A one-two punch on the nose to Property Investors that were already on the ropes and bleeding.

Withers Tsang Chartered Accountants Auckland

The Government has announced two significant changes set to impact Residential Property Investors.

1. **The phased removal of interest deductibility**

2. **Doubling the Brightline from 5 to 10 years**

These changes, particularly the removal of interest deductibility will certainly go a long way to achieving the governments stated goal of dampening enthusiasm for residential property investment in NZ.

So what are the key details….

Firstly, the changes are aimed at the existing housing stock, new builds will be exempted from both changes.

Interest deductibility removed.

Interest deductibility on any residential property purchased after 27 March 2021 will no longer be deductible after 1 October 2021.

Interest on loans for investment properties purchased before 27 March 2021 will be phased out over four years with deductibility reduced by 25% per year over each of the next four years with all deductibility gone by 1 April 2025.

This change will impact leveraged investors hard by requiring them to pay tax on profits, that in reality, don't exist. Pressure will come on cashflows as a result and we expect many investors who will be stretched by this will look to deleverage and reduce their debt exposure. The measure is sure to bring more property to market in the short term.

We stand ready to help clients budget the impacts on their own circumstances. I encourage everyone to read the attached link to get more detail on the change.

Interest deductions on residential property income - Proposed changes

Extension of the 5-year Brightline to 10-years.

This change has been well anticipated by investors and aligns the Brightline with other ten-year hold rules that apply to traders, developers and builder’s other land.

The Brightline will move from 5 years to 10 years for properties acquired after 27 March 2021.

New builds will be exempt from the Brightline extension but will still be subject to the five-year Brightline.

The main home exemption will continue and inherited property will still be exempt.

The new rules do contain a new “Change of use“ provision with respect to the main home exemption.

Currently, it's all or nothing based on whether the main home has been used as such for the predominant amount of time it has been owned. But for property purchased after 27 March 2021 that experiences a change of use from main home to rental property tax will be payable based on an apportionment of the time it was used as a home as opposed to a rental.

So, by way of example, a property purchased in 2022 for $ 800,000 that is not a new build, is used as a main home until 2028 when it is rented out. It is sold in 2030 for $1.1 Million. The property is owned 8 years so is caught by the 10-year Brightline. Despite being a main home for 6 of the year's tax will still be payable on 2/8ths of the $300,000 gain, i.e. tax of $75,000 will be payable.

This new apportionment rule only applies if the property has been used as the owner’s main home for more than 12 months of the ownership tenure.

This change will water down the main home exemption and drag many more taxpayers into the tax net if they have rented their home out for more than 12 months during their term of ownership.

I strongly encourage you to click this link for more info on the changes.

Brightline test proposed changes

Conclusion.

This is big. The removal of interest deductibility will particularly hurt highly leveraged investors. We encourage clients to engage us to budget the cashflow impacts this will have as tax will be payable even where no actual profit is being made.

Some people will need to sell and reduce the size of their portfolio if they can't afford the loans and the tax.

The flow of property to market is likely to tip the supply equation closer to the demand equation at least in the short term.

If you need to move, selling a property that is not impacted by Brightline to reduce debt and interest costs that will no longer be claimable after 2025 will be worth considering.

For those looking to buy, new builds just got a whole lot more attractive.

As always, we at Withers Tsang look forward to advising and supporting you through these changes in what is, a brave new landscape for residential investors.

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