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Property tax details revealed

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After the surprise announcements in March, followed by a consultation paper in June, late September saw the introduction of legislation designed to switch off interest deductions for many owners of residential rental properties, starting from 1 October 2021.

The legislation comes via a Supplementary Order Paper (SOP) added to the Taxation (Annual Rates for 2021-22, GST, and Remedial Matters) Bill (the Bill). The Bill had its first reading and is now with the Finance and Expenditure Committee (FEC) for consideration. The FEC will consider the contents of the Bill and SOP over the next six months and has called for public submissions by 9 November 2021. The general expectation, given the majority Labour Government, is that the legislation will largely proceed as proposed (with potential tweaks to the legislation to ensure it does work as intended). The legislation should be enacted by the end of March 2022.

What are the main proposals in relation to interest deductions?

- Interest deductions on many residential properties (including bare land zoned for residential use) acquired on or after 27 March 2021 will not be allowed from 1 October 2021.
- Interest on loans for residential properties (including bare land zoned for residential use) acquired before 27 March 2021 can still be claimed as an expense, but the interest deductions will be phased out from 1 October 2021:

Date interest incurred	Percent of interest you can claim
Before 1 October 2021	100%
1 October 2021 – 31 March 2023	75%
1 April 2023 – 31 March 2024	50%
1 April 2024 – 31 March 2025	25%
1 April 2025 onwards	0%

- If money is borrowed on, or after, 27 March 2021 to maintain or improve property acquired before 27 March 2021, it will be immediately non-deductible from 1 October 2021 rather than subject to the phase out rule. There are some transitional rules to allow refinancing of borrowing (and certain other transactions) without forfeiting interest deductions.
- Interest which is incurred in relation to non-residential property purposes will remain deductible (for example, a plumber draws down a loan against a residential property in order to buy a business van).
- Transitional rules exist to help taxpayers apportion borrowing which has mixed purposes (e.g. a loan for a mixed-use building).
- An exclusion from the interest denial rules applies to "new builds". A "new build" is a self-contained dwelling which has received a code of compliance certificate (CCC) on or after 27 March 2020 (a year earlier than originally proposed). Owners of new builds will be able to claim interest deductions for 20 years from the date of the CCC (this includes the original owner and any subsequent owners if the property is sold).
- There are also exclusions from the rules for a number of different property types and owners. For example, generally situations where the property wouldn't typically be used by an owner-occupier.
- The property exclusions are main homes (e.g. flatmate/boarder situations), most business premises (e.g. a house converted to a doctor's surgery), hospitals, hospices, nursing homes, convalescence homes, retirement villages, rest homes, hotels, motels, hostels, inns, campgrounds, houses on farmland, bed & breakfasts, employee accommodation, student accommodation and land outside New Zealand.
- Generally, social housing providers are also exempted from the rules.
- Companies which have less than 50% of total assets in residential property subject to these rules will also be outside of these rules unless they are a "close company". A company is a close company when five or fewer natural persons or trustees own more than 50% of the voting interests in the company, treating all associated persons as one person.
- A new concept of an "exempt Māori company" has been introduced which is excluded from the interest limitation rules on the same basis as companies which are not close companies. This will include a company that is a Māori Authority, eligible to be a Māori Authority or wholly owned by a Māori Authority. "Māori excepted land" is also excluded from the rules. This includes certain types of Māori land title, land transferred as part of a Treaty settlement and land owned by a Māori authority (or an entity eligible to be one) and used to provide housing to a member of the relevant iwi or hapu.
- Property developers should not be affected by these changes and will still be able to claim interest as an expense.
- If a taxpayer has been denied interest deductions but is subsequently taxable on the proceeds when the property is sold (for example it is sold within the bright-line period), the taxpayer will be able to claim interest deductions up to the amount of the taxable gain on sale.

What are the main proposals for the bright-line test?

- Earlier this year the bright-line test was extended to apply for 10 years. This legislation will reduce the bright-line test to five years for "new builds". This amendment will be backdated to 27 March 2021. For the purposes of this rule, a "new build" is a property acquired on or after 27 March 2021 which has been acquired within 12 months of receiving its CCC.
- The bright-line test has had many changes in length since it was first introduced and the following table summarises which rule applies based on the property acquisition date.

When the property was acquired	The bright-line period that applies
On or after 27 March 2021, unless the property is a "new build"	10 years
Between 29 March 2018 and 26 March 2021 (inclusive) for properties which are not "new builds"	5 years
On or after 27 March 2021 for properties which are "new builds"	5 years
Between 1 October 2015 and 28 March 2018 (inclusive)	2 years

- New roll-over relief rules will apply from 1 April 2022 to ensure that in some circumstances the bright-line test is not triggered when the ownership of a property changes, but the effective ownership is the same (for example a property is transferred from personal ownership into a family trust).
- In addition to the changes contained in the SOP, the Bill also included some other changes to the bright-line test. These changes relate to situations where a "main home" becomes subject to the bright-line test, effectively fixing anomalies from when the legislation was rushed through earlier in the year.

Deloitte commentary:

Property taxation has been the talk of the town since March 2021, and one thing has become very clear in that time - people have lots of different and complicated ways of holding property. How these rules will impact on individual taxpayers will vary depending on their particular circumstances. Taxpayers with a simple residential rental property should generally be able to understand the rules easily enough, but taxpayers with more complicated circumstances will need to review these rules in more detail. For example, taxpayers with mixed use borrowing, mixed use properties, land which contains an existing property where a new build may be added, subdivided land and properties where borrowing needs to be refinanced.

Because of the rush to have legislation drafted on time for the 1 October 2021 start date, Inland Revenue Officials have had insufficient time to prepare a detailed commentary to accompany these law changes, which is the normal public policy process when new legislation is introduced. When tax law is complex, it is the commentary which aids users of the draft legislation to understand the policy intent behind the rules. It is expected that the commentary will be completed and made available in mid-October. Still, this provides less time for tax advisors to analyse and understand the finer details before submissions are due.

As noted above, submissions on the Bill can be made until 9 November 2021. While the Government has made it clear that the substantive policy decisions will not change, there is still an opportunity to review the legislation and make submissions on how the legislation could work better or be clearer for taxpayers to comply with. Whether the Government will take this feedback on board remains to be seen.

Other land matters to be aware of

On the day the SOP was released, Inland Revenue also released a draft interpretation statement on the application of the land sale rules to changes to co-ownership, subdivisions, and changes of trustees. We think the timing of the release was not a co-incidence, and submissions on this draft item also close on 9 November 2021.

The draft interpretation statement highlights a range of scenarios where there is a change in ownership interests in land which may therefore result in a "disposal" for the purposes of the land sale rules, with the consequence possibly being a surprise tax cost (for example, if the change in ownership occurs within the bright-line period). The following table is taken from the draft interpretation statement and summarises examples and conclusions contemplated by the document:

Sample scenario	Is there a "disposal" for the purposes of the land sale rules?
Change to form of co-ownership only A change to co-ownership from 50/50 tenants in common to joint tenants, or vice versa (same two owners)	No
Change to proportionality of co-ownership A change to co-ownership from A and B as either 50/50 tenants in common or joint tenants to tenants in common, A as 25%, B as 75%	Yes – disposal by A of an interest in the land as to 25%
Addition of a co-owner A change to co-ownership from A and B as equal co-owners (either joint tenants or 50/50 tenants in common) to A, B and C as equal co-owners (either joint tenants or tenants in common as to 1/3rd each)	Yes – disposal by A of a 1/6th interest in the land to C, and disposal by B of a 1/6th interest in the land to C
Removal of a co-owner A change to co-ownership from A, B and C as equal co-owners (either joint tenants or tenants in common as to 1/3rd each) to A and B as co-owners (either joint tenants or 50/50 tenants in common)	Yes – disposal by C of a 1/6th interest in the land to A, and disposal by C of a 1/6th interest in the land to B
Subdivision – all new titles issued to original owner Subdivision of land. All new titles issued to the original owner(s) in the same proportions or notional proportions that they held in the undivided land	No
Subdivision – new titles not all issued to original owner Subdivision of land. One of the new titles issued directly to a purchaser	Yes – disposal, by the owner of the original piece of undivided land, of the land comprised in the new title that is issued to the purchaser
Subdivision – co-owners each receive separate new titles Subdivision of land by equal co-owners, with each receiving one of the new titles (reflecting their proportionate or notional proportionate interest in the undivided land)	Yes – disposal by each co-owner of an interest in the land comprised in each new title issued to another co-owner. The extent of the interest disposed of in each lot issued to another co-owner is the proportionate or notional proportionate interest the person had in the undivided land
Transfer of land on change of trustee Transfer of land to reflect that there has been a change of trustees of a trust which owns the land	No

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