Do you own residential property? Does the extended bright-line test or the phasing out of interest deductions affect you?

On 23 March 2021, the Government announced a package of tax changes intended to help address housing affordability by dampening the market. The most important (and unexpected) change is that interest deductibility will be phased out for residential property investors, removing the tax benefit that comes with borrowing to buy residential property. In addition, under the extended “bright-line” test, if you sell a residential property acquired after 27 March 2021 within 10 years after acquiring it you are likely to be required to pay income tax on any gain made due to an increase in the value of the property.

If you are a property investor, you are now more likely to need to pay more tax on the return from your investments. It is important to make sure that you are clear on how the changes affect you.

Here is our practical guide to the new rules and further proposed changes, to help you determine the impact of the changes on you.

Key changes to tax rules

- If you sell a residential property (other than your main home) within 10 years of acquisition, any gain may now be subject to tax
- Any gains made on the disposal of your main home could also be subject to tax if there were periods when it was not your main home
- Interest deductions related to residential property investments will be disallowed

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What is residential land?

"Residential land" includes:

- Land that has a dwelling on it
- Land where the owner has an arrangement to build a dwelling on it
- Bare land that may be used for erecting a dwelling under the relevant district plan
- Land that is used for providing "short-stay accommodation" e.g. AirBnB

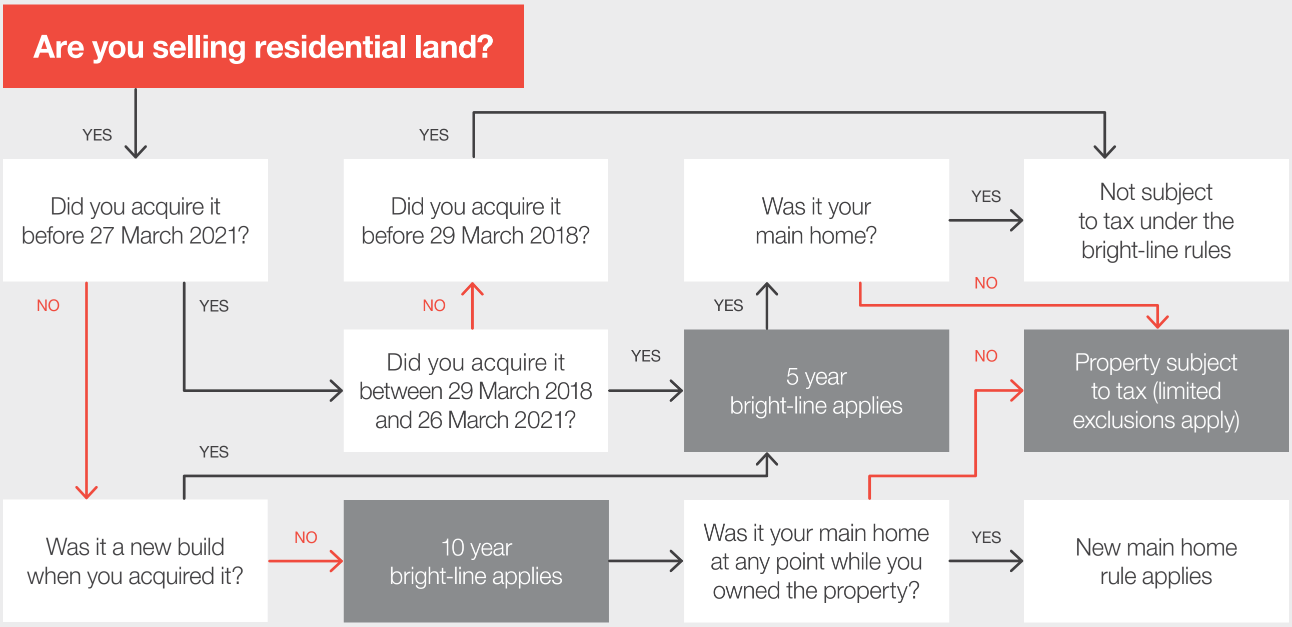
"Residential land" does not include:

- Farmland
- Hotels and motels
- Land used predominantly as business premises (but this does not include land used for providing short-stay accommodation)

When did you "acquire" the property?

This is not necessarily an easy question to answer, as Inland Revenue's 24-page interpretation statement on the topic confirms. The start date for these rules is usually the date on which a binding contract is formed. This may be the date of signing a conditional contract, or the date the contract goes unconditional, depending on what the conditions are. There are also different timing rules for new titles and other special situations.

Will you be affected by the extension to the bright-line test?



The main home exclusion

- Previously, the main home was entirely excluded from the bright-line test on an “all or nothing” basis - if the property was used as the owner’s main home for more than half of the period of ownership, it was not taxed at all under the bright-line rules.
- For properties acquired on or after 27 March 2021, a new main home exclusion will apply, where you will be taxed on some of the gain made on a “main home” if it was not used as your main home for more than 12 months at a time during the bright-line period.
- The main home exclusion can only be used twice in a 2-year period.

What if you just bought the property?

The extended bright-line test applies to properties that were acquired on or after 27 March 2021. For the purposes of these rules, “acquired” does not include properties acquired on or after 27 March as a result of an offer made by the purchaser on or before 23 March 2021 if the offer could not be revoked before 27 March.

Examples

Purchaser makes offer on 21 March 2021, accepted by seller and unconditional sale and purchase agreement signed 24 March	Five year bright-line test applies
Purchaser makes offer on 21 March 2021, accepted by seller and sale and purchase agreement signed 27 March	Ten year bright-line test applies
Purchaser makes an offer as part of a tender process that closes on 16 March 2021. The offer can be withdrawn after 22 March. Purchaser does not withdraw the offer, which is accepted by the seller and sale and purchase agreement signed 28 March	Ten year bright-line test applies
Purchaser makes offer on 21 March 2021, accepted by seller on 25 March. The purchaser then nominates another person to purchase the property on 28 March	Ten year bright-line test applies

Denial of interest deductions

- Interest payments on a loan used for residential investment property acquired on or after 27 March 2021 will **no longer be deductible from 1 October 2021**.
- Interest deductions which relate to amounts borrowed on or after 27 March 2021 for properties acquired before 27 March 2021 will also be disallowed.
- Interest on existing loans for properties acquired before 27 March 2021 can still be deducted, but the amount that can be deducted will decrease over the next four years.

Example: property acquired and loan taken out before 27 March 2021

Income year	Amount of interest you can claim
1 April 2020 to 30 September 2021	100%
1 October 2021 to 31 March 2023	75%
1 April 2023 to 31 March 2024	50%
1 April 2024 to 31 March 2025	25%
1 April 2025 onwards	0%

Who is not affected?

- Property dealers and developers
- Loans secured against residential property but used for non-housing business purposes.

Key unanswered questions

The proposals to deny interest deductions in relation to residential land will be subject to further consultation by the Government.

Key unanswered questions include:

- What is a "new build" for the purposes of the rules?
- Will interest become deductible if the property ends up being taxable on disposal?
- Will additional measures be enacted to prevent people circumventing the new rules?

Legislation for the proposed new rules to deny interest deductions, and the definition of a "new build" for the purposes of these rules is still to come. For more detail on the key features of the new rules and proposals, see our recent Tax Tips Alert.

PwC – how can we help

Please reach out to your PwC advisor if you have any questions. Our Property Advisory team can assist with any other property related queries and support you to make decisions regarding your property portfolio from a tax, legal, and commercial perspective.

Helen Johnson
Partner – Tax Legal
PwC Legal
+64 27 501 9007
helen.n.johnson@pwc.com

Louis McLennan
Partner
PwC
+64 21 249 0227
louis.j.mclennan@pwc.com

Nicky Harrison
Director – Property
PwC Legal
+64 27 326 3265
nicky.c.harrison@pwc.com

John Schellekens
Partner – Real Estate Advisory
PwC
+64 27 489 9541
john.b.schellekens@pwc.com