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Government Housing Policy Changes 2021

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On 23 March 2021, the NZ Government announced a range of measures to address NZ housing affordability and the supply and demand for residential properties. With these new measures, the Government hopes to "tilt the playing field" towards first time home buyers, reducing the competition they will face from speculators for typical first homes, cooling the investment property market.

The quick read

- The bright-line test[1] has doubled to 10 years with an exemption to incentivise new builds.
- Inherited properties, properties subject to a relationship property settlement, and those which have been the owner's main home will continue to be exempt from all bright-line tests. However, the "main home exemption" will be tightened.
- Short-stay accommodation in what are fundamentally "normal houses" is now on an equal tax footing to long-stay accommodation. Properties used for Airbnb, Bookabach etc., are within the definition of a "dwelling" and will be subject to the bright-line test and specific other rules applying to long-term accommodation.
- Interest deductions on residential property acquired on or after 27 March 2021 will not be allowed from 1 October 2021. Interest on loans for properties acquired before 27 March 2021 can still be claimed as an expense; however, the interest deductions will be phased out from 1 October 2021. An exclusion from the new interest rules will apply for "new builds".
- 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 rather than subject to the phase-out rule.
- Purely commercial properties are excluded from the new policy rules. Property developers should not be affected by these changes and can still claim interest as an expense.

[1] The bright-line test means if you sell a residential property (with the exclusion of the main family home) within a set period after acquiring it you will be required to pay income tax on any profit made through the property increasing in value (aka 'Capital Gains Tax').
Source: https://taxpolicy.ird.govt.nz/-/media/project/ir/tp/publications/2021/2021-other-fact-sheet-bright-line-test/2021-other-fact-sheet-bright-line-test.pdf

- First home buyers will also get more help to get into the housing market with increases to First Home Products' income caps and changes to regional price caps. Income caps to get financial assistance will be lifted from $85,000 to $95,000 for single buyers and from $130,000 to $150,000 for two or more buyers. The cap in Auckland rises to $650,000 for existing properties. In Wellington, it increases to $700,000. The changes to the house price and income caps will take effect on 1 April 2021.

What is being consulted on?

The changes to the bright-line test have been put into law already. However, the changes to interest deductibility have not. The Government has indicated that it will undertake consultation, in late May 2021, with legislation following.

What is being consulted on	What is not being consulted on
• The definition of a "new build"	• The change to the bright-line test
• How to ensure "business" loans are still deductible	• The main home exemption
• What interest deductions can be claimed if you end up taxed under the bright-line test	• Disallowing interest deductions
• Will there be an interest limitation rule?	• Exempting new builds
• Closing a loophole on interest-only loans to speculators	

The following looks further at the changes to the bright-line test and interest deductibility.

Changes to the bright-line test

The bright-line test has doubled from 5 years to 10 years for properties subject to a binding agreement dated on or after 27 March 2021.

An exemption applies for "main homes", and "new builds" will remain subject to a 5-year bright-line test.

What is considered a "new build"?

This is still up for consultation. Logically it should be newly constructed buildings. However, this may be defined in some way that connects to the date of completion of the building, i.e., when a code of compliance certificate is received. Consultation should also cover more complex issues, such as whether an extensive renovation can be a new build and what happens when a house is demolished and replaced with a new one (as New Zealand's housing stock hasn't been increased in the process).

What is the "main home exemption"?

Any residential property that has been used as the owner's main home for the entire time they owned it will continue to be completely exempt from any bright-line test.

There is now a ' change-of-use' rule for residential properties acquired on or after 27 March 2021, including new builds. This will affect the way tax is calculated if the property was not used as the owner's main home for ***more than 12 months at a time*** within the applicable bright-line period. This rule taxes any gain on the property in proportion to the time it is not the main home.

For example: If a property has been owned for 9 years and within that time has been rented out for 2 years, then 2/9th of the profit on the property sale will be subject to income tax.
In the past, homeowners were caught by the bright-line test only if they rented out the home for periods totalling 50% or more of the time it was owned.

Calculated as follows:

- Subtract the purchase price from the sale price
- Minus the cost of capital improvements made
- Subtract the costs to buy and sell the property; and
- Multiply the result by the proportion of time the property was not used as the main home

For example:

- *John and Beth buy an existing home to live in on 1 April 2021 for $850,000.*
- *They spend $60,000 on improving the kitchen and the bathroom.*
- *6 years later, John and Beth move to Australia for Beth's job, and they rent their house out while they are away.*

- *When they return to New Zealand in 2030, they decide to sell the house as they need something bigger for their growing family.*

- *Their house sells for $1,100,000.*

The calculation under the bright-line test will be:

Sale price	*$1,100,000*	
Less the purchase price	*$ 850,000*	*= $250,000*
Minus the cost of capital improvements	*$ 60,000*	*= $190,000*
Minus the cost to buy and sell the property	*$ 20,000*	*= $170,000*
Multiplied by the proportion of time the property was not used as the main home	*2 years out of 9 years* *2/9 = 0.22*	*$170,000 x 0.22* *= $37,400* *They will need to declare $37,000 as income and will be taxed on this "income" at their applicable tax rate*

Changes to income deductibility

Under previous rules, residential investors could deduct the interest on loans in calculating their taxable income, thereby reducing their tax bill. The Government has closed this "loophole", meaning that property investors will no longer be able to offset their interest expenses against their rental income when they are calculating their tax.

The only area where the Government is still considering its options is whether interest deductibility restrictions should also apply to new residential rental builds. The interest deductibility rules are unchanged for developers and builders.

Interest on borrowings that is not applied to residential property should remain fully deductible. For example, if a mortgage is taken out against a rental property but the money is used for another business (e.g., buying and running a cafe), then the interest will be deductible.

How does it work?

For property acquired before 27 March 2021, the ability to deduct interest will be phased out over a four-year period, starting from 1 October 2021.

Any **"new borrowing"** after 27 March 2021 will be immediately non-deductible.

How are interest costs assessed?

Income year (for standard balance date)	Percent of interest you can claim
1 April 2021 – 31 March 2022 (transitional year)	1 April 2021 to 30 September 2021 = 100% 1 October 2021 to 31 March 2022 = 75%
1 April 2022 – 31 March 2023	75%
1 April 2023 – 31 March 2024	50%
1 April 2024 – 31 March 2025	25%
1 April 2025 onwards	0%

Example of property acquired before 27 March 2021:

- *Tom acquired a rental property in 2017. He is charged $1,250 interest each month on his mortgage ($7,500 every 6 months).*

- *Tom has a standard balance date, ending 31 March. For the 2021–22 income year, Tom claims 100% of the interest charged between 1 April 2021 and 30 September 2021, which is $7,500.*

- *Between 1 October 2021 and 31 March 2022, Tom is charged $7,500 interest but can only claim 75%, which is $5,625.*

- *The total interest Tom claims for 2021–22 is $13,125.*

- *For the 2022–23 income year, Tom claims $11,250 interest charged as an expense (75% of $15,000).*

- *For the 2023–24 income year, she claims $7,500 interest charged as an expense (50% of $15,000).*

- *In the 2024–25 income year she claims $3,750 (25% of $15,000).*

- *From the 2025–26 income year onwards, Ana is no longer able to claim any interest against her rental income.*

Example of property acquired on or after 27 March 2021:

- *Cindy took out a loan to acquire a rental property on 1 April 2021. She can deduct the interest she's been charged from 1 April 2021 to 30 September 2021 against her rental income. Because she acquired the property after 27 March 2021, she cannot deduct any interest charged from 1 October 2021 onwards.*

- *Cindy has an interest-only mortgage of $500,000, at a fixed rate of 3% per year. During Cindy's 2021–22 income year (1 April 2021 to 31 March 2022), Cindy:*

    - *received $40,000 from rental income,*

    - *paid $5,000 for insurance and rates, and*

    - *paid $15,000 in mortgage interest.*

- *For the 2021–22 income year, Cindy can claim $7,500 of mortgage interest as an expense against her income (the interest charged from 1 April 2021 to 30 September 2021). She can also claim her insurance and rates.*

– *Her net rental income for 2021–22 is $27,500, and she pays tax on this amount. If Cindy receives and pays the same amounts for the 2022–23 income year, she can claim the insurance and rates as an expense against her rental income but can no longer claim any interest. Her net rental income will be $35,000.*

What is considered new borrowing?

If a property was acquired before 27 March 2021, clients could deduct the interest on the loan under the phased-out approach. This will include loans drawn down for such properties if the property settles after 27 March 2021.

If clients incur additional debt (from drawing on the same loan or taking a new loan) on or after 27 March 2021, interest on that portion of the loan will not be able to be claimed as an expense from 1 October 2021 onwards. Clients with a floating mortgage may need to keep a close eye on account balances.

What does this mean for me as an adviser?

This is a synopsis of the changes and is provided as information only for advisers. As an adviser, it is important to know any tax changes that may impact your clients. However, your fiduciary duty is to highlight risks to clients and recommend that they seek specialist advice from their accountant.

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