$

Nicole can claim 6.04% of her running costs and depreciation on the vehicle as an expense against her rental income.

Remember, you have to keep your vehicle records for 7 years, even if you stop renting out your property.

Travel expenses

If your rental property is somewhere in New Zealand other than your hometown you may have to travel to do property inspections and maintenance.

If you travel using other transport and the trip is solely to inspect or do maintenance on the rental property the cost is usually fully deductible.

This might include:

- air fares
- taxis
- rental car hire
- overnight accommodation.

If your travel is for both business (rental property activity) and personal reasons, you can only deduct the portion/part that relates to earning your rental income. This is to take into account any private use, which is not deductible. Deductions are only allowed for expenses that are part of earning your rental income.

Example

John lives in Wellington. He has a rental property in Tauranga. He has to go to replace some boards in the fence. He decides he'll go for the weekend and catch up with an old friend. John spends half his time on rental property maintenance and half his time meeting his friend. Based on the time spent on rental property maintenance only half the cost of travel and accommodation can be claimed as tax deductible. The other half is a personal cost.

If John was going to Tauranga for a holiday and just decided to pop in on his rental property, he would not be able to claim any of the cost.

If John's trip is solely to visit the rental property then the travel costs are fully deductible.

Do not forget you need receipts or invoices for any travel costs that you claim, whether this is the full cost or part-cost. Go to page 12 for more on record keeping requirements.

Fees

You can deduct as an expense any fees that you incur in:

- arranging a mortgage to finance the rental property
- drawing up a tenancy agreement
- getting a valuation required to obtain a mortgage. (A valuation acquired for insurance purposes is not deductible)
- taking legal action to recover unpaid rent
- evicting a tenant.

You can also claim legal fees as part of buying a rental property provided your total legal fees for the income year are $10,000 or less.

Mortgage repayment insurance

You can claim a deduction for the cost of any mortgage repayment insurance if you are required by the lender to incur this expense to obtain a loan.

Accounting fees

If you use an accountant to prepare your accounts the cost of the fees are tax deductible. Any fees paid when setting up the rental property, such as investigating the viability of the rental, are not deductible.

Depreciation

Depreciation covers the cost of wear and tear and general ageing of assets used to produce income.

You can:

- claim a deduction for depreciation on any furniture or fittings that belong to you, or
- elect not to claim depreciation - see page 26.

Note

When you sell or dispose of an asset (except a building) for an amount different from its adjusted tax value,* you must account for the difference - either a loss or a gain - in your income tax return.

* Adjusted tax value is generally the cost price, less depreciation deducted each year.

For more information about depreciation see Part 2 of this guide.

Expenses you cannot deduct for tax purposes

You cannot claim deductions for capital expenses, private expenses, or expenses that do not relate to your rental.

Capital expenses are the costs of buying a capital asset or increasing its value, for example the cost of buying the property and making improvements. Private expenses are things you buy or pay for that are for your own benefit, rather than to generate rental income.

The following are expenses you cannot deduct from your rental income in your tax return:

- the purchase price of a rental property
- the capital portion of any mortgage repayments
- interest on money you borrow for some purpose other than financing the rental property, even if you use the rental property to secure the loan
- the cost of repairing or replacing any damaged part of the property, if the repairs or replacement make improvements to the property and increase its value
- the cost of adding to or improving the property
- real estate agent or legal fees charged as part of selling the property.

Note

Generally, you cannot claim legal fees charged as part of selling the property. However, you may be able to claim your legal expenses for selling a rental property if:

- you are in the business of providing residential rental accommodation, and
- your total legal expenses for the income year are $10,000 or less (including any legal expenses relating to buying the property).

For more information about the expenses you can claim talk to your tax agent.

Expenditure to meet Healthy Homes standards

Owners of residential rental properties are required to make sure their properties meet certain minimum standards.

The 2019 Healthy Homes regulations apply progressively when there are changes in tenancies after 1 July 2021 with universal application from 1 July 2024.

Costs incurred in meeting the standards will be capital in nature and not deductible if the work:

- results in the reconstruction, replacement or renewal of the whole asset or substantially the whole asset, or
- goes over and above making good wear and tear (that is, it is not a repair) and changes the character of the asset.

Costs incurred in meeting the standards will be revenue in nature and deductible if work to repair or maintain an asset is completed without reconstructing, replacing or renewing the whole asset, or substantially the whole asset, or without changing its character.

For more information, see our **Question we've been asked (QB) 20/01: Can owners of existing residential properties claim deductions for costs incurred to meet Healthy Homes standards** at **taxtechnical.ird.govt.nz**

If the property is not rented out for the full year

You can claim a deduction for any expenses that you incur while your rental property is either rented out or is available to be rented out. But if the property is not occupied by tenants or available for rent for part of the year, you cannot claim the full year's ongoing costs, such as rates, insurance and interest.

Example

You own a property and live in it for the first 3 months of the year. You then rent it out for the rest of the year. The cost of rates, insurance and interest for the year is $9,230. To work out your rental income for the year, deduct the ongoing costs for the 9 months the property was rented out, that is, 9/12ths of the expenses.

$9,230 ÷ 12 = $769.16 per month

$769.16 × 9 = $6,922.44 The amount of these expenses you can claim for the year.

If a property is not occupied or available for letting for a short time, because of redecorating or other maintenance, you can still get a deduction for the ongoing costs for that period. The redecorating or maintenance costs will also be deductible, as long as the work done is not classed as capital improvements.

If your residential rental activity makes a loss

In this guide, “rental loss” refers to when your deductions for a rental property exceed the income you earned from the rental activity. Rental losses can only be used to reduce your overall tax liability by offsetting the losses against other income, like salary and wages, up to and including the 2018-19 income year.

From the start of the 2019-20 income year, deductions you can claim for residential rental property in a particular year generally cannot be more than the rental income you earn from the rental activity. Any deductions in excess of your income from the property for the year will be carried forward to the next year you earn income from the residential property. Find out more in Part 4 - Residential property deduction rules.

Example

You own a property and receive $15,000 rental income for the year. In that year, you incur $16,000 of expenses. Under the new rules, you can only claim $15,000 of expenses against your rental income for the year and must carry forward the excess deductions of $1,000 to a future income year in which you receive income from your residential property.

Note

Accumulated tax losses brought forward from the 2018-19 income year are not affected by the new rules for rental deductions, even if they include rental losses. You may continue to offset these tax losses against your net income. However, from the start of the 2019-20 income year onwards, excess residential rental deductions will be carried forward separately from the accumulated tax losses.

If the property is rented out at less than market value

If you rent your property out for less than its true rental value, for example, to a relative or friend at mates' rates, and you still make a profit from it, the profit is taxable as part of your income. But if you make a loss in this situation, because the expenses of the property are more than the reduced rental income, you generally will not be able to deduct expenses more than the amount of income you received.

Record keeping

You must keep records to be able to calculate the income and expenses of your rental property and for us to confirm your accounts. These include:

- a record of all receipts and payments
- bank statements, cheque butts and deposit books
- invoices and receipts
- working papers for all calculations, including your vehicle logbook
- a list of assets and receipts with cost price and purchase date
- a copy of the rental agreement and rent book
- a copy of any loan mortgage agreement.

It's a good idea to use a separate bank account for your rental activity.

Note

You must keep accurate records of the purchases and sales of your rental assets so we can check your depreciation deductions if we need to.

Keep all your records for 7 years, even if you stop renting out the property. You do not need to send your records or working papers with your tax return, but you must keep them in case we want to see them.

Example - Rental income - IR3R

Inland Revenue
Te Tari Taake

IR3R
March 2023

Rental income

- Complete all questions on pages 1 and 2.
- Read our booklet **Rental income – IR264** to help you fill in this form.
- Attach this form to your income tax return and keep a copy for your records.

Year ended 31 March 2023

Your name: Nicole Gregg

IRD number: 1 2 3 4 5 6 7 8 9

(8 digit numbers start in the second box. 1 2 3 4 5 6 7 8)

Address of property rented: 115 Smith Street, Ngaio

Period the property was available for renting: 12 months

Income – read Note 2 over the page.

		Box	Amount
1.	Total rents	1	$ 12,480.00
2.	Other income (specify) 2A: Interest from rental bank account	2	$ 140.00
3.	Gain or loss on disposal (enter any loss in brackets)	3	$ NIL
4.	**Total income**	4	$ 12,620.00

Expenses – read Note 3 over the page.

		Box	Amount
5.	Rates	5	$ 1,580.00
6.	Insurance	6	$ 620.00
7A.	Total interest on residential property	7A	$ 2,520.00
7B.	Interest expense claimed	7B	$ 2,205.00

7C. Reason for interest expense claimed – read Note 4 over the page.

- [ ] A Māori exempt company or not a residential land company
- [ ] Certain schedule 15 exclusions or property not in NZ
- [x] Loans drawn down prior to 27 March 2021
- [ ] Approved build-to-rent exclusion
- [ ] New build exemption
- [ ] Development or land business exemption
- [ ] Emergency, transitional, social or council housing

8. Agent's collection fees — 8: $ 250.00

9. Repairs and maintenance – read Note 5 over the page.

Description	Amount	Total
Shower head	$ 60.00	
	$	
	$	$ 60.00

10. Other (specify)

Description	Amount	Total
Vehicle costs	$ 152.00	
	$	
	$	$ 152.00

Depreciation – print the details below.

		Box	Amount
11.	Buildings – read Note 6 over the page.	11	$
12.	Assets – read Note 7 over the page.	12	$ 4,000.00
		13	$ 4,867.00
14.	**Total expenses** (do not include amount from box 7A in your total expenses)	14	$ 8,867.00

15. **Net rents** (total rents less expenses) – subtract Box 14 from Box 4 and print in Box 15. Copy this amount to your tax return, if the property is NOT residential property. For residential property, use the **Residential property deductions worksheets – IR1226** to help you complete your return. Read note 8 over the page. — 15: $ 3,753.00

Depreciation of buildings – read Note 6.

16. Date purchased: 01 04 2019 (Day Month Year)

17. Construction materials and building description: Wooden framed

	Cost of buildings (excluding cost of land) / Opening adjusted tax value	Rate	Depreciation claimed	Closing adjusted tax value
Straight line method (SL)	18: $ 150,000.00	19: 0 %	20: $ 00.00	21: $
Diminishing value method (DV)	22: $	23: %	24: $	25: $

26. **Depreciation of assets** – read Note 7.

Asset	Date purchased	Cost	Opening adjusted tax value	Rate	Method SL/DV	Depreciation claimed	Closing adjusted tax value
Chattels (Pooled)	01 04 2019	$ 10,000	$	40 %	DV	$ 4,000.00	$ 6,000
		$	$	%		$	$
		$	$	%		$	$
		$	$	%		$	$
		$	$	%		$	$
					Total	$ 4,000.00	

Note

From the start of the 2011-12 income year, depreciation on buildings is 0% where buildings have an estimated useful life of 50 years or more. This applies regardless of when the building was acquired.

Calculating the net rent

If you own a residential rental property that is subject to the residential property deduction rules, you can use the **Residential property deductions worksheets - IR1226** to calculate your net residential income and any excess residential rental deductions you may have. These worksheets help you calculate the amounts that you need to transfer to the section in your return for Income from residential property. Find out more in Part 4 - Residential property deduction rules.

For rental properties that are not subject to the rules, once you've worked out what your income and expenses are, transfer the information to our **Rental income - IR3R** and calculate the net rent. Transfer the net rent figure from Box 15 to your income tax return and attach the IR3R. Find an example of a completed IR3R on the previous page.

Paying income tax

If you're an individual property owner, or a partner in a partnership, you need to complete an IR3, or if you're a non-resident, an IR3NR, income tax return each year. You can submit your return online in myIR. You can also download a return from **ird.govt.nz/end-of-tax-year** and send it to us by post.

If your rental property is not subject to the residential property deduction rules, the net income from that property is added to your other income, and the net loss is offset against your other income.

If your rental property is subject to the rules, you cannot offset your net loss against your other income. Any excess deductions will need to be carried forward until the next year you earn residential income.

You then work out the tax on your total taxable income. If you have any tax credits, such as PAYE or RWT on interest or dividends, these are deducted from the tax on your total taxable income.

After deducting any tax credits you'll have a balance to pay or to be refunded.

The tax year ends 31 March each year for most people. If you have any tax to pay, known as residual income tax, for the year, it usually needs to be paid to us by 7 February of the following year. If you have a tax agent with an extension of time you have until 7 April.

When you start renting out your property, you’ll need to complete a tax return each year. You can do this in myIR.

Provisional tax

If you have to pay income tax of more than $5,000 ($2,500 for the 2019/20 and earlier years) at the end of any tax year, you'll most likely have to pay provisional tax for the following year. Provisional tax is not a separate tax, but a way of paying the tax on your income as you receive it through the year. You usually pay 3 instalments of provisional tax, based on what you expect your tax at the end of the year to be. If your balance date is 31 March then your instalment dates are 28 August, 15 January and 7 May each year. For more information read our **Provisional tax - IR289** guide.

Note

If you're registered for GST and also have to pay provisional tax, please read our **Provisional tax - IR289** guide.

If the property is owned by more than 1 person

If you own a residential property with 1 or more people, your income tax obligations will depend on the nature of the relationship with the other people.

You may own a residential property jointly with 1 or more people but not have entered into a formal legal partnership with them. For example, the owners of a jointly owned property may be married or in a civil union, in a de facto relationship, or relatives. In this case, each of you must complete an **Individual tax return - IR3** for your share of the rental income and deductions. A copy of the rental accounts or completed **Rental income - IR3R** schedule must be included in each individual tax return. You do not need a separate partnership IRD number and you do not need to submit an IR7 return.

Your partnership needs its own IRD number if:

- you are in a legal partnership that carries on a business in New Zealand (and you may have entered into a formal agreement recording the purpose of the partnership and details such as the responsibility, contribution, and share of each of the partners), or
- you own a property in partnership which is a limited partnership registered under the Limited Partnerships Act 2008.

You can get an IRD number for your partnership by completing an **IRD number application - resident non-individual - IR596** form. The partnership only needs to keep 1 set of accounts to record its income and expenses and file an IR7 income tax return each year. This return shows the rental income calculated in your **Rental income - IR3R** schedule and the amount of each partner's share. Each individual in the partnership then uses that share to complete their income tax return.

If the partnership owns residential property subject to the residential property deduction rules, use the **Residential property deductions worksheets - IR1226** to calculate each partner's net income and any excess deductions.

Note

Each partner's individual tax return must include their share of the rental profit or loss.

What happens if the rental property is sold or you move into it?

If you sell or move into your rental property, you'll need to make some adjustments in your tax return.

The amount of expenses you can claim for a loss-making residential rental property may change depending on whether the sale of the property was taxable. Find out more in Part 4 - Residential property deduction rules.

Please read the depreciation section on page 19 and then refer to pages 30-32. The rules applying to building sales can be quite complex so you may want to consult your tax agent.

Bright-line property rule for residential property

If you purchase or acquire a residential rental property on or after 1 October 2015 and sell or dispose of it within the applicable bright-line period, any gain on sale may be taxable income.

The bright-line property rule will apply if you purchased or acquired residential property on or after:

- 1 October 2015 through to 28 March 2018 and you sold or disposed of it within 2 years
- 29 March 2018 through to 26 March 2021 and you sold or disposed of it within 5 years. This includes property acquired on or after 27 March 2021 if it was acquired as a result of an offer the purchaser made on or before 23 March 2021 and that offer could not be revoked or withdrawn before 27 March 2021, or
- 27 March 2021 and you sold or disposed of it within 5 years to the extent the property has a 'new build' on it or 10 years for all other properties.

The date you acquire a property is generally the date a binding sale and purchase agreement was entered into for the purchase of the property (even if some standard conditions like getting finance or a building report still need to be met). This date determines which bright-line period applies.

In most cases your bright-line period starts on the date the legal title is transferred to you and ends on the date you enter into a binding sale and purchase agreement to sell or dispose of the property.

For more information on when a property is acquired, see our **Question we've been asked (QB) 17/02: Date of acquisition of land, and start date for 2-year bright-line test** at **taxtechnical.ird.govt.nz**

Note

From the 2021-22 income year, the definition of residential land has been amended to ensure the bright-line property rule applies to short-stay accommodation in a dwelling that is not the owner's main home, even if it's a business premises (for example, Airbnb).

Newly built properties

From 27 March 2021, to qualify for the shorter 5-year bright-line period for new builds, one of the following must be satisfied:

- For an existing new build, you must have acquired it no later than 12 months after the Code Compliance Certificate (CCC) was issued for that new build under the Building Act 2004.
- Where you made an off-the-plans purchase for the new build, the CCC confirming the dwelling was added to the land must be issued by the time you sold the land.

- Where you constructed the new build on your land, the CCC confirming the dwelling was added to the land must be issued by the time you sold the land.

In all cases the new build must be a self-contained dwelling and must still be on the land when you sold it, otherwise the 10-year bright-line period applies.

A remediated or converted building can also qualify as a new build in any of the following situations:

- It was removed from the earthquake prone buildings register on or after 27 March 2020 and you can prove the remediation is complete. Proof can be either a CCC or local or building consent authority records showing the work was completed and then signed off by a qualified engineer.
- It had weathertightness issues in the past but it's now at least 75% reclad and a CCC was issued on or after 27 March 2020 for the reclad.
- It has been converted from a commercial premises and a CCC was issued on or after 27 March 2020 confirming the conversion has been completed.
- It was converted from a hotel or motel, and local or building consent authority records show the conversion was completed on or after 27 March 2020.
- It is part of a building with 2 or more dwellings that before conversion was just a single dwelling, and a CCC was issued on or after 27 March 2020 confirming the conversion.

Where land has a new build and a non-new build on the same legal title, any gain on the sale of the property may need to be apportioned between the new build and the non-new build. Only the gain on sale in relation to the new build qualifies for the 5-year bright-line period.

Adding a new build to land after acquiring it does not restart the bright-line period to the date the new build was added. The start of the bright-line period remains the same, which for most people is the date property ownership is registered with Land Information New Zealand (LINZ).

Example

James signs a sale and purchase agreement for a section in March 2023. Settlement occurs and title is transferred to James on 12 April 2023. James adds a new build to the section. The new build receives its CCC confirming it has been added to the land in June 2025. James sells the property in October 2029.

The bright-line period begins on 12 April 2023 (when title was issued to James) and not from June 2025 (when the new build receives its CCC). Therefore, James would only be taxed on the gains on sale if he sold the property by 11 April 2028 (that is, within 5 years of title for the property transferring to James). Since James sold the land outside of that period, the bright-line property rule does not apply.

Note

If you're an offshore residential land withholding tax (RLWT) person and sell or dispose of your New Zealand residential property within the applicable bright-line period (see above), you may have RLWT deducted.

For more information go to **ird.govt.nz/rlwt**

For more information see our guide **Bright-line property tax - IR1227**.

GST (goods and services tax)

Renting out residential property long-term is exempt from GST. You cannot claim GST on expenses from a residential property, and you cannot include GST in the rent you charge. But, when you claim income tax deductions you use the cost of the expense including the GST.

If you're a property developer and you buy residential properties, you may have to pay GST. Go to **ird.govt.nz/gst** for more information.

Working for Families and student loans

When you apply for Working for Families you must show any rental income you earn. Go to **ird.govt.nz/working-for-families** to find out more.

If you're a student loan borrower, from 1 April 2014 rental losses will not reduce your income for working out your student loan repayment obligation. Prior to this the rental loss did reduce your income and repayment obligation.

Depreciation on buildings

If you sell a rental property that you owned before 2003 and have depreciation recovered for income tax purposes, you can reduce your income for Working for Families by the amount of any depreciation recovered.

Child support

From 1 April 2019, residential rental losses will generally no longer reduce your income for working out how much child support you pay. This is because a child support assessment is based on your taxable income.

Part 2 - Depreciation

Assets, such as the stove and carpets, that are part of the property or used in your rental activity will eventually reduce in value through wear and tear or by becoming out of date. This reduction in the value of your assets is known as depreciation. Each year you calculate the depreciation amount and deduct it as an expense.

This is a summary of the depreciation rules relating to rental properties. For more information read our guide **Depreciation - a guide for business - IR260** or go to **ird.govt.nz/depreciation**

We set depreciation rates for various assets, excluding land as it's not depreciated, for tax purposes. We base these rates on:

- its estimated useful life
- its estimated residual (market) value.

The assets commonly used in rental activity and their depreciation rates are listed on pages 22-25.

If you're claiming depreciation you have to keep a schedule of all the assets you're depreciating. This should show the depreciation claimed in previous years and the adjusted tax value of each asset. The adjusted tax value is generally the cost price, less depreciation deducted each year.

You can choose not to claim depreciation - go to page 26.

Note

If you inherited the property, the cost price for depreciation is its market value at the time the property is transferred to you as the new owner. The exception is for a spouse, civil union, or de facto partner, in this case the transfer is at cost or adjusted tax value.

If you've claimed depreciation on the sale of a building prior to the 2011-12 income year, you're required to account for the gain in your income tax return - go to pages 28-31.

If you rent a holiday home to the public for short-term stays, there may be limits to the amount of depreciation you can claim. See Part 5 for more information.

Depreciation methods

You can depreciate an asset individually or as part of a group or pool of assets - go to page 25. But you cannot pool the assets if you also use them privately, for example, the chattels in a holiday home you sometimes rent out and sometimes use yourself.

If you choose to calculate depreciation on individual assets, you can use either the diminishing value method or the straight line method.

If you pool your assets you can only use the diminishing value method.

Diminishing value method

Using this method, the amount of depreciation is worked out on the adjusted tax value of the asset. This value is the original cost price (including GST) less any depreciation already claimed in previous years.

Example 1

Using diminishing value method

Asset: Dishwasher - purchased after 20 May 2020

Cost: $1,200

Depreciation rate: 30%

Value at	Adjusted tax value start of the year	Depreciation rate	Depreciation claimed	Adjusted tax value end of year
Year 1	$1,200.00	30%	$360.00	$840.00
Year 2	$840.00	30%	$252.00	$588.00
Year 3	$588.00	30%	$176.40	$411.60
Year 4	$411.60	30%	$123.48	$288.12
Year 5	$288.12	30%	$86.44	$201.68

Note

This table excludes the 20% loading which ceased from 20 May 2010.

Straight line method

Each year you claim a set percentage of the asset's original cost. This percentage is set so that the depreciation you claim over an asset's expected useful life works out to its original cost at the time you acquired it.

Example 2

Using the straight-line method to depreciate the dishwasher in Example 1.

	Original cost	Depreciation rate	Depreciation claimed	Adjusted tax value
Year 1	$1,200	21%	$252.00	$948.00
Year 2	$1,200	21%	$252.00	$696.00
Year 3	$1,200	21%	$252.00	$444.00
Year 4	$1,200	21%	$252.00	$192.00
Year 5	$1,200	21%	$192.00	$0.00

You can claim $252.00 for the first four years, but, in the fifth year the final claim is $192.00. This is because the dishwasher's adjusted tax value is less than the original calculated depreciation of $252.00. The amount of depreciation claimed cannot exceed the adjusted tax value.

Note

You do not have to use the same method for all your assets, but you cannot switch methods for an asset part-way through any income year.

You can change the method you choose for any asset from year to year. If you do change methods, the asset's opening value at the start of one year must be its adjusted tax value at the end of the previous year, not its original cost.

Assets not used for the full year

You have to reduce the amount of depreciation you claim on an asset if it has not been part of your rental activities for the whole year. You do this based on the number of months that you use it for rental purposes.

Depreciation on buildings

From the 2011-12 income year depreciation on residential buildings is 0% where buildings have an estimated useful life of 50 years or more. This applies regardless of when the building was acquired.

If you're completing a tax return for an earlier income year, our Depreciation rate finder can help you find the correct rate of depreciation for your building. Go to **ird.govt.nz/depreciation** for more information.

Depreciation on contents

The following tables show the rates for some commonly used assets.

If you have an asset that was acquired before the end of your 2004-05 income year different rates will apply. If this is the case, or an asset being used is not listed, go to **ird.govt.nz/depreciation** to find out more.

Table 1 - Assets acquired on or after 1 April 1995 and up to 31 March 2005

Asset	Diminishing value %		Straight line %	
	General rate	Rate plus 20%	General rate	Rate plus 20%
Appliances (small)	40	48	30	36
Bedding, linen	50	60	40	48
Blinds, drapes and curtains	22	26.4	15.5	18.6
Carpets	33	39.6	24	28.8
Crockery, cutlery, glassware	50	60	40	48
Dishwashers	26	31.2	18	21.6
Furniture (loose)	18	21.6	12.5	15
Lawnmowers	40	48	30	36
Light fittings	18	21.6	12.5	15
Microwave oven	26	31.2	18	21.6
Ovens and stoves	22	26.4	15.5	18.6
Paintings, drawings	9.5	11.4	6.5	7.8
Refrigerators and freezers	22	26.4	15.5	18.6
Televisions, videos, stereos	33	39.6	24	28.8
Utensils, pots, pans	50	60	40	48
Washing machines, dryers	26	31.2	18	21.6

Table 2 - Assets acquired on or after 1 April 2005 and up to 31 March 2011

Asset	Diminishing value %		Straight line %	
	General rate	Rate plus 20%	General rate	Rate plus 20%
Appliances (small)	50	60	40	48
Bedding, linen	67	80.4	67	80.4
Blinds, drapes and curtains	25	30	17.5	21
Carpets	40	48	30	36
Crockery, cutlery, glassware	67	80.4	67	80.4
Dishwashers	30	36	21	25.2
Furniture (loose)	20	24	13.5	16.2
Lawnmowers	50	60	40	48
Light fittings	20	24	13.5	16.2
Microwave oven	30	36	21	25.2
Ovens and stoves	25	30	17.5	21
Paintings, drawings	10	12	7	8.4
Refrigerators and freezers	25	30	17.5	21
Televisions, videos, stereos	40	48	30	36
Utensils, pots, pans	67	80.4	67	80.4
Washing machines, dryers	30	36	21	25.2

Note

The 20% loading does not apply to secondhand assets and has been removed for assets purchased after 20 May 2010. The general rate of depreciation will apply.

Assets purchased, or with binding contracts for purchase, entered into on or before 20 May 2010 can continue to use the general rate with loading.

Where there's a capital improvement to an asset with the 20% loading, this improvement needs to be depreciated separately from the original asset, and without the loading allowance.

Low value items

Where you purchase an asset that has a low value you can fully deduct the cost of that asset at the time of purchase. This removes the need to depreciate that low value asset over its useful life.

A low value asset is determined by its cost:

- up to 16 March 2020 - up to $500
- 17 March 2020 to 16 March 2021 - up to $5,000
- 17 March 2021 onwards - up to $1,000

Fully or partly furnished properties

If you rent your property out fully or partly furnished you can either depreciate the contents individually or, if there are many items included in the contents (for example loose furniture, paintings), choose to pool the assets.

Table 3 - Assets acquired on or after 1 April 2011

Asset class	Estimated useful life (years)	Diminishing value rate %	Straight line rate %
Chattels (default class)	5	40	30
Air conditioners and heat pumps (through wall or window type)	10	20	13.5
Air ventilation systems (in roof cavity)	10	20	13.5
Alarms (burglar/smoke, wired or wireless)	6.66	30	21
Appliances (small)	4	50	40
Awnings	10	20	13.5
Bedding	3	67	67
Blinds	8	25	17.5
Carpets	8	25	17.5
Clotheslines	8	25	17.5
Crockery	3	67	67
Curtains	8	25	17.5
Cutlery	3	67	67
Dehumidifiers (portable)	4	50	40
Dishwashers	6.66	30	21
Drapes	8	25	17.5
Dryers (clothes, domestic type)	6.66	30	21
Freezers (domestic type)	8	25	17.5
Furniture (loose)	10	20	13.5
Glassware	3	67	67
Heaters (electric)	3	67	67
Heaters (gas, portable and not flued)	5	40	30
Lawn mowers	4	50	40
Light shades/fashion items affixed to a standard light fitting*	10	20	13.5
Linen	3	67	67

* Light fittings are connected to the electrical wiring and part of a residential rental building and without the function of lighting would not be considered complete.

Table 3 - Assets acquired on or after 1 April 2011 (continued)

Asset class	Estimated useful life (years)	Diminishing value rate %	Straight line rate %
Mailboxes	15	13	8.5
Microwave ovens	4	50	40
Ovens	8	25	17.5
Refrigerators (domestic type)	8	25	17.5
Satellite receiving dishes	12.5	16	10.5
Stereos	5	40	30
Stoves	8	25	17.5
Televisions	5	40	30
Utensils (including pots and pans)	3	67	67
Vacuum cleaners (domestic type)	3	67	67
Washing machines (domestic type)	6.66	30	21
Waste disposal units (domestic type)	8	25	17.5
Water heaters (heat pump type)	10	20	13.5
Water heaters (over-sink type)	10	20	13.5
Water heaters (other eg, electric or gas hot water cylinders)	15.5	13	8.5
Water heaters (solar type)	10	20	13.5

Pooling assets

If you have a number of low-value assets that you cannot fully depreciate in the first year, you can use a pool system to depreciate them collectively as if they were a single asset. Go to page 23 for more on low value items.

This means you do not have to work out the depreciation on each one separately. You can pool assets that individually cost up to $5,000, or have been depreciated and now have an adjusted tax value of $5,000 or less. You can apply to us to pool assets when their values are more than $5,000. You can also have more than one pool. Once an asset is included in a pool you cannot treat it as a single asset again later, except where the asset is now used by you privately.

Note

The maximum pooling value of $5,000 applies from the 2015-16 income year. If you're filing for income years prior to this the maximum pooling value is $2,000.

You depreciate each pool using the diminishing value method, at the lowest depreciation rate applying to any asset in the pool.

Example

A pool of chattels (purchased before 1 April 2005) consisting of carpets (39.6% depreciation rate), light fittings (21.6%), drapes (26.4%), stove (26.4%) and dishwasher (31.2%) is created. The lowest rate in the pool is light fittings, so the depreciation rate to use is 21.6%. If the carpets were not included in the pool, the rate to use for the pool would still be 21.6%, but the carpets could then be depreciated individually at 39.6%.

If you sell an asset in a pool for more than its cost, the excess is subtracted from the adjusted tax value of the pool.

Electing not to depreciate an asset

You may decide you do not want to claim a depreciation deduction, for example, when renting out your home while you're overseas.

Note

In this section, the term asset does not include a building. From the 2011-12 income year depreciation on buildings is 0%.

If you decide not to claim depreciation on an asset, and you do not want to pay tax on depreciation recovered when depreciation was not claimed, you should elect not to treat the asset as depreciable. Tell us on an asset-by-asset basis by telling us which assets you're choosing not to depreciate. Tell us which asset you're making an election for in your tax return for the income year when:

- you purchase your asset
- you change the use of your asset from non-business to business.

Once you've given us your election not to depreciate an asset you cannot claim depreciation on this asset in future years.

It will not be a depreciable asset and the depreciation recovery or loss on sale provisions will not apply. If you do not make an election not to depreciate an asset, even if you have not claimed depreciation, you'll be considered to have claimed it. The amount considered to be a claim needs to be included in the depreciation recovery calculation.

Note

You can backdate an election not to depreciate an asset you never claimed depreciation on. The election is made by telling us in your tax return in any income year after acquiring the asset.

Example

Geoff rented out his house while he was overseas for a year, from June 2018.

Q Does he have to claim depreciation on the chattels left in the house for the period the house is rented out?

A No, Geoff can elect not to depreciate the depreciable assets in the house for the period the house is rented.

Geoff must tell us in his tax return for the 2018-19 year. If no election is made, it's assumed that depreciation has been claimed.

Working out the value of chattels

When you buy a property, you need to work out the value of your chattels so you can make a claim for depreciation.

If you have a registered valuation, use the total value of all the chattels and apportion this amongst them on a market value basis.

If you do not have a registered valuation, use the market value of each chattel as its opening tax value on which to claim depreciation. You can get market values from second-hand dealers or from classified advertisements for similar items of the same age and condition.

Note

You can find examples of depreciable items, for example, fixtures, fittings and chattels, in our interpretation statement **IS 10/01: Residential rental properties - depreciation of items of depreciable property** at **taxtechnical.ird.govt.nz**

Transferring personal assets to your rental activity

Sometimes you might transfer a personal asset into your rental property. For example, you buy a new stove for your own house and move your old stove into your rental property.

If one of your personal assets becomes part of your rental activity, use its market value at the time of the change to use as the opening book value for depreciation.

Example

At the local second-hand dealer there's a stove the same as the one you're moving into the rental property. It's being sold for $250. This can be used as market value.

The opening value in your assets register will be $250.

Note

This rule does not apply to buildings - go to page 30 for more information.

Renting out your own home

If you start to rent out the home that you were living in, you need to use the market value of your chattels at the time you started renting the property to calculate depreciation.

You also need to make some adjustments if you later move back into the property - page 30.

Selling and disposing of assets

If you sell or dispose of a rental asset that is not a building for a different amount to its adjusted tax value, you need to account for the difference - either a loss or a gain. Remember the adjusted tax value is the remaining value of your asset once all depreciation calculated has been deducted from the value of the asset.

If you sell an asset for more than its adjusted tax value, you'll have to include the difference between the sale price and the adjusted tax value in your taxable income.

Only include the difference between the original cost and the adjusted tax value in your taxable income if the asset is sold for more than its original cost.

Note

Costs incurred in selling an asset, such as commission and advertising, can be deducted from the sale price before you work out the loss or gain on sale.

Example 1 - All depreciation deductions have been claimed

Stove purchased for	$ 1,400
Less depreciation allowed as a deduction	$ 1,260
Adjusted tax value	$ 140
Sale price of stove	$ 250
Less adjusted tax value	$ 140
Depreciation recovered	$ 110

The depreciation recovered is $110 and is included as taxable income in the year the stove was sold.

Example 2 - Not all depreciation deductions have been claimed

When an asset is sold and you did not claim all the depreciation you still have to calculate it as if all depreciation has been claimed, to find the adjusted tax value when accounting for the difference.

Depreciation claimed:

Income year	Depreciation claimed	Book value
		$ 1,400
2011	$252	$ 1,148
2012	nil	$ 1,148
2013	$252	$ 896
2014	$252	$ 644
2015	nil	$ 644

For 2012 and 2015 the depreciation that has not been claimed is considered to have been claimed. So the total depreciation allowed as a deduction is $1,260 ($252 × 5 years).

Stove purchased for	$ 1,400
Less depreciation allowed as a deduction	$ 1,260
Adjusted tax value	$ 140
Sale price of stove	$ 250
Less adjusted tax value	$ 140
Depreciation recovered	$ 110

The depreciation recovered is $110 and is included as taxable income in the year the stove was sold.

Gain

If you sell an asset for more than its adjusted tax value, include in your taxable income the lesser of:

- the total depreciation that could have been deducted
- the amount by which the sale price received exceeds the adjusted tax value, or
- the amount by which the original cost exceeds the adjusted tax value.

Loss

If you sell an asset for less than its adjusted tax value, you can claim a deduction for the difference between the sale price and the adjusted tax value.

Note

If you sell an asset for a price that's substantially different from its true market value at the time, for tax purposes the sale is treated as though you had sold the asset for its true market value. This is so people cannot avoid paying tax by selling assets to their associates for artificially low prices.

If you keep an asset, but stop using it for rental purposes, you'll have to make an adjustment as if you'd sold it for its market value at the start of the next tax year. For example, you take an asset from your rental property for your own personal use or you move into the property.

You make the adjustment in your income tax return for the year after the asset changed use or the year after you ceased renting the property.

Sale of a building

If you sell a building that you've previously claimed depreciation on, this section applies to you. Depreciation on residential buildings only applied before the 2011-12 income year.

When a residential building is sold for more than its adjusted tax value, the depreciation recovered is taxable income. The amount of depreciation recovered is the lesser of:

- the original cost price of the building, less the adjusted tax value, or
- the sale price, less the adjusted tax value.

This ensures that any capital profit made on the sale of a residential building is not included as depreciation recovered.

Moving back into your own home

If you stop renting your own home and move back into it (or move into a property you have been renting), for the purpose of depreciation you treat this as if you've sold the property. The sale value of the property is the market value as at the beginning of the next income year.

If you've claimed depreciation on the property, and the sale value is more than its adjusted tax value, the depreciation recovered is taxable income. The depreciation recovered is the lesser of:

- the original cost price of the building less the adjusted tax value or
- the sale value less the adjusted tax value.

You'll need to show the depreciation recovery income in your income tax return the year after you moved back into the property.

Example

Original purchase price (excluding land value)	$ 100,000
Total depreciation claimed	$ 10,000
Adjusted tax value	$ 90,000
Sale value (excluding land value)	$ 125,000
Adjusted tax value	$ 90,000
Gain on sale	**$ 35,000**

Depreciation recovered $10,000

The depreciation recovered ($10,000) is less than the gain on sale ($35,000). Include the $10,000 of depreciation recovered as income in your tax return the year after you move back into the property.

Generally, depreciation claimed on a house would be recoverable because the market value of the house would usually be higher than the adjusted tax value. Chattels though, in most circumstances, depreciate faster than a house and the market value of the chattels is likely to be close to the adjusted tax value, reducing any likely difference.

When you rent out your home with the intention of moving back in the future you may want to consider the effect of depreciating each asset. Electing not to depreciate the asset could reduce any depreciation to be recovered.

If you sell the property for a loss, generally you cannot claim this or any excess deductions unless you have other income from a taxable property sale. These will need to be held and offset in a future year, when you have income from a taxable property sale.

Note

Losses on the sale or disposal of buildings are not deductible, unless the building has been rendered useless for the purposes of deriving income - page 32.

The rules applying to building sales can be quite complex, so you may need to talk to a tax agent.

Disposal costs

You're allowed a deduction for the cost to dismantle, demolish and remove an asset. You include this cost when you work out a loss or gain on the disposal of the asset.

Example

Machinery is damaged by a flood and a cost is incurred to remove the machinery from the business premises.

Original purchase price		$ 1,200
Less total depreciation claimed		$ 1,000
Adjusted tax value		$ 200
Proceeds from sale as scrap metal	$ 500	
Less cost of removal from premises	-$ 800	
Net disposal proceeds		-$ 300
Loss on disposal		-$ 500

Insurance proceeds

Assets lost or destroyed

If you receive an insurance payout for an asset which is lost or destroyed, treat it like you've sold the asset for the amount of the insurance payout:

- If the insurance payout is more than the asset's adjusted tax value but less than its original cost, you must include the difference between the insurance payment and the adjusted tax value as taxable income.
- If the insurance payout is more than the asset's adjusted tax value and also more than the asset's original cost, you must include the difference between the cost and the adjusted tax value as taxable income. The difference between the insurance payout and the asset's cost is a capital gain and not taxable.
- If the insurance payout is less than the asset's adjusted tax value, you can treat it like a loss on sale and claim the difference. Remember, if the asset was a building, there's no deduction for any loss on sale.

Damaged assets

If you receive an insurance payout to repair a damaged asset, do not include it as income and do not claim the cost of the repairs which are covered by the insurance. However, please note the following:

- If the insurance payment is more than the cost of the repairs, you need to deduct the excess from the asset's adjusted tax value. If this makes the adjusted tax value a negative amount, you're required to include this amount in your gross rental income.
- If the insurance payout is less than the cost of the repairs, you can deduct the extra cost of the repairs from your taxable income. Remember to keep all invoices relating to the repairs.

Loss on disposal of buildings

If an unexpected event causes damage to the building or to the neighbourhood of the building so that it's useless and cannot be used to earn income, then you're allowed a deduction for a loss on the disposal of the building. This is providing the damage has not been caused by the owner. The unexpected event could be a natural disaster such as an earthquake, flood or fire.

Damage of the neighbourhood of the building can be where:

- 2 buildings next door are badly damaged by fire, and your building has to be demolished to demolish the fire damaged buildings
- the building is undamaged but an earthquake has made the ground unstable so that it must be demolished.

You can offset any disposal costs (for example demolition costs) from any disposal proceeds to calculate the final loss or gain on disposal.

Example

A building is damaged in an earthquake and must be demolished.

Original purchase price		$ 140,000
Less total depreciation claimed (before 2011-12 income year)		$ 40,000
Adjusted tax value		$ 100,000
Insurance proceeds	$ 120,000	
Less demolition costs	-$ 25,000	
Net disposal proceeds		$ 95,000
Loss on disposal		-$ 5,000

The building is disposed of for less than its adjusted tax value resulting in a loss of $5,000. This can be claimed as a deduction.

Part 3 – Interest

Overview of the rules

Since 1 October 2021, interest limitation rules mean interest is not deductible for residential property in New Zealand acquired on or after 27 March 2021 (unless an exclusion or exemption applies).

For properties acquired before 27 March 2021, the ability to deduct interest is being phased out as shown in the table below (provided the loan was first drawn down before 27 March 2021 or was for the settlement of the property):

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%

Note

You can continue to deduct a portion of your interest expense during the interest phase-out period in certain situations where legal ownership changes - see Changes in how property is held on page 47.

Interest on any new loans drawn down on or after 27 March 2021 cannot be claimed from 1 October 2021 onwards.

Example

In May 2021, Petra drew down an additional $100,000 to add an extra floor onto her rental property. Interest on this $100,000 is $250 per month.

The additional $100,000 was not part of the loan required to complete the terms of the sale and purchase agreement signed before 27 March 2021. Therefore, from 1 October 2021, Petra cannot claim any deduction for the $250 per month interest expense incurred on the additional $100,000.

A property purchased on or after 27 March 2021 can qualify for phased-out interest deductions only if it was purchased as a result of an offer made on or before 23 March 2021, and that offer was not able to be revoked or withdrawn before 27 March 2021 (for example, by tender).

Note

Special rules apply for loans in a foreign currency, refinanced loans and for interest on variable balance loans (such as revolving credit and overdraft facilities) – see page 44.

We have tools to help you work out if the interest limitation rules apply to your property. You can find our Guided help on our website **ird.govt.nz/property-interest-rules**.

Property the rules apply to

The interest limitation rules apply to residential property in New Zealand. Overseas properties are not subject to the rules.

Generally, any property with a dwelling on it (such as a house or apartment) is subject to these rules, and also bare land that could be used for residential property.

It does not matter whether the property is rented out long or short-term, used for short-stay accommodation some or all of the time, or left vacant.

Property the rules do not apply to

Certain properties are not affected by these rules, for example, farmland, employee accommodation owned by a business and an accommodation business where the owner lives on the property. Certain types of Māori land are also unaffected by interest limitation, along with housing provided by Māori authorities to its shareholders or beneficiaries (for example, papakāinga and kaumātua housing). For more information on these and other properties not affected by the interest limitation rules, go to **ird.govt.nz/property-interest-rules**

This means that if you satisfy the general deductibility rules, you are still able to deduct interest for these properties.

If a property you own is partly affected and partly unaffected by the rules, then you will need to apportion your interest expense between the different parts of the land using standard tax apportionment principles (for example, considering area and time).

Main home

You generally cannot claim interest deductions for private use, but if you use your main home to earn income for example, from a flatmate, boarder or as short-stay accommodation, you are able to deduct some interest against that income.

An interest deduction is also allowed if you use your main home for a non-accommodation income-earning purpose, for example, a workshop or a contractor's home office.

Example

Tane owns two residential properties – one in Wellington and another up the coast at Waikanae beach. He spends most of his time in Wellington. Tane has a flatmate at his Wellington property.

He spends many weekends at his property in Waikanae, normally driving up Friday night and returning to Wellington on Sunday.

Tane's Wellington property is his main home and is not subject to the interest limitation rules. However, the proportion of his interest expense he can deduct in relation to the rent from his flatmate is limited under other parts of the Income Tax Act 2007.

Tane's Waikanae property is subject to the interest limitation rules as it is not Tane's main home.

For interest to be deductible, it must satisfy the general deductibility rules. In a flatmate situation, this means apportioning expenses between shared areas, areas exclusively used by the flatmate, and areas exclusively used by the homeowner to determine the amount that is deductible.

Example

Consider Tane's main home in Wellington and the income he derives from having a flatmate. Tane's monthly interest expense is $600.

Tane has exclusive use of one bedroom, an ensuite and a spare room, which he uses as an office. His flatmate has exclusive use of a second bedroom and a different bathroom. They both have shared use of the lounge, dining room, kitchen and laundry. Looking at the shared-use and exclusive-use areas, Tane calculates that 30% of his interest expense relates to the income from his flatmate and is deductible, and the remaining 70% is non-deductible due to the private nature of the use. Tane would be able to deduct $180 of his monthly interest expense.

Where there are multiple residential properties on the same parcel of land (for example, a main dwelling and a self-contained flat or cottage, sometimes advertised as "home and income"), only the property used by the owner as the main home qualifies for the main home exclusion.

Example

Mandi owns a property that is split into two – a self-contained one-bedroom flat on the ground floor and a larger three-bedroom unit above it.

Mandi lives in the upstairs three-bedroom unit. Mandi wants a flatmate in her unit and also wants to find a tenant for the downstairs flat. Mandi's friend Miriama moves in to one of the bedrooms upstairs. Mandi advertises the downstairs flat online and finds a tenant to move into it.

The upstairs three-bedroom unit is Mandi's main home and qualifies for the main home exclusion. Mandi is able to deduct some of her interest expense against her rental income from Miriama. The downstairs one-bedroom flat is not part of her main home and is residential property subject to the interest limitation rules.

To qualify for the main home exclusion, the person who incurs the interest and the person who owns the main home generally need to be the same person. In most cases, only natural persons can be considered to have main homes. However, if you hold your residential property through a transparent entity like a look-through company (LTC), the main home exclusion may still apply. This is because shareholders in LTCs are deemed to hold their proportion of LTC assets directly for tax purposes.

Note

Non-LTC companies (ordinary companies) do not have access to the main home exclusion.

If the property is owned by a trust, the property will meet the main home exclusion if it is the main home of one of the trust's beneficiaries and a principal settlor does not have a different main home of their own. A principal settlor is someone whose settlements for the trust are the greatest, or greatest equal, by market value.

Build-to-rent land

A medium-to-large scale housing development (with 20 or more dwellings with a single owner) built to provide long-term rental accommodation is excluded from the interest limitation rules. You'll qualify for this exclusion if your development is approved as build-to-rent land by Te Tūāpapa Kura Kāinga – Ministry of Housing and Urban Development (HUD).

A full list of the requirements and information about the application process is available at **www.hud.govt.nz/our-work/build-to-rent/**

For new developments, the requirements must be met and you'll need to apply as soon as the development is completed. If approved, the exclusion will apply from the date your application is received by HUD.

Note

Any existing developments have until 1 July 2023 to meet the requirements and for you to apply. If the development does not meet this deadline, it will never qualify for the exclusion. If this deadline is met, the exclusion can apply retrospectively meaning the interest incurred on or after 1 October 2021 can be claimed.

Once approved, HUD will record your land on a register of build-to-rent assets and will share this information with us. You will need to notify HUD of any changes to your approved build-to-rent land, for example units or dwellings that no longer meet the requirements.

Only interest relating to the portion of the development meeting the build-to-rent land definition can be claimed. You'll have to apportion your interest expense in your income tax return for any units or dwellings that do not meet the build-to-rent land definition.

Individual units or dwellings that become ineligible can never qualify for the exclusion again in the future.

If this results in your development no longer meeting the requirements for build-to-rent land, the development will no longer qualify for an exclusion from the interest limitation rules. Even if your development meets the requirements in the future, it can never qualify for the build-to-rent exclusion again.

Once your exclusion comes to an end, you must stop claiming interest as an expense in your income tax return unless another exclusion or exemption applies.

Note

A development is not prevented from accessing the new build exemption instead of the build-to-rent exclusion. However, to access the build-to-rent exclusion at any time in the future (for example once the 20-year new build exemption ceases) the development must meet the requirements from:

- 1 July 2023 for an existing development
- as soon as the development is completed for a new development.

For more information about the new build exemption, see page 40.

Emergency, transitional and social housing

If your property is used for the sole purpose of emergency, transitional or social housing, or housing for people in need, and is leased to a government department, for example to Te Tūāpapa Kura Kāinga - the Ministry of Housing and Urban Development (HUD) or Kāinga Ora, or a registered community housing provider, then you can still claim interest deductions. This exemption also covers connected or related services provided in the same building or in a different building on the same land. The whole property needs to be leased to the housing provider in order to qualify (for example, 1 bedroom in a 5 bedroom house would not qualify for this exemption).

Note

A full list of eligible government departments can be found in schedule 2, Part 1 of the Public Service Act 2020 available at **www.legislation.govt.nz** The Community Housing Regulatory Authority maintains a register of community housing providers registered under the Public and Community Housing Management Act 1992 at **www.chra.hud.govt.nz**

Example

Kris owns a house in the Bay of Plenty that is occasionally rented by a social housing provider when the provider requires emergency or transitional housing for its clients. The booking arrangement is on a casual basis and is dependent on the availability of the property, as the property can also be booked by members of the public for short-stay accommodation.

During the 2022–23 tax year, the house is rented by the social housing provider for the provision of emergency or transitional housing from 16 June to 31 August, and again from 28 October to 17 November. For the remainder of the year, it is either rented by members of the public or not rented by anyone and vacant.

For the 2022–23 tax year, Kris would qualify for the social housing exemption for interest incurred from 16 June to 31 August and from 28 October to 17 November.

Example

Olivia owns a house in Christchurch and leases it to the Chan Community Housing Trust (CCH Trust), a registered community housing provider, for use as social housing. The lease is for a fixed period of three years starting from 1 July 2021.

From 1 October 2021 until 7 June 2022, the CCH Trust rents the house as social housing to Jason. Jason moves out of the house on 7 June 2022. The house is temporarily vacant while the CCH Trust prepares it for another social housing tenant to move in. On 1 August 2022 the CCH Trust begins renting the house as social housing to Rosemary.

Olivia's Christchurch property would be exempt from the interest limitation rules while it is under lease to the CCH Trust. This would include the period it is vacant from 8 June 2022 to 31 July 2022.

Council housing

If your property is used by a local authority or a council-controlled organisation (CCO) for the sole purpose of providing housing to people assessed by a local authority as being eligible for housing at less than market rent, it is not subject to the interest limitation rules. The exemption still applies if connected or wraparound services are provided on site either in the same building or in a different building on the same land (for example, rehabilitation). The whole property needs to be leased to the local authority or CCO in order to qualify (for example, 1 bedroom in a 5 bedroom house would not qualify for this exemption).

Interest incurred on a property is subject to interest limitation if the property is not used for council housing, for example, if the CCO provides rental housing at market rates.

Note

This exemption uses the definition of "council-controlled organisation" provided in section 6 of the Local Government Act 2002.

How the rules work for different entities

The interest limitation rules apply to:

- Individuals
- Look-through companies
- Partnerships
- Trusts
- Close companies
- Certain non-close companies (see below for criteria).

Close companies

If your company is a close company where 5 or fewer individuals or trustees own more than 50% of the company, you will usually have to apply the rules.

Certain non-close companies

The interest limitation rules apply to certain non-close companies. If your company is not a close company the interest limitation rules only apply if your company is a residential land company or a residential land wholly owned group member.

A company will be a "residential land company" for an income year if it is not a member of a wholly-owned group and the value of its residential property that is subject to interest limitation rules is equal to or is greater than 50% of the value of its total assets at any time during that income year. If the company owns shares in a company that is a residential land company, the value of those shares is treated as residential property for the purposes of the 50% threshold calculation.

If your company is part of a wholly-owned group, this 50% test is applied on a consolidated basis at the group level. This means if your company is below the 50% threshold on its own, the interest limitation rules will still apply if it is part of a wholly-owned group and the group exceeds the 50% threshold.

Example

A Ltd's total assets consist of the following:

- Residential property with a value of $400,000.
- Other business property with a value of $500,000.
- 50% of the shares in B Ltd with a value of $300,000.

To determine if A Ltd is a residential land company, it must first determine if B Ltd is a residential land company. This is because shares owned by non-close companies in residential land companies are treated like residential property for the purposes of this test.

The percentage of B Ltd's residential property of its total assets is 66.7% (being $400,000/$600,000). B Ltd is therefore a residential land company.

A Ltd must therefore treat the value of its shares in B Ltd ($300,000) as residential property in applying the residential land company test itself.

The value of A Ltd's residential property as a percentage of its total assets is therefore 58.3% (($400,000 + $300,000)/$1,200,000). A Ltd is therefore also a residential land company

Exempt Māori company

Interest limitation rules do not apply to an Exempt Māori company, even if it is a close company. An Exempt Māori company is a company that is not a residential land company or residential land wholly-owned group member and is one of the following:

- a Māori authority or eligible to be a Māori authority, or
- wholly-owned by a Māori authority or by a company or trust that is eligible to be a Māori authority.

For more details about Māori authorities, read our guide **Becoming a Māori authority - IR487** or go to **ird.govt.nz/maori-authorities**

For more information, read the **Tax Information Bulletin, Vol 34, No 5 (June 2022)**.

Exemptions from interest limitation rules

If the interest limitation rules apply to your property, you may still be able to claim interest if you qualify for one of the following exemptions:

- **land business** - land held as part of a developing, subdividing, or land-dealing business, or a business of erecting buildings on land
- **property development** - land that you develop, subdivide, or build on to create a new build
- **new build land** - a self-contained residence that receives a Code Compliance Certificate (CCC) issued under the Building Act 2004 confirming the residence was added to the land on or after 27 March 2020.

For interest to be deductible, it must not be private in nature and the general deductibility rule must be met.

Exemption for property development

The **development exemption** does not require you to have a 'land business' and applies to land that you develop, subdivide, or build on to create a new build. The development may be a one-off.

The exemption applies from the time you start developing the land and ends when you sell the land, cease the development project or a Code Compliance Certificate (CCC) is issued for your new build under the Building Act 2004. Once a CCC is issued for your new build, the new build exemption applies instead.

Interest relating to remediation work done to an existing property that is not significant enough to create a new build does not qualify for this exemption.

Example

Romy has engaged in sufficient development activity on her land, creating a new self-contained residence. The development exemption applies to the land while Romy is completing the development and building of the new self-contained residence. Her interest is deductible if the general deduction criteria set out in existing tax rules is met. Once a CCC is issued, the development exemption will end, and Romy's property will transition to the new build exemption.

Exemption for new build land

A new build is defined as a self-contained residence that receives a Code Compliance Certificate (CCC) confirming the residence was added to the land on or after **27 March 2020**. It also includes a self-contained residence acquired off the plans that receives a CCC on or after **27 March 2020** confirming it has been added to the land.

A place only qualifies as a new build if it is self-contained. This means the new build needs to contain its own cooking and bathroom facilities and have its own entrance. The entrance can be from a shared accessway – for example, a hallway shared by a block of flats in the same building.

Example

Kate owns residential land with an existing dwelling on it. She adds a sleepout to the property, which she intends to rent out, behind the existing dwelling. The sleepout can function as an extra bedroom, but it does not have its own kitchen and bathroom. Anyone staying in the sleepout would have to use the kitchen and bathroom located in the existing dwelling. Having no kitchen and bathroom means the sleepout is not self-contained and is therefore not considered a new build. The land attributable to the sleepout does not satisfy the definition of new build land.

Example

Assume the same facts as the above example. Six months later, Kate renovates the sleepout and adds a kitchen and bathroom. The building work receives its CCC on 3 March 2021. As the sleep-out is now self-contained, and it received its CCC after 27 March 2020, it qualifies as a new build. The land the new build is on, any land used exclusively by the residents of the new build, and a reasonable proportion of any shared areas, is considered new build land. The remainder of the land (attributable to the existing dwelling) is not considered new build land.

A new build does not have to be made of new material or constructed onsite, so it can include modular and relocated homes.

The following are new build examples. A self-contained dwelling:

- added to bare land
- added to land that has an existing dwelling on it, whether stand-alone or attached (apportionment will be required)
- or multiple self-contained dwellings replacing an existing dwelling
- converted from a commercial premises or from a hotel/motel
- part of a building of dwellings converted from a single dwelling
- previously on the earthquake prone buildings register that has been remediated
- that has been at least 75% reclad because of weathertightness issues.

Example

Haydn owns a large hotel complex in Rotorua comprising 100 separate units. Ever since the borders closed because of the COVID-19 pandemic, the reduced number of tourists has meant that many of his units have sat empty or have only been booked a fraction of the time they were previously. He has heard there is a shortage of long-term rental accommodation in the region, so he decides to convert his units into places that can be let as long-term rentals instead.

The units were already configured for short-term stays by tourists, and included bathrooms but no kitchens. Haydn engages tradespeople to do some work to ensure the units are configured as self-contained residences by adding kitchens. The work Haydn has done to the property is not significant enough to require building consents, which means CCCs are not issued for the work.

Haydn gets in touch with his local authority (which is also a building consent authority) and notifies them that he has converted all his hotel units into residential accommodation. This conversion is noted down as having been completed on 24 October 2021 in the authority's records. The new build exemption applies to Haydn's units for 20 years from 4 October 2021 until 23 October 2041.

When does the new build exemption begin?

The new build exemption generally starts from the date a CCC is issued for a new build.

For new builds purchased off the plan, the exemption starts from the date you entered into an agreement to purchase it.

For hotel and motel conversions, the new build exemption starts from the date the local authority or building consent authority records indicate the conversion was complete.

When does the new build exemption expire?

The exemption will expire 20 years after the date a new build receives its CCC (or after the date recorded by the local authority as evidence the conversion/remediation work was completed), or when the new build ceases to be on the land (for example, it is demolished or removed), whichever is earlier.

Where a new build is acquired off the plans and before its CCC is issued, the 20-year fixed period will still run from the date of the CCC.

Example

Bagheera enters into an agreement to buy a new build from Neo-Archie Homes Ltd on 1 October 2021. The new build is still being constructed and does not receive a CCC until 24 October 2022. On 31 October 2022, title for Bagheera's new build is registered to him.

Bagheera qualifies for the new build exemption from 1 October 2021, because he has acquired a new build off the plans. He is able to deduct interest from that date, provided he satisfies the requirements to do so under existing tax rules. The new build exemption applies to the land until 23 October 2042, 20 years after the new build received its CCC.

Special rules also apply for new builds that receive their CCC after a significant delay.

The exemption applies to anyone who owns the new build within this 20-year fixed period, and the timing of the exemption does not reset when the property is sold.

Apportionment required where land is only partially new build land

If interest relates to land with both a new build and a non-new build, then only part of the land is considered new build land. In these circumstances, you need to apportion the interest between the new build land and the non-new build land. Only interest incurred in relation to the new build land qualifies for the exemption.

Example

This example illustrates how interest could be reasonably apportioned where it only partially relates to new build land. There may be other apportionment methods that, if applied in accordance with existing tax principles, could also be considered acceptable.

Viv and Adrian acquire 1500m^2 of land in Kaitaia. The land has a 1970s standalone house (non-new build), as well as two new build townhouses. They take out a loan of $1m to acquire the land. All three buildings on the land are used as long-term rentals.

The total land area of 1500m^2 is used as follows:

- 400m^2 is used exclusively by the non-new build
- 800m^2 is used exclusively by the new builds, and
- 300m^2 is a shared outdoor area.

After apportioning the shared outdoor area:

- **500m^2 is not considered new build land.** This is the 400m^2 used exclusively by the non-new build, plus one third of the shared outdoor areas (1/3 x 300m^2 = 100m^2).
- **1000m^2 is considered new build land**. This is the 800m^2 used exclusively by the new builds, and two thirds of the shared outdoor areas (2/3 x 300m^2 = 200m^2).

It is reasonable for Viv and Adrian to deduct two thirds of the interest they incur in relation to the land, because two thirds of the total land area (1000m^2 of the total 1500m^2) is attributable to the new builds. One third of the interest they incur is not deductible, because it is attributable to the non-new build portion of the land.

Loans that cannot be reasonably traced

The interest limitation rules do not apply to 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 are not affected.

If you have a loan drawn down before 27 March 2021 and used that loan for residential property and non-residential property purposes, you need to trace the loan and determine how much of the loan was used for residential property. Interest incurred on the portion of the loan used for residential property will be subject to phasing (that is, denial on a progressive basis between 1 October 2021 and 31 March 2025). The deductibility of the interest incurred on the non-residential property portion of the loan is determined under the general deductibility rules.

If it cannot reasonably be determined how much of the loan was used for residential property and how much was used for non-residential property purposes (an "untraceable loan"), a special transition rule applies (which ends on 31 March 2025). Whether a loan cannot in fact reasonably be traced is objectively determined and is dependent on question of fact and degree in each case.

The transitional rule treats an untraceable loan as being used to acquire other income generating property before being used to acquire residential property that is subject to the interest limitation rules. Other income generating property includes residential property that is not subject to the interest limitation rules because an exemption from the rules applies to the property. For more information about exemptions, see page 40.

Under the rule, if the balance of an untraceable loan on 26 March 2021 is less than the value of other income generating property held on 26 March 2021, none of the interest on the loan is subject to limitation under the interest limitation rules. If the balance of the untraceable loan (on 26 March 2021) exceeds the value of other income generating property held on 26 March 2021, the excess is treated as having been used to acquire the residential property subject to the interest limitation rules. The interest incurred is denied on a progressive basis between 1 October 2021 and 31 March 2025.

There is also a rule that specifies how repayments of an untraceable loan are to be treated. Generally, repayments are applied to the residential property which is subject to the interest limitation rules first, unless the repayment is funded from the disposal of other income generating property held on 26 March 2021.

Loans in foreign currency, refinanced loans and variable balance loans

Special rules apply for loans in a foreign currency, refinanced loans and for interest on variable balance loans (such as revolving credit and overdraft facilities).

Loans in a foreign currency

If your rental property is financed by a loan in foreign currency, any interest is non-deductible from 1 October 2021. However, if you refinance the loan with a New Zealand dollar loan, the new loan will qualify for phasing out for the period from when the New Zealand dollar loan is drawn down.

Refinance

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 the treatment remains the same.

Note

If you have used the money in your home loan account or you have topped up your home loan for another purpose not related to your residential rental property, the interest is not deductible, and you don't claim it in your income tax return.

Variable balance loans

If you have a variable balance loan (for example, a revolving credit facility or an overdraft) for your residential rental property, you need to trace each individual withdrawal and deposit to that loan account to work out the amount of deductible interest. The calculation may be time consuming. To simplify the calculation, you may use the "high water mark" method to work out how much interest is deductible.

The high water mark method is designed to simplify the calculation of deductible interest for variable balance loans. If your loan is solely used to finance your residential rental property, then any interest incurred will be deductible (subject to phasing) if the loan balance remains at or below the loan balance as at 26 March 2021.

However, if the loan is used to finance a mixture of taxable and private activities, then you can calculate the amount of interest based on the lower of:

- the affected loan balance – this is the amount of the actual loan balance at any particular time that applies to the residential rental property (for example, exclude funds used to finance private expenditure)
- the initial loan balance – this is the loan balance on 26 March 2021.

If the affected loan balance is lower than the initial loan balance, all interest incurred will be deductible after applying the phasing percentage for the year.

If the affected loan balance is higher than the initial loan balance, only the interest incurred up to the initial loan balance is deductible after applying the phasing percentage for the year. The amount of interest incurred above the initial loan balance is not deductible after 1 October 2021.

Completing your income tax return

When completing your income tax return you will need to consider how the interest limitation rules apply to your property and calculate the total interest on residential property and the amount of interest that can be claimed.

Total interest on residential property is the total interest incurred on your borrowings on all your residential properties for the year. We also encourage you to keep a record of the interest incurred for each of your rental properties because you may be able to claim this amount when the property is sold if the sale is taxable under the bright-line property rule. For more information – see the next section What happens to denied interest deductions when I sell?

Interest expense claimed is the total interest you can claim on your borrowings on all your residential properties under the interest limitations rules. If you claim interest, you will also be asked to provide the reason(s) why you are claiming that interest.

To assist with your calculation of interest expense claimed please refer to the calculators on our website **ird.govt.nz/tools-calculators** or refer to examples below for guidance.

Example

Joe took out an interest-only loan to acquire a residential rental property in 2017. As at 26 March 2021, the balance of Joe's loan is $500,000 and the interest rate is 4.0% pa. Joe does not make any principal repayments on the loan.

As the loan was drawn down before 27 March 2021, Joe can calculate the deductible interest as follows:

- From 1 April 2021 to 30 September 2021, Joe incurs interest expenditure of $10,000, which is fully deductible. From 1 October 2021 to 31 March 2022, Joe incurs interest expenditure of $10,000, but only 75% of this ($7,500) is deductible.

  When completing his 2022 income tax return, Joe will enter $20,000 into the 'Total interest on residential property box' and $17,500 in the 'Interest expense claimed' box.
- From 1 April 2022 to 31 March 2023, Joe incurs interest expenditure of $20,000, but 75% of this ($15,000) is deductible. When completing his 2023 income tax return, Joe will enter $20,000 into 'Total interest on residential property' box and $15,000 in the 'Interest expense claimed' box.
- From 1 April 2023 to 31 March 2024, Joe incurs interest expenditure of $20,000, but 50% of this ($10,000) is deductible. When completing his 2024 income tax return, Joe will enter $20,000 into 'Total interest on residential property' box and $10,000 in the 'Interest expense claimed' box.
- From 1 April 2024 to 31 March 2025, Joe incurs interest expenditure of $20,000, but 25% of this ($5,000) is deductible. When completing his 2025 income tax return, Joe will enter $20,000 into 'total interest on residential property' box and $5,000 in the 'Interest expense claimed' box.

  For each of the years, Joe selects 'Loan drawn down prior to 27 March 2021' as the reason for claiming interest.
- From 1 April 2025 onwards, Joe is not allowed to claim deductions for interest under his loan.

What happens to denied interest deductions when I sell?

If you sell/dispose of a residential property and the sale is taxable under the bright-line property rule, the amount of the previously denied interest under the interest limitation rules is treated as if it were part of the cost of the property in the year of disposal.

If this results in a net loss, the deduction for the net loss is limited under the current rule that applies to losses from the disposal of bright-line property. Under that rule, the loss can only be deducted against other taxable land sale gains. Any excess loss must be carried forward and deducted against other land sale gains in later income years.

If the disposal is not taxable, you cannot claim the interest previously denied under the interest limitation rules.

For more detail about what happens to interest previously denied under the interest limitation rules on disposal, read the **Tax Information Bulletin, Vol 34, No 5 (June 2022)**.

Interposed entity rules

Interest deductions are denied for a person who indirectly holds residential rental property through an Interposed residential property holder (IRP holder). This does not apply to look-through companies or to partnerships.

An IRP holder for a person may be one of three types of residential property holders:

- a close company for which the person has voting interests or market value interests and the company has, at the end of each quarter in the income year, a residential property percentage of more than 10%.
- a company that is not a close company for which the person has voting interests or market value interests and the company has, at any time during the income year, a residential property percentage of more than 50%.
- trustees of a trust of which the person is a direct or indirect beneficiary, and the relevant trust has, at any time during the income year, a residential property percentage of more than 10%.

The residential property percentage is the value of the entity's residential rental property as a percentage of the value of the entity's total assets. For this calculation, residential rental property excludes:

- property covered by the land business, development and new build exemptions
- property used for social, emergency, transitional and council housing.

If a close company is an IRP holder for a person, the interest incurred by the person is limited in proportion to the close company's residential property percentage. If a company other than a close company is an IRP holder for a person, all interest incurred by the person for legal or beneficial ownership of the company is denied.

If a trust is an IRP holder for a person, all interest incurred by the person for legal or beneficial ownership of the trust is denied.

Talk to a tax agent if you think the interposed entity rules may apply to you. For more information, read the **Tax Information Bulletin, Vol 34, No 5 (June 2022)**.

Changes in how property is held

Rollover relief allows you to change the legal ownership of property after 27 March 2021 while allowing you to deduct a portion of your interest expense during the interest phase-out period.

This applies to the following:

- relationship property settlements
- transfers as part of a company amalgamation that qualifies as a resident's restricted amalgamation
- transfers following the death of the owner, to an executor or administrator of an estate or to a beneficiary of the estate
- some transfers to or from look-through companies and partnerships
- some transfers to or from family trusts.

Specific relief also applies for certain transfers of land subject to the Te Ture Whenua Māori Act 1993.

Relationship property settlements

Example

Dale and Dawn, a married couple, decide to separate in April 2022. As part of the relationship property settlement, they agree that Dale will keep the family home and Dawn will keep the investment property they acquired back in 2003, shortly after they got married. Dawn decides to retain the property as an investment rather than move into it herself. There is an existing mortgage over the property that has an outstanding loan balance of $20,000. Dawn has agreed to take this over.

Since the loan was drawn down before 27 March 2021, the interest on the loan will be deductible subject to phasing. Dale and Dawn are entitled to deduct 75% of the amount of interest they each incurred for the property over the period from 1 October 2021 to 31 March 2022.

Rollover relief also applies to the transfer of Dale's share of the property to Dawn in April 2022, so Dawn is entitled to deduct a reducing amount of interest on the loan of $20,000 over the remaining period to 31 March 2025.

Inherited property

Example

Pat purchased a house as a private residence for himself in 2010 and borrowed $200,000 at that time to finance the purchase. In his will, Pat has provided that all his property should be inherited by his son Robin when he dies.

At the time of Pat's death in July 2021, $40,000 is still owing on the loan. This loan was drawn before 27 March 2021 and therefore the interest is deductible subject to phasing. Robin would like to keep Pat's house and use it as a rental property to supplement his income, so he agrees with the executors of Pat's estate that he will obtain a loan from another bank to repay the loan outstanding to Pat's bank.

Robin borrows $90,000 – of which $40,000 is used to repay Pat's bank and the remaining $50,000 is used to fund renovations before Robin finds tenants.

Rollover relief applies to the transfer of the property to Robin, but only on the $40,000 required to repay Pat's bank, as only this amount was drawn before 27 March 2021.

Robin is entitled to deduct a reducing amount of interest for the $40,000 over the transition period (1 October 2021 to 31 March 2025).

Transfers to or from look-through companies (LTCs) and partnerships

Rollover relief also applies to transfers to or from LTCs and partnerships to the extent a person transferring the residential property to the LTC or partnership (or acquiring it from the LTC or partnership) has the same ownership interest before and after the transfer.

Example

Mary and Bob, a married couple, are the shareholders in a look-through company, Company A. Mary and Bob jointly own an investment property in equal shares (50:50). They each hold 50 percent of the shares in Company A. Mary and Bob had drawn down a loan in 2018 to purchase the property. In September 2021, the loan has an outstanding balance of $100,000.

In September 2021, Mary and Bob sell the property to Company A. Company A borrows $150,000 from the bank for the purchase of the property and uses its equity to fund the remainder of the purchase price. Partial rollover relief applies to the transfer of the property, meaning that Company A can deduct the interest on a loan balance of $100,000 (being the amount of Mary and Bob's original loan balance on the date of the transfer) subject to phasing until 31 March 2025. Company A's excess loan balance of $50,000 does not qualify for rollover relief.

Transfers to or from family trusts

Rollover relief applies for transfers of residential property to or from family trusts, provided that:

- each transferor (in the case of transfers to a trust) or each recipient (in the case of transfers from a trust) of the residential property is a beneficiary of the trust
- all principal settlors are beneficiaries of the trust, and
- each beneficiary is either a principal settlor, has a family connection with a principal settlor, or is a company controlled by a family member beneficiary or is a charity.

In addition, when the trustees of a family trust transfer the property back to the settlors who originally transferred the property to the trust, each recipient's proportionate interest in the property must be the same as what was held before the property was transferred to the trust.

Rollover relief may apply to a transfer from the trustees of a qualifying family trust to the settlors, even if the settlors did not previously transfer the property to the trust, but the trustees instead acquired the property from a third party. In this instance, all the settlors receiving the property from the trustees have to have been principal settlors of the trust both at the time the trustees acquired the property and when the trustees transferred the property to them for rollover relief to apply.

Example

Neo acquired a rental property and drew down a loan of $500,000 for the property on 3 March 2017. On 29 October 2022, Neo sells the property to his family trust. He and his son, Archie, are beneficiaries of the trust. The outstanding balance of Neo's loan is $400,000. The trustee takes out a loan of $450,000 to purchase the property from Neo. Neo uses $400,000 of the sale proceeds to repay the outstanding balance of his loan.

The transfer of the property to the trust qualifies for partial rollover relief and therefore enables the trustee to deduct limited interest deductions until 31 March 2025. However, only interest on $400,000 of the trustee's loan is deductible (being the amount of Neo's loan balance on the date of the transfer). Interest on the additional $50,000 borrowed does not qualify for rollover relief and is not deductible.

Example

Maude acquired an investment property in 2017 using a combination of savings and a loan from the bank. In April 2021, Maude sold the property to her family trust, the beneficiaries of which are her and her adult children, Fran and Josiah. At the time of sale, the outstanding balance on Maude's loan is $150,000. To finance the purchase of the property, the trustees of the trust borrow $150,000 from the bank.

Rollover relief applies to the transfer of the property. This means the trustees can deduct the interest on a loan balance of $150,000 subject to phasing until 31 March 2025.

If certain criteria are met, rollover relief also applies when residential property held in a qualifying family trust is resettled onto another family trust.

Rollover relief does not apply when you transfer shares in an LTC to a trust.

Transfers to a Māori authority or Māori family trust

Rollover relief is available for a transfer of residential property to a Māori authority, or person eligible to be a Māori authority, as the trustee of a trust if:

- the residential property is subject to Te Ture Whenua Māori Act 1993
- each transferor is both a settlor and beneficiary of the trust, and
- the transferors of the residential property and the beneficiaries of the trust are all either:
  - members of the same iwi or hapū, or
  - the descendants of the same tipuna (living or dead).

In addition, when the trustees of a trust transfer property that is subject to Te Ture Whenua Māori Act 1993 back to the persons who originally transferred the property to the trust, each recipient's proportionate interest in the property must be the same as what was held before the property was transferred to the trust.

Part 4 – Residential property deduction rules

Overview of the rules

In some situations, you may have more expenses for a residential rental property in an income year than the rental income you earn. This is sometimes described as a "rental loss".

In previous years, rental losses could be used to reduce your overall taxable income. From the start of the 2019-20 income year, this is no longer the case.

Now, you can generally only deduct expenses for residential rental property up to the amount of income you earn from the property for the year. Any deductions that exceed your income from the property, called excess deductions, must be carried forward to the next income year you earn income from the property (or from another residential property). This means that rental property losses cannot be used to reduce your tax liability for other income, such as salary and wages or business income. These rules are the residential property deduction rules, also known as the ring-fencing rules.

The rules apply whether you hold the property yourself, or in a partnership, look-through company, or close company. They also apply to trustees of a trust who earn taxable income from a residential rental property.

The rules may also apply to limit interest deductions if you have borrowed money to invest in an entity and more than 50% of the entity's assets are residential land. Please read Investment in an entity with significant holdings in residential land - interposed entity rules on page 60.

Property the rules apply to

The residential property deduction rules apply to most residential land in New Zealand and overseas – the exceptions are listed in the next section. Residential land includes a rental property with an existing dwelling, land that is to have a dwelling built on it and bare land that may have a dwelling built on it under the relevant district plan. From the 2021-22 income year the definition of residential land has been amended to ensure the residential property deduction rules apply to property used for short-stay accommodation and the dwelling is not the owner's main home, even if it's a business premises (for example, Airbnb).

Income and deductions for residential land are reported in a section of the income tax return separate from other kinds of rental income.

Property the rules do not apply to

The residential property deduction rules do not apply to:

- your main home - if you have more than 1 home, this is the home you have the greatest connection with
- your holiday home, if it is used privately, used to earn income, and it is unused for at least 62 days in the year. See Part 5 for more information about the mixed-use asset rules
- farmland
- land that is used mainly as a business premises. From the 2021-22 income year, the definition of residential land has been amended to ensure that the provision of short-stay accommodation in a dwelling that is not the owner's main home is subject to the residential property deduction rules, even if it's a business premises.

Rents for these kinds of properties must be reported in the Other rents field in the IR3 income tax return.

Residential land may also be excluded if it is land that will be taxed on sale regardless of when it's sold. This is called revenue account land. For this land to be excluded from the rules you must notify us that it is revenue account land. You must also be able to separately identify the deductions for that land, unless all your residential land is subject to tax on sale. There is no need to notify us of land that will be taxed because it was acquired for a land-related business. For more information about revenue account land and how to notify us, go to Residential rental property on revenue account on page 59.

How do I calculate my net residential income?

You must calculate your residential income and the total deductions you can claim for the year for a residential portfolio or individual residential property. For an explanation of the portfolio basis and individual property basis, see Applying the rules on the portfolio basis or the individual property basis on page 54.

You can generally claim allowable deductions up to the amount of residential income you earned in the income year. If you have more deductions than income for a residential portfolio or individual property, then you will have excess deductions.

Working out what to show on your income tax return

You can use our **Residential property deductions worksheets - IR1226** to calculate:

- the amount of deductions you can claim for the year against your income from a residential portfolio or individual property
- your net residential rental income for a residential portfolio or individual property
- the amount of any excess deductions for a residential portfolio or individual property that you must carry forward to a future income year.

These amounts are calculated for each residential portfolio and individual property you own and are then added together and included in your income tax return.

In your income tax return, you will need to show the following income from a residential portfolio and/or individual property:

- gross residential rental income
- net bright-line profit (excluding losses)
- other residential income.

Other residential income includes the total from the following amounts:

- income in relation to a loan denominated in a foreign currency from a portfolio and/or individual property
- all depreciation recovery income from assets disposed of from a portfolio and/or individual property
- the net income from the taxable disposal of a residential property outside the residential property deduction rules because it is held on revenue account. For more information about revenue account land, go to Residential rental property on revenue account on page 59.

These amounts are added together to calculate your 'Total combined residential income'.

To calculate your total deductions for a residential portfolio or individual property for an income year, add together all of the following amounts:

- deductible expenses for the individual property or the portfolio (as applicable), for the current income year
- any excess deductions brought forward for the portfolio or individual property (as applicable) from previous years
- any excess deductions left over after the sale of another residential property or the last property in a residential portfolio.

What do I do if I have excess deductions?

You will need to calculate the amount of excess deductions you have (if any) for each residential portfolio and each individual property you own. If your deductions exceed your residential income for an individual property or residential portfolio in a year, the excess deductions cannot be used to offset income in that year. The excess deductions will instead be carried forward to the next year you derive residential income, and are added to your deductions for the individual property or residential portfolio in that year.

It is important to remember that, provided there has not been a sale of property, excess deductions can only be used against income from the same individual property or residential portfolio the excess deductions relate to. This means excess deductions from a property in a portfolio can offset any income from the portfolio, but cannot be used to offset income from any other residential property. Excess deductions from an individual property can only be offset against income from that same property.

If you have sold an individual property or the last property in a residential portfolio and you have unused excess deductions remaining, there are different rules depending on whether the sales were taxable or not. If the sales were non-taxable, the excess deductions are transferred to another residential property that you own. If you do not own any other residential property, the unused excess deductions are carried forward until you do. For more information see Transferred excess deductions at page 58.

If the sales are taxable, the excess deductions may be released. Released excess deductions can be used to offset any other residential rental income and other income such as salary and wages and business income. However, the amount released will be reduced by the amount of all unused excess deductions transferred to the property from non-taxable sales. For more information on released excess deductions see What happens when I sell a residential rental property at page 55.

Once you have calculated your excess deductions for each residential portfolio and individual property, you enter the total amount of excess deductions from all your residential properties into the Excess residential deductions carried forward field on your income tax return.

Note

If you complete your return in myIR, the amount that you enter in your return in the Excess residential rental deductions carried forward box will be pre-populated on your return for the next income year in the Excess residential rental deductions brought forward box.

Note

You will need to keep track of the amount of excess deductions carried forward for each individual property and portfolio each year. This is because the amount you show in your return in each box is the total for all your individual properties and portfolio.

Note

The shareholder continuity rules apply to close companies that have excess deductions. When there has been a change of shareholding, a close company's excess deductions cannot be used in a later income year if the rules that restrict the carrying forward of a company's loss balance apply. This guide does not cover the continuity rules for companies. Talk to your tax agent if you think that these rules apply.

Applying the rules on the portfolio basis or the individual property basis

You can calculate your net residential rental income and excess deductions using one of 2 methods, or a combination of both. These methods are:

- the portfolio basis
- the individual property basis (also called the property-by-property basis), or
- a combination of the portfolio basis and the individual property basis.

Portfolio basis

Under the portfolio basis you calculate your income and deductions across a residential portfolio.

A portfolio includes all residential properties in your portfolio from the beginning of the income year you first had the residential portfolio until the end of the income year you dispose of the last property included in the portfolio. This means that properties in a portfolio can change from year to year as they are bought and sold.

Individual property basis

For the individual property basis, you apply the rules to a single property separately. This means that the deductions for an individual property can be offset only against the income from that property. You can have more than 1 individual basis property, but you must do the calculations for each property separately. Your net income from each property gets combined in your tax return, as well as the excess deductions for each property.

If you have expenses that relate to more than 1 property, such as interest on a loan used for 2 properties, the individual property basis cannot be used.

You must choose to use the individual property basis from the first year the rules apply to the property. This could be when you buy the property, start renting out the property, or the start of the 2019-20 income year when the rules came in.

You can decide at any time to move to the portfolio basis, but once you start using the portfolio basis you must continue to use this method.

Example

Aroha owns two residential rental properties. For the 2019-20 income year, property A has income of $15,000 and deductible expenses of $2,000. Property B has income of $12,000 and deductible expenses of $15,000.

In Aroha's 2019-20 income tax return, she calculates her net residential rental income and excess deductions on an individual property basis for both properties.

As a result, property A has net residential rental income of $13,000 and no excess deductions to carry forward. Property B has net residential income of $0 and excess deductions of $3,000 to carry forward.

Example

In the 2019-20 income year, Aroha had 2 properties that she accounted for income and deductions on an individual property basis - property A and property B.

In the following year, Aroha buys a third residential rental property, property C. Aroha decides that the new property will form a portfolio with property A.

Aroha completes her 2020-21 return on the basis that she has 1 property on an individual property basis, property B, and a portfolio consisting of 2 residential rental properties, property A and property C.

Aroha cannot go back to applying the individual property basis to property A.

Combination of portfolio basis and individual property basis

This guide and the **Residential property deductions worksheets - IR1226** are aimed at people who own 1 or 2 rental properties, and who are not in the business of providing residential rental accommodation. However, if you have 2 or more residential properties, you may use a combination of the portfolio basis and the individual property basis. This means that some properties can be held on the portfolio basis and some can be held on the individual basis.

In any case, it is important to calculate your deductions for each residential portfolio and individual property that you own. In your income tax return, you will show totals for all your residential properties.

If you are unsure about which option is right for you, we suggest you talk to your tax agent.

What happens when I sell a residential rental property?

You may still have unused excess deductions for a residential rental property after it is sold. In some circumstances these excess deductions may be released. This means they can be used against your other income, such as your salary and wages.

Sale of an individual property basis property

If you sell a property treated on an individual property basis and the sale is not taxable, any unused excess deductions must be transferred, or carried forward until they can be transferred to another residential portfolio or individual property that has earned residential income. If you have another individual property or residential portfolio you can transfer the unused excess deductions from the property that was sold to the other individual property or residential portfolio in the current year. You can offset the transferred excess deductions against residential income of the other property. You need to track the transferred deductions until they are used to offset income as they can never be released.

If you do not have other residential rental properties, the unused excess deductions must be carried forward to the next income year you earn residential income from another individual property or portfolio. At this point the unused excess deductions would be treated as transferred to that individual property or portfolio see Transferred excess deductions on page 58.

If the sale of the individual property was taxable, any unused excess deductions for the property will be released. However, if the excess deductions included an amount transferred from another property the amount released must be reduced by an amount equal to the total unused excess deductions transferred. The excess deductions released can be used to offset any income you have from any source in the year of the sale. The excess deductions released can also be carried forward to future years as part of a tax loss if you have a net loss for the tax year.

Example

Nikita has 3 residential rental properties – property A and property B are in a portfolio, and Nikita used the individual property basis for property C. Nikita also has salary income of $70,000. Property C has accumulated excess deductions of $80,000.

Nikita decides to sell property C. The sale is taxed and has a net gain of $60,000. Nikita uses $60,000 of the excess deductions against the net sale income from Property C. Because Nikita has applied the residential property deduction rules on a property-by-property basis for this property, the remaining excess deductions of $20,000 are released and used against Nikita's salary income.

Sale of one property in a portfolio

If you have taxable income from the sale of a property that is part of a residential portfolio, and there are other properties still in the portfolio, include the net income from the sale in your residential income for the portfolio for the year.

You need to keep track of whether the sale of each property in your portfolio was taxable or not so that when you dispose of the last property in your portfolio, you can correctly deal with any remaining excess deductions. For more information about what happens when you dispose of the last property in a portfolio, go to the Sale of all properties in a portfolio section.

Example

In the 2019-20 income year, Minerva owns 2 residential rental properties and applies the residential property deduction rules on the portfolio basis.

In the 2020-21 income year, Minerva sells 1 of her properties. The sale is taxable, and Minerva earns net income of $20,000 from the sale. This amount is added to the rental income of $30,000, giving a total income of $50,000 for the portfolio. Deductions for the portfolio amounted to $35,000.

In her tax return, Minerva can use all the deductions for the portfolio in that year because the deductions of $35,000 are less than the total income of $50,000. Minerva will have net residential income of $15,000.

If the sale of the property was not taxable, then the residential income of the portfolio would be $30,000. In this situation, because the deductions of $35,000 are more than the income of $30,000, Minerva cannot use all of the deductions for the income year. Minerva would show in her tax return net income of $0 for the portfolio and excess deductions to carry forward of $5,000.

Sale of all properties in a portfolio

If you sell all the properties, or the last property, in your residential portfolio in an income year, you may still have unused excess deductions. If the sale of each of the properties in the portfolio was taxable, any unused deductions would be released. This means they can be used to offset any income you have from any sources in the year of the sale, or be carried forward to future years as a regular loss if required. However if the excess deductions included an amount transferred from another property the amount released is reduced by an amount equal to the total unused excess deductions transferred. For more information, go to Transferred excess deductions on page 58.

If any of the properties in the portfolio in any income year were not taxed on sale, any unused excess deductions for the portfolio must be transferred, or carried forward until they can be transferred, to another residential portfolio or individual property that has earned residential income. If you have another individual property or residential portfolio you can transfer the unused excess deductions from the property that was sold to the other individual property or residential portfolio in the current year. You can offset the transferred excess deductions against residential income of the other property. You need to track the transferred deductions until they are used to offset income as they can never be released.

If you do not have other residential rental properties, the unused excess deductions must be carried forward to the next income year you earn residential income from another residential portfolio or individual property. At this point the unused excess deductions would be treated as transferred to that individual property or portfolio, see Transferred excess deductions on page 58.

Example

Jairus owns a portfolio of 2 residential properties. He has not previously owned other residential properties. In the 2019-20 income year, Jairus sells both of his properties for a total net taxable gain of $10,000. He also has gross rental income of $20,000 from the properties in that year, rental deductions for the properties of $35,000, and a salary of $70,000.

The taxable sale and rental income gives Jairus a total of $30,000 residential income from the portfolio for the year. He can use $30,000 of the rental deductions against his residential income. Because the sale of both properties in the portfolio were taxed, the remaining $5,000 of rental deductions are released and can be used against his salary income.

If only 1 of the properties was taxed on sale, any excess deductions must continue to be carried forward and used against any residential income Jairus has from another residential property or portfolio in the future.

Transferred excess deductions

You may have unused excess deductions remaining after the non-taxable sale of an individual property or residential portfolio. In this situation, the unused excess deductions must be transferred to another residential rental property. The transfer can be made in the year of sale to another residential portfolio or individual property that you have earned residential income from. Otherwise, the unused excess deductions are carried forward to the next income year that you earn residential income and then they are transferred.

Once transferred, the excess deductions continue to be subject to the residential property deduction rules and they become part of the total deductions of the property they were transferred to.

When an individual property is sold, and the sale is taxable, excess deductions are released. When the last property in a residential portfolio is sold, and each sale in the portfolio was taxable, any excess deductions remaining are released. Once released, these excess deductions can be used to offset income from other sources, such as salary and wages or business income. However, transferred excess deductions can never be released from the residential property deduction rules. They can only be offset against residential income. In this situation, the amount of any excess deductions transferred to the property is subtracted from the amount of excess deductions that would otherwise be released.

Example

George owns a residential rental property A. In the 2019-20 income year George sells property A and the sale was not taxable. After the sale, George has remaining unused excess deductions of $2,000.

2 years later, George acquires another residential rental property, property B, and earns rental income from it. The unused excess deductions from property A transfer to property B.

In the 2023-24 income year, George sells property B. The sale is taxable under the bright-line rules and George makes a loss on the sale. George has excess deductions of $5,000 for property B, including the $2,000 of deductions transferred from property A.

Because the sale of property B was taxable, some of the excess deductions can be released from the rules. The released amount is the total remaining excess deductions of $5,000 less the transferred deductions of $2,000 from property A.

This means that $3,000 of deductions are released and can be used against any other income George has. The excess deductions of $2,000 transferred from Property A must be carried forward to the next year George earns income from a residential property.

Residential rental property on revenue account

The residential property deduction rules may not apply to residential land that is taxable on sale regardless of when it is sold. This is called revenue account land.

For this land to be excluded from the rules, you must let us know it is revenue account land. You need to do this by the due date for filing your income tax return for the year it becomes known that the land will be taxed on sale, or the 2019-20 income year if you held it on revenue account then.

You must also keep the deductions relating to the land separate, unless all your residential land is subject to tax on sale. If you do not let us know the land is revenue account land, you'll need to apply the rules to it.

If the land is taxed on sale because it is held by a person in the business of dealing, development, subdivision, or building business you do not need to let us know for the exclusion to apply.

If you have net income from revenue account land that is excluded from the rules, you can include it in the calculation of residential income that income to offset residential rental deductions from a residential portfolio or individual basis property.

You can include net income from revenue account land in the residential income of a portfolio or an individual basis property. You can also spread the income across more than 1 property or portfolio, but you cannot use any of the income more than once.

Net income from residential land that is revenue account land is included as residential income in your income tax return. However, net losses for this type of property should be included as Other rents or Income from taxable property sales/disposals.

To notify us of land that is revenue account land and excluded from the rules, you will need to provide us with the address of the property and its land title number or certificate of title number. The certificate of title number for your property can be found through your local council or at **homes.co.nz** We will also need confirmation that you can separately identify any deductions relating to the revenue account property. You can notify us by phone, or secure mail in myIR.

Investment in an entity with significant holdings in residential land – the interposed entity rules

There are special rules that may apply if you have borrowed money to buy a share or interest in an entity like a close company, partnership, or look-through company, and the entity holds significant interests in residential land. These rules are called the interposed entity rules. The interposed entity rules may apply if more than 50% of the entity's assets by value are residential land.

In this situation, the amount of the interest expense you can claim as a deduction may be limited.

The amount of the interest that can be deducted in the year is calculated as the lesser of:

- the deductible interest under the interest limitation rules multiplied by the percentage of the entity's capital used to acquire residential rental property, or
- your share of the entity's calculated net residential income.

Any excess amounts of interest expenditure are carried forward to later income years.

If you think the interposed entity rules apply to you, you may want to talk to a tax agent. Read the **Tax Information Bulletin, Vol 31, No 8 (September 2019)** for more information.

Part 5 - Holiday homes

Mixed-use asset rule

There are special deduction rules for mixed use assets, including holiday homes. These rules came into effect from the beginning of the 2013-14 tax year. The rules determine the deductibility and apportionment of expenditure when certain assets are used partly to earn income and partly for private purposes. They apply to natural persons and to close companies and apply differently depending on whether a mixed-use asset is owned by a natural person or a close company. The description of the rules below is for when a holiday home is owned by a natural person(s).

If, during the tax year, your holiday home is used both for private use and income-earning use, and it's unused for 62 days or more, then you have a mixed-use holiday home.

If your holiday home is used privately and for income-earning but is not vacant for 62 days or more, the standard tax rules apply. For more information about how the standard tax rules apply to holiday homes, go to Standard tax rules on page 64.

The rules do not apply if your property is a residential property used for long-term rental.

If you own a mixed-use holiday home, you will generally need to pay tax on the income you earn from letting it and apportion some of your expense claims.

Note

If you buy or sell your property part-way through the tax year, you'll need to reduce the 62 days figure to reflect your period of ownership.

Example

You buy your property on 1 October. Your period of ownership from 1 October to 31 March is 182 days. The 62 days figure is reduced as follows:

$$\frac{182 \times 62}{365} = 30.91 \text{ days}$$

Private use

Private use of your holiday home means use by:

- you or your family, even if 100% market rent is paid.
- non-associated people if they pay rent at less than 80% of market rates.

To help you work out if someone is associated to you, use our guide **Associated persons definitions for income tax purposes - IR620.**

Income-earning use

Income-earning use of your holiday home means use by a non-associated person from which you earn rent at 80% or more of market rates.

Interest limitation rules and mixed-use asset rules

When interest is incurred for a holiday home, the interest limitation rules apply to that interest, unless an exclusion or exemption applies.

Paying tax on your rent

You must pay income tax on rent earned from income-earning use. Any rent from private use is exempt from income tax.

Deducting your expenses

Expenses from mixed-use holiday homes fall into 3 categories:

1. Fully deductible

You can claim 100% of any expense relating solely to the income-earning use of the holiday home (subject to any limitations or exceptions outside of mixed-use asset rules, such as interest limitation rules).

Examples: Costs of advertising for tenants, costs of repairing damage caused by tenants.

2. Not deductible

You cannot claim any expenses relating to the private use of the holiday home.

Example: Costs of a boat and quad bike stored in a locked garage unavailable to the non-associated people renting the holiday home.

3. Apportioned

If an expense relates to both income-earning use and private use, you need to apportion it using this formula:

$$\text{Expense} \times \frac{\text{income-earning days}}{\text{income-earning days} + \text{private-use days}}$$

The amount resulting from the formula is allowed as a deduction subject to any limitations, such as the interest limitation rules.

Expenses might include interest, rates, insurance, repairs for general wear and tear, depreciation on chattels. When the expense is interest, the amount resulting from the formula will be subject to the interest limitation rules, unless an exclusion or exemption applies.

Note

If you're registered for GST, you'll need to make adjustments in your GST return. Read our **GST guide - IR375** for details.

Opting out

If your income from income-earning use is less than $4,000 for the year, you can choose to keep the holiday home outside the tax system. That means your rental activity does not need to be included in your income tax return. You do not return any income or claim any expenses for your holiday home.

You can also choose to keep your rental activity outside the tax system if you have an amount of quarantined expenditure for the year.

These opting out exemptions do not apply to holiday homes owned by companies.

Quarantining expenditure (mixed-use asset)

If you make a loss from your mixed-use asset, you may not be able to claim the loss straightaway. Instead, you may have to quarantine the excess expenditure and carry it forward to a future tax year to offset against future profits from the asset. This rule applies if your gross income from income-earning use of the asset is less than 2% of the value of the asset.

The cost or value of the asset is the most recent of the:

- purchase price or market value if purchased from an associated person, or
- the local authority capital or annual value (rateable value).

Example 1

David has a city apartment with a rateable value of $300,000. He rents out the apartment and also uses it privately. He receives market rate rental of $4,000 from non-associates, and $6,000 from associates. His total allowable expenditure, after applying the apportionment rules is $15,000.

Since David's income from non-associates is less than 2% of the apartment's rateable value, the excess expenditure of $11,000 cannot be claimed as a deduction.

The quarantined expenditure can be offset against profits in subsequent income years.

Example 2

In the next income year, David makes $10,000 from renting his city apartment at market rates to non-associates. His total allowable expenditure after applying the apportionment rules is $8,000. As calculated above, he also has expenditure of $11,000 quarantined from the previous income year.

David can deduct $2,000 of that quarantined expenditure to reduce his profit to zero. The $9,000 left continues to be quarantined and can be used as a deduction in a later income year.

There are restrictions around the use of the quarantined deductions in later years. The profit:

- must be from the use of the same asset
- must come from the asset being used as a mixed-use asset.

There is one exception to the same asset rule - if the asset for which the loss arose is damaged, destroyed, or lost and is no longer held by the person, and the replacement asset is identical or substantially the same as the original mixed-use asset, the loss from the first asset can be offset against subsequent profits from the second asset.

You can find more information about mixed-use holiday homes at **ird.govt.nz/mixed-use**

Standard tax rules

If your holiday home is used privately and for income-earning but is not vacant for 62 days or more, the mixed-use asset rules will not apply. The standard tax rules for what counts as income and how expenses should be apportioned apply.

Paying tax on your rent

You must pay income tax on rent earned from income-earning use.

Under the standard rules, the amounts you receive from paying guests will generally be income. This includes mates' rates rent.

An exception would be where family or friends use the property and are not charged rent, but make a minor contribution to your expenses, for example, they pay you $20 towards power. In that situation, the contribution is not rental income, but you also cannot claim any deductions for that period.

Deducting your expenses

Expenses from holiday homes that are in the standard tax rules fall into three categories:

1. Fully deductible

You can claim 100% of any expense relating solely to the income-earning use of the holiday home.

Examples: Costs of advertising for tenants, cleaning costs for the rental periods, any additional insurance or rates you have to pay because you rent the property out.

2. Not deductible

You cannot claim any expenses relating to the private use of the holiday home.

Example: If you use the property for a month over the summer and you can identify actual usage charges for some of your expenses, like power, you cannot deduct any of the usage component for that period.

3. Apportioned

If an expense relates to both income-earning use and private use, you need to apportion it using this formula:

$$\text{Expense} \times \frac{\text{nights the property is rented out or available to be rented out}}{\text{nights in the year}}$$

Expenses might include interest, rates, insurance, repairs for general wear and tear. Depreciation on chattels is dealt with separately on page 27.

You'll need to keep track of the number of nights you rent out the dwelling, and you'll need to have evidence of when it was available to be rented out. This evidence needs to show the property was genuinely available to rent – including that there was active and regular marketing of the property at market rates.

Depreciation

Once you know the depreciation losses for the year for the chattels in the property that paying guests can use (page 27), you need to work out what proportion of those losses you can deduct. To do this, use this formula:

$$\text{Depreciation losses} \times \frac{\text{nights the property is rented out or available to be rented out}}{\text{nights in the year the property is used or available for any purpose}}$$

The difference between this formula and the approach for mixed expenses is that if the property is not available for use by anyone for a period, those nights are not counted. For example, if the property cannot be lived in while some building work is being done.

Part 6 - Services you may need

myIR

You can manage your tax and entitlements online with a myIR account.

In myIR you can:

- check if you're due a refund
- keep up to date with your student loan
- check and update your Working for Families details
- review your KiwiSaver contributions
- manage your child support payments
- file returns
- update your contact and bank account details.

myIR is available 24 hours a day, seven days a week. Find out more, and register, at **ird.govt.nz/myir**

0800 self-service number

Our 0800 self-service number, 0800 257 777, is open 7 days a week. Make sure you have your IRD number ready when you call.

For access to your account-specific information, you'll need to be enrolled with voice ID or have a PIN.

When you call, confirm what you want from the options given. If you need to talk with us, we'll re-direct your call to someone who can help you.

Need to speak with us?

Have your IRD number ready and call us on one of these numbers.

General tax, tax credits and refunds	0800 775 247
Employer enquiries	0800 377 772
General business tax	0800 377 774
Overdue returns and payments	0800 227 771

We're open 8am to 6pm Monday to Friday, and 9am to 1pm Saturday. We record all calls.

Our self-service lines are open 7 days a week. They offer a range of automated options, especially if you're enrolled with voice ID.

Find out more at **ird.govt.nz/contact-us**

Tax Information Bulletin (TIB)

The TIB is our monthly publication containing detailed technical information about all tax changes. Subscribe at **taxtechnical.ird.govt.nz/subscribe** and we'll send you an email when we publish each issue.

For more detail about the residential property deduction rules legislation, see **Tax Information Bulletin, Vol 31, No 8 (September 2019)**, pages 51 to 66.

For more detail about the interest limitation rules and the bright-line property rule, see **Tax Information Bulletin, Vol 34, No 5 (June 2022)** pages 36 to 148.

Publications

These publications contain information that may be useful.

Associated persons definitions for income tax purposes - IR620
Use this guide to work out if someone is associated to you.

Bright-line property tax - IR1227

A detailed guide about the bright-line property rule. It helps you work out if you need to pay tax on any profit made from buying and selling a residential property.

Depreciation - a guide for business - IR260

This guide explains how to claim depreciation on your business assets.

GST - do you need to register? - IR365

This is an introduction to GST (goods and services tax). It helps you work out if you have to register for GST.

GST guide - IR375

A detailed guide about GST (goods and services tax) for all individuals, businesses and organisations that have to charge GST.

Provisional tax guide - IR289

Tells you what provisional tax is and how and when it must be paid.

Penalties and interest - IR240

A guide to help you understand the different types of penalties and interest we may charge if you do not file or pay on time. It also tells you how you can reduce or avoid penalties.

Record keeping - Getting it right - IR955
Explains record keeping requirements.

Tax rules for holiday homes - IR1021
A summary about how the mixed-use asset rules apply to holiday homes owned by a natural person(s).

QB 17/02 - Date of acquisition of land, and start date for 2 year bright-line test

Explains how to determine the date a property is acquired and when the period for the bright-line property rule begins.

QB 19/05 to QB 19/09 - Short stay accommodation overview
QB 19/05 to QB 19/09 cover your tax obligations if you rent out your home, a room in your home, or a separate residential property or dwelling. They focus on short-stay accommodation provided through peer-to-peer platforms such as Airbnb or Bookabach.

QB 20/01 - Can owners of existing residential rental properties claim deductions for costs incurred to meet Healthy Homes standards?
Explains what income tax deductions you can claim for costs incurred to meet Healthy Homes standards.

Privacy

Meeting your tax obligations means giving us accurate information so we can assess your tax and entitlements under the Acts we administer. We may charge penalties if you do not.

We may also exchange information about you with:

- some government agencies
- another country, if we have an information supply agreement with them, and
- Statistics New Zealand (for statistical purposes only).

You can ask for the personal information we hold about you. We'll give the information to you and correct any errors unless we have a lawful reason not to. Find our full privacy policy at **ird.govt.nz/privacy**

Te Kāwanatanga o Aotearoa
New Zealand Government