



Should interest deductions be allowed when property is sold?

Many people favour investing in residential property because capital gains made there are usually not taxed, while at the same time loan interest is able to be deducted as an expense to reduce an investor's tax bill. This investment creates pressure on house prices and makes it hard for first-home buyers and owner-occupiers to compete with investors. Therefore the Government has extended the bright-line test so more investors will pay tax on income made through capital gains, and is proposing to deny, or in some cases defer, deductions for interest expense.

The Government is consulting on whether interest, disallowed under the new rules, should be allowed to be claimed as an expense if the gain on sale is taxed. Consider the following example:

- Anika buys a rental property for \$1 million in 2022, and immediately rents it out.
- She sells it for \$1.1 million 6 years later.
- She pays \$150,000 interest during that time (none of which is deductible).
- As it is subject to the 10-year bright-line test, \$100,000 income from the sale is taxable.

The Government is considering four options, as in the table below. For more information on the options see chapter 5 in the [Discussion Document](#) at taxpolicy.ird.govt.nz.

Brief explanation of the options being considered	Taxable income on Anika's sale
Interest cannot be deducted at any time	\$100,000
Interest can be deducted when the property is sold	-\$50,000
Interest deductions at the time of sale cannot create a loss	\$0
Interest can be deducted when the property is sold but losses can only be deducted from residential property income	-\$50,000 from residential property income or real property gains only

The Government is also considering whether to allow a portion of interest to be deducted from taxable income even when the income from a capital gain is **not** taxed. In the example above, if the property Anika bought was sold after 11 years, she would not pay any tax on the \$100,000 income from the capital gain under the bright-line test.

The Government is consulting on whether \$50,000 of the \$150,000 interest should be allowed to be deducted from Anika's other taxable residential property income (since \$100,000 of the interest already offsets the income from the non-taxable capital gain).

