Cabinet

Minute of Decision

Taxation of Housing: Limiting Interest Deductions for Residential Property and Changes Related to the Bright-Line Extension

Portfolios **Finance / Housing / Revenue**

On 27 September 2021, Cabinet:

Previous decisions

1 **noted** that on 8 March 2021, Cabinet took a series of in-principle decisions to form part of the government's broader response to housing affordability [CAB-21- MIN-0045];

2 **agreed** to the following modifications of the decisions made on 8 March 2021 [CAB-21- MIN-0045]:

2.1 apart from length, the settings that apply for the extended bright-line test will also apply for the new build bright-line test (paragraph 25);

2.2 the new build exemption from interest limitation will apply to any qualifying new build that receives its code compliance certificate on or after 27 March 2020, even if the property is acquired before this date (paragraph 29);

3 **confirmed** the in-principle decisions made on 8 March 2021, other than those listed at paragraph 2 above;

Scope and exclusions

4 **agreed** that, as a general principle, interest limitation will apply to properties suitable for long-term accommodation even if they are not currently being used as such;

5 **agreed** that the main home will not be subject to interest limitation;

6 **agreed** that public, council, emergency, and transitional housing will not be subject to interest limitation;

7 **agreed** that, as a general principle, property not suitable for long-term owner-occupation should not be subject to interest limitation;

8 **agreed** that, as a general principle, businesses and organisations not involved in residential property investment should not be subject to interest limitation;

9 **agreed** that companies will not be subject to interest limitation unless they are residential property-rich or controlled by a small number of shareholders;

10 **agreed** that Kāinga Ora – Homes and Communities and its wholly-owned subsidiaries will not be subject to interest limitation;

11 **agreed** that the interest limitation proposal will not apply to:

11.1 Māori customary land, Māori freehold land, Crown land reserved for Māori, and land set aside as a Māori reservation;

11.2 housing provided on land held by a Māori authority (or an entity eligible to be one) to a shareholder or beneficiary of that entity; or

11.3 land held by a Māori authority (or an entity eligible to be one) that was acquired under a Treaty settlement or a post-Treaty settlement mechanism, including a leasehold interest in that land is held by a wholly-owned subsidiary;

12 **agreed** that properties located outside New Zealand will not be subject to interest limitation;

Property development and new builds

13 **agreed** that taxpayers undertaking property development will not be subject to limitation on interest expenses relating to that development as incurred, even if they are not property developers;

14 **agreed** that interest deductions relating to residential property acquired for the purposes of a business involved in dealing in, subdividing, developing, or building on land also should not be subject to limitation;

15 **agreed** that the new build exemption will apply to the first purchaser and subsequent purchasers of a new build until 20 years after the new build's code compliance certificate is issued;

Purpose-built rentals

16 **agreed** that purpose-built rentals (PBRs) should be subject to the interest limitation rules (including the development and 20-year new build exemptions, which would apply to new purpose-built rentals);

17 **invited** the Minister of Housing, as part of the work being undertaken on PBRs, to report back to Cabinet on the value proposition for PBRs and the case for whether this asset class should be excluded from the interest limitation rules and, if so, what criteria should apply;

Interest deductions when property is taxed on sale

18 **agreed** that if a residential property is taxed on sale, previously limited interest deductions relating to that property will be allowed on sale;

19 **agreed** that if a residential property is taxed on sale under the bright-line test, any losses arising from the deferred interest deductions being allowed will be subject to the existing restrictions applying to bright-line losses;

Bright-line issues

20 **agreed** to amend the main home exclusion for properties acquired on or after 27 March 2021, so that where land is not used predominantly as a main home, the main home portion of the land is not taxed under the extended or new build bright-line tests;

21 **agreed** that, as a general principle, legal transfers where there is no change in economic ownership should not trigger the bright-line test;

Additional policy decisions

22 **authorised** the Minister of Finance and the Minister of Revenue to make additional joint decisions on any policy and drafting issues arising for the interest limitation proposal or additional bright-line changes, in consultation with the Minister of Housing and the Minister for Land Information as appropriate;

Financial implications

23 **noted** the following changes in tax revenue as a result of decisions in paragraphs 2 to 21 above, with a corresponding impact on the operating balance and net core Crown debt:

	$m – increase/(decrease)			
Vote Revenue Minister of Revenue	**2021/22**	**2022/23**	**2023/24**	**2024/25**
Tax revenue: Income tax	80.000	200.000	350.000	490.000

24 **agreed** that the changes in tax revenue under paragraph 23 above are managed against the Budget 2022 operating allowance, which can be used to increase total gross spending for Budget 2022, while not increasing overall allowances for Budget 2022;

25 **noted** that the revenue impacts will continue beyond the current forecasting period (2024/25) and that these will be reflected in the operating balance and net core Crown debt at appropriate future dates;

26 **noted** that any rent increases arising from the interest limitation reforms may also lead to an increase in Crown spending on the accommodation supplement and temporary additional support, which is difficult to quantify at this stage;

27 **noted** that to give effect to the policy decisions in paragraphs 2 to 21, Inland Revenue will incur capital costs of $1.400 million;

28 **noted** that Inland Revenue will cover the associated depreciation and capital charge from its existing baseline funding;

29 **noted** that Inland Revenue will self-fund these capital costs from its accumulated reserves and that this will not materially affect the department's ability to fund the future replacement of its existing assets;

30 **noted** that a further effect of the policy decisions will be to increase the outreach, assistance, compliance and policy work expected of Inland Revenue and that it is consequently seeking funding totalling $19.380 million to cover operating costs (excluding depreciation and capital charge) for the period up to 30 June 2025;

31 **approved** the following changes to appropriations to help meet the costs referred to in paragraph 30 above, with the corresponding impact on the operating balance and net core Crown debt:

	$m – increase/(decrease)			
Vote Revenue	**2021/22**	**2022/23**	**2023/24**	**2024/25**
Multi-Category Expenses and Capital Expenditure: Services for Customers MCA				
Investigations (funded by revenue Crown)	0.330	2.000	2.000	2.000
Management of debt and unfiled returns (funded by revenue Crown)	-	0.380	0.380	0.380
Services to Ministers and to inform the public about entitlements and meeting obligations (funded by revenue Crown)	2.390	2.430	2.020	1.590
Services to process obligations and entitlements (funded by revenue Crown)	0.860	0.860	0.860	0.650
Departmental Output Expenses:				
Policy Advice (funded by revenue Crown)	-	0.250	-	-
Total operating	**3.580**	**5.920**	**5.260**	**4.620**

32 **agreed** that the expenses incurred under paragraph 30 be charged against the operating allowance of the Between-Budget Contingency;

33 **agreed** that the changes to appropriations in 2021/22 above be included in the 2021/22 Supplementary Estimates and that, in the interim, the increases be met from Imprest Supply;

34 **noted** that Inland Revenue intends to raise funding for out-years beyond 2024/25 in future Budget discussions, by which time more certainty will exist;

35 **directed** Inland Revenue to report to the Minister of Finance and Minister of Revenue annually on the effect of this funding on taxpayers' compliance with the interest limitation rules and the changes to the bright-line rules.

Legislative implications

36 **authorised** the Minister of Revenue, in consultation with the Leader of the House, to release a Supplementary Order Paper containing the measures in paragraphs 2 to 21 at the Finance and Expenditure Committee consideration stage of the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Bill.

Michael Webster
Secretary of the Cabinet