Inland Revenue
Te Tari Taake

INTERPRETATION STATEMENT | PUTANGA WHAKAMĀORI

The interest limitation rules and short-stay accommodation

Issued | Tukuna: 2 June 2023

IS 23/04

This Interpretation statement considers how the interest limitation rules apply to interest incurred for property used to provide short-stay accommodation. It also explains what other income tax rules may be relevant to any interest that is deductible, depending on your circumstances. This Interpretation statement explains how the rules apply to natural persons and trustees only.

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

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Introduction | Whakataki

What this Interpretation Statement is about

1. This Interpretation Statement explains how the interest limitation rules apply if you incur loan interest for a property you use to provide short-stay accommodation. It also explains what other income tax rules may be relevant to any interest that is deductible, depending on your circumstances. It covers short-stay accommodation provided:

   - in your holiday home,
   - in your main home,
   - in a separate dwelling on the same land as your main home,
   - in a property used only to provide short-stay accommodation, or
   - on your farm, or lifestyle block (that is not a farm).

2. This Interpretation Statement explains how the rules apply to interest incurred by natural persons or trustees. It does not cover the situation where the interest is incurred by a company. It also does not cover the situation where the short-stay accommodation is used to provide social, emergency, transitional, or support housing.

3. In this Interpretation Statement:

   - "Short-stay accommodation" is accommodation provided to a guest for up to four consecutive weeks.
   - A "short-stay dwelling" is a dwelling in which you provide short-stay accommodation.
   - A "guest" is a person who pays an amount[1] to use a short-stay dwelling.

4. The tax rules apply to land. Under general law, dwellings affixed to land are part of the land. When this Interpretation Statement refers to a short-stay dwelling, this includes the land on which the dwelling is placed. When this Interpretation Statement refers to land, this includes any dwellings on the land.

5. This Interpretation Statement is part of a series of items covering the tax rules that apply to persons who provide short-stay accommodation. The earlier items are available on Inland Revenue's website here. Those earlier items pre-date the interest limitation rules and the residential rental ring-fencing rules (referred to in this

[1] The amount paid will usually be in money, but also includes money's worth. Money's worth is something which has a monetary value.

Interpretation Statement as the ring-fencing rules). Therefore, the explanation of the deductibility of interest in this item supersedes the explanations of the deductibility of interest in those earlier items.

Structure of this Interpretation Statement

6. This Interpretation Statement is structured so that you only need to read the parts that are relevant to your circumstances. First there is an overview of the interest limitation rules, and then the Interpretation Statement is broken up into sections that explain how the interest limitation rules, and other relevant tax rules, apply to each of the short-stay accommodation situations specified in [1]. An appendix provides additional detail on some aspects of the interest limitation rules and the other relevant tax rules that may apply.

7. The Interpretation Statement and appendix cross-reference one another to assist you to locate the information relevant to your situation (without the need to read the entire item, as some content may not be relevant to your situation). For example, if your short-stay dwelling is a separate dwelling on the same land as your main home, we suggest you read the relevant section in the Interpretation Statement and then, if you need to, read the relevant cross-referenced content in the appendix that provides additional detail.

8. First, however, we suggest you read the overview of the interest limitation rules in [9] to [22].

Analysis | Tātari

Overview of the interest limitation rules applying to short-stay dwellings

9. The interest limitation rules in subpart DH apply to interest incurred on or after 1 October 2021 to the extent it is for disallowed residential property (DRP). The rules:

    - Deny all interest deductions for DRP acquired on or after 27 March 2021.
    - Progressively deny deductions for grandparented residential interest, which is interest incurred for DRP acquired before 27 March 2021 with a loan drawn down before that date or a loan that refinances such a loan (a grandparented transitional loan). A portion of grandparented residential interest is allowed during the phase-out period (1 October 2021 to 31 March 2025) and from 1 April 2025 interest deductions will be fully denied.

Disallowed residential property

10. Relevantly (in the context of short-stay accommodation), DRP is land in New Zealand to the extent to which it has a place configured as a residence or abode (ie, a dwelling), and it includes any appurtenances belonging to or enjoyed with the place. It does not matter whether the place is used as a residence or abode.

11. The words "residence" and "abode" are not defined for the purposes of the Act and have their ordinary meaning. "Residence" means a person's home[2] and "abode" means a house or home.[3]

12. An appurtenance is an accessory to some more important thing. In the context of a dwelling, an example of an appurtenance is a standalone garage that is used with a dwelling. An appurtenance also includes the curtilage (garden or yard) of the dwelling.

Excepted residential land

13. DRP does not include land to the extent it is "excepted residential land". Relevantly for this Interpretation Statement, "excepted residential land" includes:
    - a person's main home,
    - the main home of a beneficiary of a trust, if the owner of the home is a trustee, provided no principal settlor of the trust has a different main home (ie, either no principal settlor has a main home, or the place is their main home as well as being the beneficiary's main home), and
    - farmland (including any dwellings on the land).

14. Unless it is excepted residential land (eg, a main home or farmland), land with a short-stay dwelling on it is DRP. This is because it is land that has a place (the dwelling) configured as a residence or abode. The interest limitation rules will apply to interest incurred for the short-stay dwelling unless the "new build land" exemption applies.

The new build land exemption

15. If the new build land exemption applies, the interest limitation rules do not apply and interest incurred for the land will be deductible for a 20-year period, subject to normal deductibility rules. The new build land exemption applies to every owner of the new build land during the exemption period.

16. In general terms, "new build land" is land to the extent to which it has a place configured as a self-contained residence or abode and a code compliance certificate

[2] *Concise Oxford English Dictionary* (12th ed, Oxford University Press, 2011).

[3] *Concise Oxford English Dictionary* (12th ed, Oxford University Press, 2011).

has been issued on or after 27 March 2020 evidencing that the place was added to the land or converted into a residence or abode.

17. The phrase "self-contained residence or abode" is not defined for the purposes of the Act. Its ordinary and plain meaning requires that a dwelling has the necessary facilities, such as a kitchen, bathroom, toilet, and electricity, to enable it to be used as a residence or abode. A dwelling will not be self-contained if it shares essential facilities with another dwelling.

The rules may apply to part of a piece of land

18. The statutory definitions of DRP and "excepted residential land" and the new build land exemption use the phrase "to the extent to which". This means the interest limitation rules may apply to only part of a piece of land (for example, if part of the land is the owner's main home and part is not, or if part of the land is new build land and part is not).

19. If the interest limitation rules apply to only part of a piece of land, it is necessary to determine the proportion of the land the rules apply to. This is known as apportionment. In many circumstances, a land area apportionment will be appropriate and will achieve a fair and reasonable assessment. In other circumstances, a different apportionment approach might be appropriate – for example, apportionment based on valuation of different parts of the land.

Identifying the interest incurred for DRP

20. Tracing is generally used to identify whether interest is incurred for DRP. This requires identifying whether the loan under which the interest is paid was used for a short-stay dwelling (for example, whether the loan was used to purchase the short-stay dwelling or to pay for repairs or maintenance to the short-stay dwelling). In rare cases, a special rule applies if it is not possible to trace a grandparented transitional loan.

The interest limitation rules are overriding

21. The interest limitation rules override all other deduction rules. If a deduction for interest is denied under the interest limitation rules, a deduction is not allowed under any other rule.

22. However, interest that has been denied deductibility only under the interest limitation rules (ie, it would otherwise have been deductible) may become deductible in the year the DRP is disposed of, if the disposal is taxable – for example, if the disposal is taxed under the bright-line test. Because of this, it may be necessary to keep track of how much interest you would have been allowed to deduct if not for the interest limitation rules.

How the interest limitation rules apply to specific types of short-stay accommodation

23. The following discussion explains how the interest limitation rules and other tax rules apply to different short-stay accommodation scenarios. Please go to the section relevant to you. If you provide short-stay accommodation:

    - **in your holiday home** – go to [24],
    - **in your main home** – go to [71],
    - **in a separate dwelling on the same land as your main home** – go to [84],
    - **in a separate property used only for short-stay accommodation** – go to [154], or
    - **on your farm or lifestyle block** – go to [177].

Short-stay accommodation provided in your holiday home

24. The basis of the following discussion is that your holiday home is the only place configured as a residence or abode on the land.

25. The interest limitation rules apply to interest to the extent to which it is incurred for DRP.

26. Relevantly (in the context of short-stay accommodation), DRP is land in New Zealand to the extent to which it has a place configured as a residence or abode. It includes any appurtenances belonging to or enjoyed with the place.

27. The land with your holiday home is land with a place configured as a residence or abode. Therefore, it is DRP. The interest limitation rules will apply to the interest incurred for your holiday home unless the holiday home is new build land.

28. In general terms, new build land is land to the extent to which it has a place that is a configured as a self-contained residence or abode and a code compliance certificate has been issued on or after 27 March 2020 evidencing that the place was added to the land or converted into a residence or abode. The new build land exemption is discussed in more detail in the appendix from [A8].

29. If your holiday home is new build land, see from [57]. If your holiday home is not new build land, see from [30].

If your holiday home is not new build land

30. The table below (figure 1) provides an overview of the rules relevant to interest deductibility for your holiday home.

Figure | Hoahoa 1 – Short-stay accommodation provided in your holiday home and the holiday home is not new build land – overview of rules relevant to interest deductibility

Interest limitation rules	Apportionment rules	Ring-fencing rules
The interest limitation rules apply. Interest deductions are not allowed – subject to partial deductibility in the phase-out period[4] if you have a grandparented transitional loan.[5]	If there is private use of the holiday home and: • you can deduct a portion of the interest in the phase-out period because you have a grandparented transitional loan: • the sale of the holiday home could be taxed apportion the interest under either the MuA rules or standard deductibility rules (see from [46]). The interest limitation rules override the ability to deduct interest under the MuA rules or standard deductibility rules. But performing the apportionment will calculate the interest that would have been deductible but is denied by the interest limitation rules. Keep track of denied interest deductions if the sale of the holiday home could be taxed (eg, under the bright-line test), as denied interest may become deductible in the future.	The ring-fencing rules are unlikely to apply to limit your total deduction for the income year, but they will if: • the MuA rules do not apply to the holiday home, and • the rental activity for the holiday home[6] is loss-making.

The interest limitation rules apply

31. Since your holiday home is not new build land, the interest limitation rules will apply. The way the interest limitation rules apply depends on whether the interest you incurred for the holiday home is grandparented residential interest.

32. Grandparented residential interest is interest paid under a grandparented transitional loan (that is, a loan drawn down before 27 March 2021 or a loan that refinances such a loan). Grandparented transitional loans and grandparented residential interest are discussed in detail in the appendix from [A22].

33. If the interest you incurred for your holiday home:

    - is grandparented residential interest, you will be able to deduct a portion of the interest during the phase-out period (from 1 October 2021 to 31 March 2025) and interest deductions will be fully denied from 1 April 2025,

[4] The phase-out period is 1 October 2021 to 31 March 2025.

[5] A grandparented transitional loan is a loan drawn down before 27 March 2021 or a loan that refinances such a loan.

[6] Or a portfolio of rental properties if you have one.

- is not grandparented residential interest, you will be denied a deduction for the interest.

34. Whether you have grandparented residential interest or not, if the future disposal of your holiday home is taxable, interest incurred in prior years that would have been allowed had it not been denied under the interest limitation rules is recognised in the year of disposal. The way in which it is recognised depends on which land sales provision the disposal is taxed under (see [40] to [43]).

Interest limitation rules override ability to deduct interest under the mixed-use asset rules or standard deductibility rules

35. If you use your holiday home to earn income and use it privately,[7] most deductible expenses need to be apportioned between those uses of the property. The method for this apportionment depends on whether the mixed-use asset rules (the MuA rules) apply. If the MuA rules apply, they provide a formula for apportionment. If the MuA rules do not apply, you need to apply general apportionment principles (referred to here as the standard deductibility rules). See further from [46].

36. However, the interest limitation rules override the ability to deduct interest that would otherwise be deductible. This means the interest that would be apportioned to the income-earning use of your holiday home, which would otherwise have been allowed as a deduction under either the MuA rules or standard deductibility rules, is denied a deduction under the interest limitation rules.[8]

Apportionment of interest for private use relevant during phase-out period or if future disposal taxable

37. Despite the interest limitation rules overriding both the MuA rules and standard deductibility rules, you may still need to apportion the interest you have incurred for your holiday home under the relevant rules (discussed from [46]). This will be the case if you use your holiday home privately as well as to earn income and:
    - The interest is grandparented residential interest, in which case you will be able to deduct a portion of the interest during the phase-out period.
    - A future disposal of your holiday home could be taxable.

38. This is because any deductible interest during the phase-out period, or any interest that becomes deductible on a future taxable disposal of the land, is limited based on the extent to which you used the short-stay dwelling to earn income.

[7] This may include use by you or your family, or use by friends who are not charged full market rent.
[8] Except if it is partially deductible during the phase-out period (see [33]).

If you have some deductible interest in the phase-out period

39. If you have some deductible interest in the phase-out period because your interest is grandparented residential interest, you will need to apportion your deductible interest under either the MuA rules or standard deductibility rules (see from [46]).

Treatment of previously denied interest if the future disposal of your holiday home is taxable

40. If the future disposal of your holiday home is taxable, interest incurred in prior years that would have been allowed under either the MuA rules or standard deductibility rules but was denied under the interest limitation rules is recognised in the year of disposal.

41. A disposal of your holiday home would be taxable if, for example, you dispose of it within the bright-line period[9] or you acquired it with a purpose or intention of disposing of it.

42. If the disposal of your holiday home is taxable under the bright-line test, the interest previously denied because of the interest limitation rules is treated as part of the cost of the property. This means it is taken into account in determining your taxable profit (if any) from the disposal. If the disposal is loss-making, your deduction for the cost of the property is limited to the amount of income derived from the disposal plus any other net land sale income from land disposals taxed under ss CB 6 to CB 14. Any excess amount that you cannot deduct is carried forward to a future year in which you have land sale income – whether under the bright-line test or one of the other land sale provisions (s EL 20).

43. If your disposal is taxable under any of the other land sales provisions, the previously denied interest is allowed as a deduction in the income year of disposal but is subject to allocation under the ring-fencing rules.[10] The ring-fencing rules are discussed in the appendix from [A48].

If it is clear the future disposal of your holiday home will not be taxable

44. If you do not have deductible interest expenditure in the phase-out period (or the phase-out period has finished) and it is clear a future disposal of your holiday home will not be taxable, you do not need to apportion your interest under either the MuA rules or standard deductibility rules. This is because the interest is not deductible and

[9] Generally, for land acquired before 27 March 2021 and for all new build land, the bright-line period is 5 years, and for land acquired on or after 27 March 2021, the bright-line period is 10 years.

[10] Subpart EL contains rules for the allocation of deductions for excess residential land expenditure. These rules are commonly referred to as the "residential loss- ringfencing rules".

will not become deductible on the disposal of the holiday home. It will be clear a future disposal will not be taxable if you have owned the holiday home for longer than the applicable bright-line period and none of the other land sales provisions could apply (for example, you did not acquire the holiday home with a purpose or intention of disposal).

If it is not clear whether the future disposal of your holiday home will be taxable

45. However, it may not be clear whether the disposal of your holiday home will be taxable until the time of disposal. In this case, you should apply the relevant apportionment calculation under either the MuA rules or standard deductibility rules to your interest for the property for each year and retain evidence of the calculation. This calculates the interest that would have been allowed as a deduction in each income year but was denied under the interest limitation rules. This means you will readily be able to determine the total amount of interest that can be recognised if a future disposal of the land is taxable. The discussion from [46] to [54] will help you determine whether the MuA rules or standard deductibility rules are relevant.

If you need to apportion for private use – MuA rules or standard deductibility rules

46. If you need to apportion the interest you have incurred for your holiday home because you use it privately as well as to earn income and you have some deductible interest during the phase-out period and/or a future disposal of your holiday home could be taxable, you will need to work out which apportionment rules to use.

47. You will need to apportion your interest either under the MuA rules or the standard deductibility rules, depending on your circumstances. A dwelling can move in and out of the MuA rules from one year to the next, so you need to consider which rules apply each income year.

48. If you use your holiday home partly for income-earning purposes and partly for private purposes and it is also not used for at least 62 days in the income year, the MuA rules will apply. This is unless you opt out of the rules, which you can do in two situations (see [52] to [53]).

49. For the MuA rules, private use is when you, or a person associated with you (for example, close relatives such as your children, grandchildren, siblings, or in-laws), use the dwelling. It is irrelevant whether you are paid for that use. Private use also includes use of the dwelling by a guest who pays less than 80% of the market value amount for use of the dwelling.

50. If the MuA rules apply, they apportion your interest (and other expenditure for the property) between income-earning use and private use by using a prescribed formula.

This determines the deduction you are allowed. The formula apportions relevant expenditure based on the number of income-earning days relative to total days the property is physically used.

51. If the MuA rules do not apply,[11] your expenses for the property will be apportioned based on the standard deductibility rules. Generally, this would involve time and space-based apportionment, with potential deductibility for days the property is not used privately and is available for rent.[12]

52. The two situations in which you can choose to opt out of the MuA rules (if they would otherwise apply) are where:

   - If the amount of income you derive for the income year from your holiday home is less than $4,000.
   - Your holiday home rental activity for the year is loss-making (that is, the expenses you could deduct for the year under the MuA rules exceed the income) and your income from renting out the dwelling during the income year is less than 2% of the property's value.[13]

53. If you opt out of the MuA rules, the income from your holiday home for that year is treated as exempt income and all interest (and other expenses) incurred for the holiday home will be non-deductible.

54. Comprehensive explanations of how to determine which apportionment rules apply to short-stay dwellings and how those rules are applied are contained in:

   - QB 19/06: What income tax rules apply if I have a dwelling that I sometimes rent out as short-stay accommodation and sometimes use myself? *Tax Information Bulletin* Vol 31, No 6 (July 2019): 12.
   - QB 19/07: How do the mixed-use asset income tax rules apply to a dwelling that I sometimes rent out as short-stay accommodation and sometimes use privately? *Tax Information Bulletin* Vol 31, No 6 (July 2019): 16.
   - QB 19/08: How do the standard income tax rules apply to a dwelling that I sometime rent out as short-stay accommodation and sometimes use privately? *Tax Information Bulletin* Vol 31, No 6 (July 2019): 22.

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[11] Other than because you opted out of the MuA rules.

[12] See QB 19/08: How do the standard income tax rules apply to a dwelling that I sometime rent out as short-stay accommodation and sometimes use privately? *Tax Information Bulletin* Vol 31, No 6 (July 2019): 22.

[13] The value to use in determining if you are under the 2% threshold is: the most recent capital value or annual value set by your local authority or, if you purchased the property after the most recent local authority valuation, the purchase price you paid for the property (unless you acquired it from an associated person – in which case the market value at the time you acquired the property).

55. As noted at [5], the above items pre-date the interest limitation rules and the ring-fencing rules. Therefore, the explanation of the deductibility of interest in this item supersedes the explanations of the deductibility of interest in those earlier items.

If your holiday home is new build land

56. The table below (figure 2) provides an overview of the rules relevant to interest deductibility for your holiday home.

Figure | Hoahoa 2 – Short-stay accommodation provided in your holiday home and the holiday home is new build land – overview of rules relevant to interest deductibility

Interest limitation rules	Apportionment rules	Ring-fencing rules
The interest limitation rules do not apply. Interest is deductible subject to the following columns.	If there is private use of the holiday home, interest and most other expenses will need to be apportioned (so will be partially deductible). Apportionment is under either the MuA rules or standard deductibility rules (see from [59]).	If the MuA rules do not apply and the rental activity for the holiday home[14] is loss-making, the amount of total deduction (including interest) allowed in the income year may be limited by the ring-fencing rules (see from [62]).

Interest limitation rules do not apply

57. Since your holiday home is new build land, the interest limitation rules do not apply to interest incurred for your holiday home.

58. Interest will be deductible to the extent it is incurred in relation to income-earning use of your holiday home and is not prohibited because it is expenditure of a private nature. Apportionment for private use is discussed from [59]. If you have only used your holiday home privately, you cannot deduct any interest you incurred for the property.

Apportionment for private use – mixed-use asset rules or standard deductibility rules

59. If you have used your holiday home both privately[15] and for earning income in an income year, you will need to apportion most of your deductible expenses for the property (including interest) between those different uses of the property.[16] Your

[14] Or a portfolio of rental properties if you have one.

[15] This may include use by you or your family, or use by friends who are not charged full market rent.

[16] There are some expenses that do not need to be apportioned – for example, fees for advertising the holiday home on holiday rental sites.

deduction for these expenses will be limited based on the extent to which you used the property to earn income.

60. You will need to apportion your interest (and most other expenses for the property) either under the mixed-use asset rules (the MuA rules) or based on general apportionment principles, depending on your circumstances. A dwelling can move in and out of the MuA rules from one year to the next, so you need to consider which rules apply each income year.

61. The discussion from [48] to [54] will help you determine whether the MuA rules or standard deductibility rules apply and direct you to further guidance on how to apply the relevant rules.

If the MuA rules do not apply, the ring-fencing rules may apply if the property (or portfolio) is loss-making

62. If the MuA rules do not apply to your holiday home, the ring-fencing rules[17] may apply to limit your total deduction (including interest) for the property in the income year.

63. The ring-fencing rules apply to "residential rental property". "Residential rental property"[18] is residential land for which a person who owns the land is allowed a deduction relating to the use or disposal of the land.[19] "Residential land"[20] includes land that has a dwelling on it, unless the land is farmland or is used predominantly as business premises. The business premises exclusion will not apply if the land is used predominantly as business premises for a business of supplying accommodation and it is not the main home for the owner (or other relevant person if the property is held in a trust). Therefore, it is highly unlikely that the business premises exclusion could apply.

64. The ring-fencing rules do not apply to a person's residential land for an income year if the MuA rules apply to the land for that income year.[21]

65. Your holiday home used to provide short-stay accommodation will be residential rental property (provided it is not farmland and not within the business premises exclusion). This is because it is land with a dwelling, and you are allowed a deduction for expenditure relating to the land (because you are using the land to derive income).

[17] Subpart EL contains the ring-fencing rules.

[18] See section EL 3 for the definition of "residential rental property".

[19] The ring-fencing rules will not be relevant if the MuA rules do not apply because you opted out of them, because in this situation your expenses for the property will be non-deductible (see [53]).

[20] "Residential land" is defined in section YA 1.

[21] Section EL 12.

66. There is a main home exclusion from the ring-fencing rules.[22] The main home exclusion is available (meaning the ring-fencing rules do not apply for a particular income year) if:

- more than 50% of the land is used for most of the income year by the owner as their main home; or
- the land is trust property and more than 50% of the land is used for most of the income year by a beneficiary of the trust as their main home and no principal settlor of the trust has a separate main home.

67. When your holiday home is the only place configured as a residence or abode on the land, the main home exclusion rule is unlikely to apply.[23]

68. If the ring-fencing rules apply, the total deduction for expenditure incurred for your holiday home that you can allocate to the income year is limited to the income you derive from your holiday home in the income year.[24]

69. If your deduction is limited under the ring-fencing rules, the excess deduction not allocated to the income year is suspended and carried forward to a future income year in which you derive income from a residential rental property and added to the amount of the deduction or loss for that later year.

70. The ring-fencing rules are discussed in more detail in the appendix from [A48].

Example | Tauira 1 – Holiday home

On 1 February 2021, Tamati purchased a holiday home for $850,000 using a bank loan of $450,000 and $400,000 of his own money. The code compliance certificate (evidencing the home was added to the land) was issued on 1 June 2015. The most recent capital value for the holiday home is $925,000, set by the local authority in 2022.

For the income year ending 31 March 2023, Tamati incurs interest expenditure of $24,750 under the loan for the holiday home, other expenditure (not relating solely to the use of the holiday home to derive income) of $5,000 for the holiday home, and $2,000 of expenditure that relates solely to the use of the holiday home to derive income and from which no personal benefit is received (eg, advertising costs).

[22] Section EL 9.

[23] It would only be in rare scenarios that it might – for example, if the property is trust property and one of the beneficiaries of the trust used the dwelling as their main home for more than six months of the year and the principal settlors of the trust were deceased.

[24] Or, if your holiday home is part of a portfolio of residential rental properties you own, your deduction for expenditure incurred on your portfolio of properties for the income year is limited to the income derived from your portfolio in that income year.

The holiday home is used for 70 days to earn income of $17,500 from (non-associated) guests, used for 100 days by Tamati for his private use, and not used for 195 days.

How the taxation laws apply

Income from land use

Tamati has income of $17,500 from the holiday home.

If Tamati does not opt-out of the MuA rules (as explained below), the income of $17,500 will be assessable income.

If Tamati meets the requirements to opt-out of the MuA rules and chooses to do this, the income of $17,500 will be treated as exempt income.

Deductions for interest

The MuA rules (rather than the standard deductibility rules) apply, unless Tamati is able to opt-out of them and chooses to do so.[25] This is because the holiday home is used partly for income-earning purposes and partly for private purposes and is not used for 195 days, which is more than the minimum 62 non-use days required for the MuA rules to apply.

A deduction for interest is allowed under the MuA rules if the deduction is not denied under the interest limitation rules. If Tamati does not opt-out of the MuA rules, he will be allowed to deduct some of his interest expenditure for the holiday home because he has a grandparented transitional loan (discussed below), so it is sensible to consider first the MuA rules and then consider the extent to which the deduction is denied under the interest limitation rules.

If Tamati meets the requirements to opt-out of the MuA rules and chooses to do this, he will not be allowed to deduct any interest (or other expenses) for the holiday home.

The MuA Rules

Since the amount of Tamati's income of $17,500 from the holiday home is less than 2% of its most recent capital value of $925,000 (2% of $925,000 is $18,500), Tamati can elect to opt out of the MuA rules.

If Tamati opts out of the MuA rules:

- His income of $17,500 is treated as exempt income.

[25] QB 19/06 explains when the MuA rules apply.

- None of his expenditure for the holiday home will be deductible because it is incurred in deriving exempt income so the exempt limitation applies.

If Tamati does not opt-out of the MuA rules, he must apportion the total expenditure he has incurred in providing the short-stay accommodation (other than any fully deductible expenses such as the advertising costs) using the MuA apportionment formula. The formula calculates the amount apportioned to income-earning use and the amount apportioned to private use. Only the amount apportioned to income-earning use is deductible under the MuA rules – subject to the interest limitation rules.

Since a deduction for interest is only allowed under the MuA rules if the deduction is not denied under the interest limitation rules, Tamati separately applies the MuA apportionment formula to his interest expenditure to identify the amount of interest apportioned to income-earning use. He then applies the MuA apportionment formula to his other expenditure that needs to be apportioned.

Applying the MuA apportionment formula to his interest expenditure of $24,750, Tamati calculates the amount apportioned to income-earning use is $10,191.18. Of this amount, he is allowed a deduction only to the extent the deduction is not denied under the interest limitation rules.

Applying the MuA apportionment formula to the $5,000 of other expenditure for the holiday home that does not relate solely to the use of the holiday home to derive income, Tamati calculates that he can deduct $2,058.82 of the $5,000.

The $2,000 expenditure that relates solely to the use of the holiday home to derive income and from which no personal benefit is received (eg, advertising costs) is fully deductible under the MuA rules.

The interest limitation rules

If Tamati does not opt-out of the MuA rules, he needs to consider how the interest limitation rules apply to his interest expenditure of $10,191.18 apportioned to income-earning use under the MuA rules. The is because the interest of $10,191.18 has been incurred for DRP, and the new build land exemption does not apply (because the code compliance certificate, evidencing the holiday home was added to the land, was issued before 27 March 2020).

Tamati's bank loan is a grandparented transitional loan because it was first drawn down before 27 March 2021. Therefore, the interest payable under the loan is grandparented residential interest and deductibility is phased-out between 1 October 2021 and 31 March 2025. The percentage denied for the period 1 April 2022 to 31 March 2023 is 25%.

Therefore, Tamati is denied a deduction of $2,547.80 (25%) of the $10,191.18. He is allowed a deduction of the remaining $7,643.38.

If Tamati disposes of the holiday home in a later income year and that disposal is taxable, the denied interest deduction would be recognised in that year. If the disposal were taxable:

- under the bright-line test, the amount of $2,547.80 denied under the interest limitation rules would be treated as a cost of the holiday home when calculating the amount of Tamati's income from the disposal;
- under a provision other than the bright-line test, the amount of $2,547.80 denied under the interest limitation rules would be allowed as a deduction in the year of disposal and allocated under the ring-fencing rules.

Total allowable deduction

If he does not opt-out of the MuA rules, Tamati's total allowable deduction for the holiday home is $11,702.20 (comprised of the $7,643.38 allowable interest deduction, $2,058.82 allowable deduction for other expenses that must be apportioned, and $2,000 of other fully deductible expenses).

The ring-fencing rules

The ring-fencing rules may apply to limit the deduction that is allocated to an income year when a person owns a residential property (or for a portfolio of residential properties) and has expenditure that relates to the property (or portfolio) for which they are allowed a deduction.

However, the ring-fencing rules do not apply to residential land for an income year when it is an asset referred to in s DG 3 – that is, an asset as defined for the MuA rules (ie, an asset that in the income year is used partly privately, partly for income-earning and is vacant for at least 62 days).

Because the holiday home is an asset as defined for the MuA rules, the ring-fencing rules cannot apply.

The MuA quarantine rule

There is a specific rule (the quarantined expenditure rule) in the MuA rules that may limit a person's deduction for an income year if the amount of income derived from the asset is less than 2% of the asset's value. Tamati's income from the holiday home ($17,500) is less than 2% of the holiday home's value (2% of $925,000 = $18,500). However, the quarantined expenditure rule applies to limit the deduction that can be taken only if the allowable deduction for expenditure exceeds the income from the

asset. That is not the case here. Tamati's total allowable deduction for the holiday home ($11,702.20) is less than the income from the holiday home ($17,500). Therefore, the quarantine rule does not apply to limit the deduction Tamati can take in the income year.

Example | Tauira 2 – Holiday home

On 1 April 2022, Kate purchased a holiday home for $750,000 using a bank loan of $400,000 and $350,000 of her own money. The code compliance certificate (evidencing the home was added to the land) was issued on 1 December 2020. The most recent capital value for the holiday home is $825,000, set by the local authority in 2022.

For the income year ending 31 March 2023, Kate incurs interest expenditure of $22,000 and other expenditure (not relating solely to the use of the holiday home to derive income) of $3,000 for the holiday home. The holiday home is used for 40 days to earn income of $10,000 from (non-associated) guests, is used for 225 days for private use by Kate's son (following his return to New Zealand after living overseas), used for 50 days for private use by Kate, and not used for 50 days. The holiday home is marketed and available for rent for those 50 vacant days. The holiday home is the only land Kate owns that she derives rental or other income from.

How the taxation laws apply

Income from land use

Kate has assessable income of $10,000 from the holiday home.

Deductions for interest

The interest limitation rules

The interest limitation rules do not apply because the new build land exemption applies. This is because compliance certificate, evidencing the home was added to the land, was issued on or after 27 March 2020.

The MuA Rules

The MuA rules do not apply. This is because holiday home is not used for 50 days, which is less than the minimum of 62 non-use days required for the MuA rules to apply.

The standard deductibility rules

Because the MuA rules do not apply, Kate's expenses for the property that relate to both income-earning and private use ($22,000 interest + $3,000 other expenses) need to be apportioned under the standard deductibility rules.

Kate uses QB 19/08 to help her apportion these expenses. As explained in QB 19/08, she also has some expenses that are fully deductible, such as website listing and host fees.

The ring-fencing rules

The ring-fencing rules apply because the holiday home is a residential rental property, and the holiday home is not Kate's main home.

The amount of Kate's deduction for the holiday home is limited to her residential income of $10,000.

If the total of Kate's deductible expenses in relation to the holiday home exceeds $10,000, Kate can only deduct $10,000 of those expenses in the income year. Any excess would be suspended as a deduction for the 2023 income year and carried forward to a later income year in which Kate derives residential income (that is, income from a residential rental property).

Short-stay accommodation provided in your main home

71. The table below (figure 3) provides an overview of the rules relevant to interest deductibility for your main home.

Figure | Hoahoa 3 – Short-stay accommodation provided in your main home – overview of rules relevant to interest deductibility

Interest limitation rules	Apportionment rules	Ring-fencing rules
The interest limitation rules do not apply. Interest is deductible subject to the following columns.	Interest and most other expenses will need to be apportioned (so partially deductible). See QB 19/05 for guidance on how to apportion interest and other expenses.	The ring-fencing rules do not apply provided more than 50% of the land has been used as a main home for most of the income year (see from [78]). If the main home exclusion applies and the rental activity is loss-making, the amount of total deduction you can take in the income year (after apportionment) is not limited by the ring-fencing rules.

The interest limitation rules do not apply

72. The interest limitation rules apply to interest to the extent to which it is incurred for DRP. The statutory definition of DRP is discussed in detail in the appendix from [A2].

73. Relevantly (in the context of short-stay accommodation), DRP is land in New Zealand to the extent to which it has a place configured as a residence or abode. It includes any appurtenances belonging to or enjoyed with the place.

74. DRP does not include land to the extent to which it is "excepted residential land". A person's main home is excepted residential land and therefore is not DRP.

75. A person's main home is the one dwelling they use as their residence. If a person has more than one home, their main home is the place they have the greatest connection with.

76. If you provide short-stay accommodation in your main home (whether by renting a room or the entire home):

    - the main home exception applies, and
    - the interest limitation rules do not apply to interest incurred for your home.

77. QB 19/05: What are my income tax obligations if I rent out my home or a dwelling on your property as short-stay accommodation? *Tax Information Bulletin* Vol 31, No 6 (July 2019): 3 explains how the other relevant tax rules, including deductions for interest, apply when you provide short-stay accommodation in your main home.

The ring-fencing rules do not apply

78. The ring-fencing rules will not apply to limit your total deduction (including interest) for the property in the income year if:

    - you are the owner of the land, more than 50% of the land is used for most of the income year by you as your main home, or
    - the land is trust property, more than 50% of the land is used for most of the income year by a beneficiary of the trust as their main home and no principal settlor of the trust has a separate main home.

79. For example, the main home exclusion to the ring-fencing rules will apply in an income year to your land if the area of the land for your main home is 60% of the total land area and you use the main home as your main home for the entire income year.

80. If the above criteria are not met, the main home exclusion from the ring-fencing rules will not be available. In this case, see the discussion on the ring-fencing rules in the appendix from [A48].

Change in use of main home

81. If your main home ceases to be your main home and you use that dwelling to provide short-stay accommodation, the interest limitation rules apply to interest incurred for that dwelling from the date of the change in use.

82. Equally, if you use a dwelling to provide short-stay accommodation and that dwelling becomes your main home, the interest limitation rules cease to apply to interest incurred for the dwelling from the date of the change in use.

83. The ring-fencing rules may commence or cease applying in the income year of a change of use of the property. This depends on whether more than 50% of the land is used as a main home for most of the income year.

Example | Tauira 3 – Main home

On 1 April 2023, Javan purchases a property with a two-storey house for $900,000 using a bank loan of $550,000 and $350,000 of his own money. There are 3 bedrooms on the top floor and one bedroom on the ground floor. The house has one kitchen, which is on the top floor and one laundry, which is on the ground floor. There are bathrooms and toilet facilities on both floors. Javan uses the house as his main home. He uses the bedroom on the ground floor to provide short-stay accommodation.

For the income year ending 31 March 2024, Javan incurs interest expenditure of $32,500 and has paying guests for 123 nights, deriving income of $9,840.

How the taxation laws apply

Income from land use

Javan cannot use the standard-cost approach (referred to in QB 19/05), as he rented the room out for more than 100 nights in the income year.[26]

Javan therefore has income of $9,840.

Deductions for interest

The interest limitation rules

The interest limitation rules do not apply. This is because the main home exclusion applies.

The MuA rules

[26] If the standard-cost approach is used, some or all of the income will be exempt, and no deductions for actual costs can be claimed.

The MuA rules do not apply. This is because the MuA rules apply to an asset in its complete form. The asset in its complete form is the house. The house (in its complete form) is used on each day in the income year as Javan's main home. There are therefore not the minimum of 62 non-use days required for the MuA rules to apply.

The standard deductibility rules apply

The standard deductibility rules apply. These are explained in QB 19/05, which Javan uses to help him apportion the interest and any other expenses he has incurred that need to be apportioned.

The ring-fencing rules

The ring-fencing rules do not apply because the main home exclusion to the ring-fencing rules applies. This because more than 50% of the land is used for most of the year as Javan's main home.

Short-stay accommodation provided in a separate dwelling on the same land as your main home

84. Your main home and your separate short-stay dwelling will be on the same land when they are on the same legal title (called a record of title). For example, you may have a sleepout or cottage on the same record of title as your main home.

85. The interest limitation rules apply to interest to the extent to which it is incurred for DRP.

86. Relevantly (in the context of short-stay accommodation), DRP is land in New Zealand to the extent to which it has a place configured as a residence or abode. It includes any appurtenances belonging to or enjoyed with the place.

87. DRP does not include land to the extent to which it is "excepted residential land".

88. Excepted residential land includes:

    - a person's main home,
    - farmland.

89. A person's main home is the one dwelling they use as their residence. If a person has more than one home, their main home is the place they have the greatest connection with.

90. When your main home and short-stay dwelling are on the same land and that land is farmland, the interest limitation rules do not apply. What is farmland is discussed from [177].

91. When your main home and short-stay dwelling are on the same land and that land is not farmland, the interest limitation rules:

- do not apply to your main home (because it is excepted residential land); but
- do apply to your short-stay dwelling, unless your short-stay dwelling is new build land.

92. In general terms, new build land is land to the extent to which it has a place that is configured as a self-contained residence or abode and a code compliance certificate has been issued on or after 27 March 2020 evidencing that the place was added to the land or converted into a residence or abode. The new build land exemption, including when a place will be self-contained, is discussed in the appendix from [A8].

93. How the interest limitation rules apply to your short-stay dwelling depends on whether you have one loan for both your main home and the short-stay dwelling or separate loans for each and whether your short-stay dwelling is new build land. If you have:

- **one loan** for both your main home and short-stay dwelling, and the short-stay dwelling **is not new build land**, see from [94],
- **one loan** for both your main home and short-stay dwelling, and the short-stay dwelling **is new build land**, see from [111],
- **separate loans** for your main home and short-stay dwelling, see from [126].

One loan for your main home and short-stay dwelling and the short-stay dwelling is not new build land

94. The table below (figure 4) provides an overview of the rules relevant to interest deductibility for your short-stay dwelling.

Figure | Hoahoa 4 – Short-stay accommodation provided in a separate dwelling on the same land as your main home – one loan and the short-stay dwelling is not new build land – overview of rules relevant to interest deductibility

Interest limitation rules	Apportionment rules	Ring-fencing rules
Apportion the loan interest between your main home and the short-stay dwelling. The interest limitation rules apply to the interest apportioned to the short-stay dwelling. Interest deductions for the interest apportioned to the short-stay dwelling are not allowed – subject to partial deductibility in the phase-out period[27] if you have a grandparented transitional loan.[28]	If there is private use of the short-stay dwelling and: • you can deduct a portion of the interest in the phase-out period because you have a grandparented transitional loan: • the sale of the property could be taxed apportion the interest under either the MuA rules or standard deductibility rules (see from [101]). The interest limitation rules override the ability to deduct interest under the MuA rules or standard deductibility rules. But performing the apportionment will calculate the interest that would have been deductible but is denied by the interest limitation rules. Keep track of denied interest deductions if the sale of the property could be taxed (eg, under the bright-line test), as denied interest may become deductible in the future.	The ring-fencing rules are unlikely to apply to limit your total deduction for the income year, but they will if: • you have not used more than 50% of the land for your main home, • the MuA rules do not apply to the short-stay dwelling, and • the rental activity for the short-stay dwelling[29] is loss-making.

95. If you have one loan for both your main home and your separate short-stay dwelling, you will need to determine how much of the interest incurred in the income year is for your short-stay dwelling and how much is for your main home. This is called "apportionment". It is discussed in the appendix from [A17].

96. Apportionment is necessary because the interest limitation rules:

- Apply to the interest apportioned to your short-stay dwelling.

[27] The phase-out period is 1 October 2021 to 31 March 2025.

[28] A grandparented transitional loan is a loan drawn down before 27 March 2021 or a loan that refinances such a loan.

[29] Or a portfolio of rental properties if you have one.

- Do not apply to the interest apportioned to your main home (because the main home exception applies). That said, a deduction for interest apportioned to your main home will generally be denied under the private limitation.[30]

The interest limitation rules apply to interest apportioned to the short-stay dwelling

97. Since your short-stay dwelling is not new build land, the way the interest limitation rules apply depends on whether the interest you incurred for the dwelling is grandparented residential interest.

98. Grandparented residential interest is interest paid under a grandparented transitional loan (that is, a loan drawn down before 27 March 2021 or a loan that refinances such a loan). Grandparented transitional loans and grandparented residential interest are discussed in detail in the appendix from [A22].

99. If the interest incurred and apportioned to your short-stay dwelling:
    - is grandparented residential interest, you will be able to deduct a proportion of the interest during the phase-out period (from 1 October 2021 to 31 March 2025) and interest deductions will be fully denied from 1 April 2025,
    - is not grandparented residential interest, you are denied a deduction for the interest.

100. Whether you have grandparented residential interest or not, if the future disposal of the property with your main home and short-stay dwelling on it is taxable, interest incurred in prior years that would have been allowed had it not been denied under the interest limitation rules is recognised in the year of disposal. While it is not common for a property with someone's main home on it to be taxed on disposal, it is possible (see from [A66] in the appendix for examples of when this might be the case).

Apportionment of interest for private use relevant during phase-out period or if future disposal taxable

101. Any deductible interest during the phase-out period, or any interest that becomes deductible on a future taxable disposal of the land, is limited based on the extent to which you used the short-stay dwelling to earn income.

[30] The private limitation is in s DA 2(2) and provides that a person is denied a deduction for an amount of expenditure or loss to the extent to which it is of a private or domestic nature. The exception to full denial would be if you have some income-earning use of your home (eg, a home office or you rent out a room in your home), in which case you may be able to deduct some of your interest.

102. Therefore, if you have used the short-stay dwelling both privately[31] and to earn income in an income year, you may also need to apportion the interest incurred for your short-stay dwelling between those different uses for the dwelling. This will be the case if:

- the interest you incurred for the short-stay dwelling is grandparented residential interest, in which case you will be able to deduct a portion of the interest during the phase-out period, or
- a future disposal of the land with your main home and separate short-stay dwelling could be taxable.

103. The method for apportionment between your income-earning use and private use of the short-stay dwelling depends on whether the mixed-use asset rules (the MuA rules) or standard deductibility rules apply. Paragraphs [46] to [54] explain how to work out which apportionment rules apply and refer to comprehensive guidance on how to apply the relevant rules. The explanation in those paragraphs applies equally to your short-stay dwelling and the interest apportioned to it.

104. In summary:

- The interest limitation rules override the ability to deduct interest under the MuA rules or standard deductibility rules. This means the interest apportioned to the income-earning use of your short-stay dwelling which would be allowed a deduction under the relevant apportionment and deductibility rules is denied a deduction under the interest limitation rules.
- Despite the interest limitation rules overriding both the MuA rules and the standard deductibility rules, you may still need to apportion the interest you have incurred for your short-stay dwelling under the relevant rules. As noted at [102], this will be the case if the interest is grandparented residential interest or a future disposal of the land could be taxable.
- On a taxable disposal, interest incurred in previous years that would have been allowed under either the MuA rules or the standard deductibility rules but was denied under the interest limitation rules is recognised in the year of disposal.
- It would not be common for property with someone's main home and a short-stay dwelling on it to be taxable on disposal, but there are some situations where this could be the case. This is discussed in the appendix from [A66].
- You do not need to apportion your interest between income-earning and private use of the short-stay dwelling if:

[31] This may include use by you or your family, or use by friends who are not charged full market rent.

    - you do not have deductible interest expenditure in the phase-out period (because the interest is not grandparented residential interest), or the phase-out period has finished, and
    - it is clear the future disposal of the property will not be taxable.
- If it is not clear whether the future disposal of the property could be a taxable disposal and you have used the short-stay dwelling in an income year both privately and to earn income, you should apply the relevant apportionment calculation under MuA rules or standard deductibility rules to your interest for the dwelling for that year and retain evidence of the calculation. This calculates the interest that would have been allowed as a deduction in the income year but was denied under the interest limitation rules. This means you will readily be able to determine the amount of interest that can be recognised if a future disposal of the land is taxable.
- If the disposal of your land is taxable, interest apportioned to income-earning use under either the MuA rules or the standard deductibility rules in prior income years and denied under the interest limitation rules is recognised in the year of disposal as follows:
    - If the disposal is taxable under the bright-line test, the previously denied interest is treated as part of the cost of the property. This means it is taken into account in determining your taxable profit (if any) from the disposal. If the disposal is loss-making, your deduction for the cost of the property is limited to the amount of income derived from the disposal plus any other net land sale income from land disposals taxed under ss CB 6 to CB 14. Any excess amount that you cannot deduct is carried forward to a future year in which you have land sale income – whether under the bright-line test or one of the other land sale provisions (s EL 20).
    - If your disposal is taxable under any other provision, the previously denied interest is allowed as a deduction (in the income year of disposal) but is subject to allocation under the ring-fencing rules. The ring-fencing rules are discussed in the appendix from [A48].

The ring-fencing rules

105. The ring-fencing rules[32] may apply to limit your total deduction (including interest) for the short-stay dwelling in the income year. However, given the interest limitation rules apply to deny interest deductions for the short-stay dwelling, it is unlikely the ring-fencing rules would limit your deduction other than:

[32] Subpart EL contains the ring-fencing rules.

- potentially during the phase-out period, or
- if the property is part of a portfolio for which interest is deductible.

106. This is because the ring-fencing rules only limit the deduction allocated to the income year if the rental activity of the property or portfolio is loss-making – which it is not likely to be if interest is not deductible.

107. In addition, the ring-fencing rules will not apply to limit your total deduction (including interest) for the property in the income year if:

- you are the owner of the land, more than 50% of the land is used for most of the income year by you as your main home, or
- the land is trust property, more than 50% of the land is used for most of the income year by a beneficiary of the trust as their main home and no principal settlor of the trust has a separate main home.

108. For example, the main home exclusion to the ring-fencing rules will apply in an income year to your land if the area of the land for your main home is 60% of the total land area and you use the main home as your main home for the entire income year.

109. If the above criteria are not met, the main home exclusion from the ring-fencing rules will not be available. In this case, the ring-fencing rules may be relevant in the situations noted at [105].

110. The ring-fencing rules are discussed in more detail in the appendix from [A48].

One loan for main home and short-stay dwelling and short-stay dwelling is new build land

111. The table below (figure 5) provides an overview of the rules relevant to interest deductibility for your short-stay dwelling.

Figure | Hoahoa 5 – Short-stay accommodation provided in a separate dwelling on the same land as your main home – one loan and the short-stay dwelling is new build land – overview of rules relevant to interest deductibility

Interest limitation rules	Apportionment rules	Ring-fencing rules
Apportion the loan between your main home and the short-stay dwelling. The interest limitation rules do not apply to the loan interest	If there is private use of the short-stay dwelling, interest and most other expenses will need to be apportioned (so will be partially deductible). Apportionment is under either the MuA rules or standard deductibility rules (see from [116]).	The ring-fencing rules are unlikely to apply to limit your total deduction for the income year, but they will if: • you have not used more than 50% of the land for your main home, • the MuA rules do not apply to the short-stay dwelling, and

apportioned to the short-stay dwelling.[33] Interest for the short-stay dwelling is deductible subject to the following columns.		• the rental activity for the short-stay dwelling[34] is loss-making.

Interest limitation rules do not apply

112. If you have one loan for both your main home and short-stay dwelling and your short-stay dwelling is new build land, the interest limitation rules do not apply to the interest incurred:

- for your main home, because the main home exception applies,
- for your short-stay dwelling, because the new build land exemption applies.

Apportionment of interest between main home and short-stay dwelling

113. You will need to apportion the interest you have incurred to determine the portion incurred for your main home and the portion incurred for your short-stay dwelling.

114. This is because the standard deductibility rules will apply to the interest apportioned to your main home and a deduction will generally be denied for that interest under the private limitation.[35] The interest incurred for your short-stay dwelling will generally be deductible, subject to apportionment under either the mixed-use asset rules (the MuA rules) or standard deductibility rules (see from [116]) and the application of the ring-fencing rules (see from [119]).

115. Apportionment between different parts of your property is discussed in the appendix from [A17].

Apportionment for private use – MuA rules or standard deductibility rules

116. If you have used the short-stay dwelling both privately[36] and for earning income in an income year, you will need to apportion your deductible expenses for the property

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[33] The interest limitation rules will also not apply to the interest apportioned to your main home. Interest for your main home will only be partly deductible if you have some income-earning use of your home.

[34] Or a portfolio of rental properties if you have one.

[35] The private limitation is in s DA 2(2) and provides that a person is denied a deduction for an amount of expenditure or loss to the extent to which it is of a private or domestic nature. The exception to full denial would be if you have some income-earning use of your home (eg, a home office or you rent out a room in your home), in which case you may be able to deduct some of your interest.

[36] This may include use by you or your family, or use by friends who are not charged full market rent.

(including interest) between those different uses of the property. Your deduction for these expenses will be limited based on the extent to which you used the property to earn income.

117. You will need to apportion your expenses either under the MuA rules or based on general apportionment principles (the standard deductibility rules), depending on your circumstances.

118. Paragraphs [46] to [54] explain how to work out which apportionment rules apply and refer to comprehensive guidance on how to apply the relevant rules. The explanation in those paragraphs applies equally to your short-stay dwelling and the interest apportioned to it.

If the MuA rules do not apply, the ring-fencing rules may apply if the property (or portfolio) is loss-making

119. If the MuA rules do not apply to the interest that is apportioned to your short-stay dwelling, the ring-fencing rules[37] may apply to limit your total deduction (including interest) for the short-stay dwelling in the income year.

120. However, the ring-fencing rules will not apply to limit your total deduction (including interest) for the property in the income year if:

- you are the owner of the land, more than 50% of the land is used for most of the income year by you as your main home, or
- the land is trust property, more than 50% of the land is used for most of the income year by a beneficiary of the trust as their main home and no principal settlor of the trust has a separate main home.

121. For example, the main home exclusion to the ring-fencing rules will apply in an income year to your land if the area of the land for your main home is 60% of the total land area and you use the main home as your main home for the entire income year.

122. If the above criteria are not met, the main home exclusion from the ring-fencing rules will not be available.

123. If the ring-fencing rules apply, the total deduction for expenditure incurred for the short-stay dwelling that you can allocate to the income year is limited to the income you derive from the short-stay dwelling in the income year.[38]

[37] Subpart EL contains the ring-fencing rules.

[38] Or, if the property is part of a portfolio of residential rental properties you own, your deduction for expenditure incurred on your portfolio of properties for the income year is limited to the income derived from your portfolio in that income year.

124. If your deduction is limited under the ring-fencing rules, the excess deduction not allocated to the income year is suspended and carried forward to a future income year in which you derive income from a residential rental property and added to the amount of the deduction or loss for that later year.

125. The ring-fencing rules are discussed in detail in the appendix from [A48].

Separate loans for main home and short-stay dwelling

126. If you have separate loans for your main home and for your short-stay dwelling, the interest limitation rules:

- Do not apply to the interest incurred under the loan for your main home (because the main home exception applies). That said, a deduction for interest apportioned to your main home will generally be denied under the private limitation.[39]
- Do apply to the interest incurred under the loan for the short-stay dwelling unless the dwelling is new build land.

127. As already noted, in general terms, new build land is land to the extent to which it has a place that is configured as a self-contained residence or abode and a code compliance certificate has been issued on or after 27 March 2020 evidencing that the place was added to the land or converted into a residence or abode. The new build land exemption is discussed in more detail in the appendix from [A8].

128. If your short-stay dwelling is new build land, see from [145]. If your short-stay dwelling is not new build land, see from [130].

If your short-stay dwelling is not new build land

129. The table below (figure 6) provides an overview of the rules relevant to interest deductibility for your short-stay dwelling.

[39] The private limitation is in s DA 2(2) and provides that a person is denied a deduction for an amount of expenditure or loss to the extent to which it is of a private or domestic nature. The exception to full denial would be if you have some income-earning use of your home (eg, a home office or you rent out a room in your home), in which case you may be able to deduct some of your interest.

Figure | Hoahoa 6 – Short-stay accommodation provided in a separate dwelling on the same land as your main home – separate loan for the short-stay dwelling and the dwelling is not new build land – overview of rules relevant to interest deductibility

Interest limitation rules	Apportionment rules	Ring-fencing rules
The interest limitation rules apply to the interest on the loan for the short-stay dwelling. Interest deductions for the interest are not allowed – subject to partial deductibility in the phase-out period[40] if you have a grandparented transitional loan.[41]	If there is private use of the short-stay dwelling and: • you can deduct a portion of the interest in the phase-out period because you have a grandparented transitional loan: • the sale of the property could be taxed apportion the interest under either the MuA rules or standard deductibility rules (see from [134]). The interest limitation rules override the ability to deduct interest under the MuA rules or standard deductibility rules. But performing the apportionment will calculate the interest that would have been deductible but is denied by the interest limitation rules. Keep track of denied interest deductions if the sale of the property could be taxed (eg, under the bright-line test), as denied interest may become deductible in the future.	The ring-fencing rules are unlikely to apply to limit your total deduction for the income year, but they will if: • you have not used more than 50% of the land for your main home, • the MuA rules do not apply to the short-stay dwelling, and • the rental activity for the short-stay dwelling[42] is loss-making.

The interest limitation rules apply to interest for the short-stay dwelling

130. Since your short-stay dwelling is not new build land, the way the interest limitation rules apply depends on whether the interest you incurred for the dwelling is grandparented residential interest.

131. Grandparented residential interest is interest paid under a grandparented transitional loan (that is, a loan drawn down before 27 March 2021 or a loan that refinances such a loan). Grandparented transitional loans and grandparented residential interest are discussed in detail in the appendix from [A22].

132. If the interest incurred and apportioned to your short-stay dwelling:

[40] The phase-out period is 1 October 2021 to 31 March 2025.

[41] A grandparented transitional loan is a loan drawn down before 27 March 2021 or a loan that refinances such a loan.

[42] Or a portfolio of rental properties if you have one.

- is grandparented residential interest, you will be able to deduct a proportion of the interest during the phase-out period (from 1 October 2021 to 31 March 2025) and interest deductions will be fully denied from 1 April 2025,
- is not grandparented residential interest, you are denied a deduction for the interest.

133. Whether you have grandparented residential interest or not, if the future disposal of the property with your main home and short-stay dwelling on it is taxable, interest incurred in prior years that would have been allowed had it not been denied under the interest limitation rules is recognised in the year of disposal. While it is not common for a property with someone's main home on it to be taxed on disposal, it is possible (see from [A66] in the appendix for examples of when this might be the case).

Apportionment of interest for private use relevant during phase-out period or if future disposal taxable

134. Any deductible interest during the phase-out period, or any interest that becomes deductible on a future taxable disposal of the land, is limited based on the extent to which you used the short-stay dwelling to earn income.

135. Therefore, if you have used the short-stay dwelling both privately[43] and to earn income in an income year, you may also need to apportion the interest incurred for your short-stay dwelling between those different uses for the dwelling. This will be the case if:

- the interest you incurred for the short-stay dwelling is grandparented residential interest, in which case you will be able to deduct a portion of the interest during the phase-out period, or
- a future disposal of the land with your main home and separate short-stay dwelling could be taxable.

136. The method for apportionment between your income-earning use and private use of the short-stay dwelling depends on whether the mixed-use asset rules (the MuA rules) or standard deductibility rules apply. Paragraphs [46] to [54] explain how to work out which apportionment rules apply and refer to comprehensive guidance on how to apply the relevant rules. The explanation in those paragraphs applies equally to your short-stay dwelling and the interest apportioned to it.

137. In summary:

- The interest limitation rules override the ability to deduct interest under the MuA rules or standard deductibility rules. This means the interest apportioned to the income-earning use of your short-stay dwelling which would be allowed

[43] This may include use by you or your family, or use by friends who are not charged full market rent.

a deduction under the relevant apportionment and deductibility rules is denied a deduction under the interest limitation rules.

- Despite the interest limitation rules overriding both the MuA rules and the standard deductibility rules, you may still need to apportion the interest you have incurred for your short-stay dwelling under the relevant rules. As noted at [135], this will be the case if the interest is grandparented residential interest or a future disposal of the land could be taxable.
- On a taxable disposal, interest incurred in previous years that would have been allowed under either the MuA rules or the standard deductibility rules but was denied under the interest limitation rules is recognised in the year of disposal.
- It would not be common for property with someone's main home and a short-stay dwelling on it to be taxable on disposal, but there are some situations where this could be the case. This is discussed in the appendix from [A66].
- You do not need to apportion your interest between income-earning and private use of the short-stay dwelling if the interest is not grandparented residential interest and it is clear the future disposal of the property will not be taxable.
- If it is not clear whether the future disposal of the property could be a taxable disposal and you have used the short-stay dwelling in an income year both privately and to earn income, you should apply the relevant apportionment calculation under MuA rules or standard deductibility rules to your interest for the dwelling for that year and retain evidence of the calculation. This calculates the interest that would have been allowed as a deduction in the income year but was denied under the interest limitation rules. This means you will readily be able to determine the amount of interest that can be recognised if a future disposal of the land is taxable.
- If the disposal of your land is taxable, interest apportioned to income-earning use under either the MuA rules or the standard deductibility rules in prior income years and denied under the interest limitation rules is recognised in the year of disposal as follows:
    - If the disposal is taxable under the bright-line test, the previously denied interest is treated as part of the cost of the property. This means it is taken into account in determining your taxable profit (if any) from the disposal. If the disposal is loss-making, your deduction for the cost of the property is limited to the amount of income derived from the disposal plus any other net land sale income from land disposals taxed under ss CB 6 to CB 14. Any excess amount that you cannot deduct is carried forward to a future year in which you have land sale income –

whether under the bright-line test or one of the other land sale provisions (s EL 20).

- If your disposal is taxable under any other provision, the previously denied interest is allowed as a deduction (in the income year of disposal) but is subject to allocation under the ring-fencing rules. The ring-fencing rules are discussed in the appendix from [A48].

The ring-fencing rules

138. The ring-fencing rules[44] may apply to limit your total deduction (including interest) for the short-stay dwelling in the income year. However, given the interest limitation rules apply to deny interest deductions for the short-stay dwelling, it is unlikely the ring-fencing rules would limit your deduction other than:
   - potentially during the phase-out period, or
   - if the property is part of a portfolio for which interest is deductible.
139. This is because the ring-fencing rules only limit the deduction allocated to the income year if the rental activity of the property or portfolio is loss-making – which it is not likely to be if interest is not deductible.
140. In addition, the ring-fencing rules will not apply to limit your total deduction (including interest) for the property in the income year if:
   - you are the owner of the land, more than 50% of the land is used for most of the income year by you as your main home, or
   - the land is trust property, more than 50% of the land is used for most of the income year by a beneficiary of the trust as their main home and no principal settlor of the trust has a separate main home.
141. For example, the main home exclusion to the ring-fencing rules will apply in an income year to your land if the area of the land for your main home is 60% of the total land area and you use the main home as your main home for the entire income year.
142. If the above criteria are not met, the main home exclusion from the ring-fencing rules will not be available. In this case, the ring-fencing rules may be relevant in the situations noted at [138].
143. The ring-fencing rules are discussed in more detail in the appendix from [A48].

[44] Subpart EL contains the ring-fencing rules.

If your short-stay dwelling is new build land

144. The table below (figure 7) provides an overview of the rules relevant to interest deductibility for your short-stay dwelling.

Figure | Hoahoa 7 – Short-stay accommodation provided in a separate dwelling on the same land as your main home – separate loan for the short-stay dwelling and the dwelling is new build land – overview of rules relevant to interest deductibility

Interest limitation rules	Apportionment rules	Ring-fencing rules
The interest limitation rules do not apply to the interest on the loan for the short-stay dwelling. Interest for the short-stay dwelling is deductible subject to the following columns.	If there is private use of the short-stay dwelling, interest and most other expenses will need to be apportioned (so will be partially deductible). Apportionment is under either the MuA rules or standard deductibility rules (see from [146]).	The ring-fencing rules are unlikely to apply to limit your total deduction for the income year, but they will if: • you have not used more than 50% of the land for your main home, • the MuA rules do not apply to the short-stay dwelling, and • the rental activity for the short-stay dwelling[45] is loss-making.

Interest limitation rules do not apply

145. Since your short-stay dwelling is new build land, the interest limitation rules do not apply to interest incurred under the loan for the dwelling because the new build land exemption applies.

Apportionment for private use – mixed-use asset rules or standard deductibility rules

146. If you have used the short-stay dwelling both privately[46] and for earning income in an income year, you will need to apportion your deductible expenses for the property (including interest) between those different uses of the property. Your deduction for these expenses will be limited based on the extent to which you used the property to earn income.

147. You will need to apportion your expenses either under the mixed-use asset rules (the MuA rules) or based on general apportionment principles (the standard deductibility rules), depending on your circumstances.

[45] Or a portfolio of rental properties if you have one.

[46] This may include use by you or your family, or use by friends who are not charged full market rent.

148. Paragraphs [46] to [54] explain how to work out which apportionment rules apply and refer to comprehensive guidance on how to apply the relevant rules. The explanation in those paragraphs applies equally to your short-stay dwelling and the interest incurred for it.

If the MuA rules do not apply, the ring-fencing rules may apply if the property (or portfolio) is loss-making

149. If the MuA rules do not apply to the interest that is apportioned to your short-stay dwelling, the ring-fencing rules[47] may apply to limit your total deduction (including interest) for the short-stay dwelling in the income year.

150. The ring-fencing rules apply to "residential rental property". "Residential rental property"[48] is residential land for which a person who owns the land is allowed a deduction relating to the use or disposal of the land. "Residential land"[49] includes land that has a dwelling on it, unless the land is farmland or is used predominantly as a business premises. The business premises exclusion will not apply if the land is used predominantly as business premises for a business of supplying accommodation and it is not the main home for the owner (or other relevant person if the property is held in a trust). Therefore, it is highly unlikely that the business premises exclusion could apply. The ring-fencing rules do not apply to a person's residential land for an income year if the MuA rules apply to the land for that income year.[50]

151. In addition, there is a main home exclusion from the ring-fencing rules.[51] The main home exclusion is available (meaning the ring-fencing rules do not apply for a particular income year) if:

- more than 50% of the land is used for most of the income year by the owner as their main home, or
- the land is trust property and more than 50% of the land is used for most of the income year by a beneficiary of the trust as their main home and no principal settlor of the trust has a separate main home.

152. For example, the main home exclusion to the ring-fencing rules will apply in an income year to your land if the area of the land for your main home is 60% of the total land area and you use the main home as your main home for the entire income year.

153. The ring-fencing rules are discussed in more detail in the appendix from [A48].

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[47] Subpart EL contains the ring-fencing rules.

[48] See section EL 3 for the definition of "residential rental property".

[49] "Residential land" is defined in section YA 1.

[50] Section EL 12.

[51] Section EL 9.

Example | Tauira 4 – Main home and short-stay dwelling on the same land

On 1 April 2023, Maia purchases a property with a house (the original dwelling), built in the 1960s, for $1m using a bank loan of $600,000 (loan 1) and $400,000 of her own money. The area of the property is 1,000m^2. The house is positioned on the front half of the property.

At the time of purchase, the current rating valuation for the property (issued in 2022) provides the land has a capital value of $980,000, with a land value of $690,000 and improvements (original dwelling) of $290,000.

Shortly after the purchase, Maia takes out an additional bank loan for $300,000 (loan 2) and purchases a pre-built self-contained dwelling (the second dwelling), which is positioned on the back half of the property. The area of the property with the original dwelling (and its appurtenances) is 650m^2 and the area with the second dwelling (and its appurtenances) is 350m^2.

The code compliance certificate for the second dwelling, evidencing it has been added to the land, is issued on 31 March 2024. Following the issuing of the code compliance certificate, the local authority issues an amended rating valuation for the property. The rating valuation provides the land has a value of $875,000 and the improvements (that is, the original dwelling and the second dwelling) have a value of the $600,000.

From 1 April 2024, Maia uses the second dwelling to provide short-stay accommodation.

For the income year ending 31 March 2025, Maia uses the original dwelling as her main home. She incurs interest expenditure of $33,000 for loan 1 and $18,425 for loan 2. She derives income from the second dwelling of $27,500. There is no private use of the second dwelling, and it is rented out or available for rent for the whole income year.

How the taxation laws apply

Income from land use

Maia has assessable income of $27,500 from the second dwelling.

Deductions for interest

The interest limitation rules

Loan 2

The interest limitation rules do not apply to loan 2. This is because the interest paid under loan 2 is for the second dwelling and the new build land exemption applies to the dwelling. The exemption applies because the code of compliance for the second

dwelling, evidencing it has been added to the land, is issued on 31 March 2024 – so after the relevant date of 27 March 2020.[52]

Loan 1

The new build land exemption will also apply to part of the interest paid under loan 1. This is because from 31 March 2024, part of the interest paid under loan 1 is for the part of the land with the second dwelling, and the new build land exemption applies to the second dwelling.[53]

Maia must apportion the property to determine the proportion of the land to which the new build land exemption applies. Using the land area apportionment methodology, she determines that the area of the second dwelling (including its appurtenances) is 35% of the total land area.

Since loan 1 is for the entire property including the original dwelling, Maia must determine how much of loan 1 is for the land excluding the original dwelling (since the original dwelling is not new build land). The 2022 rating valuation provides that the land value is $690,000 of the total value of the improved land (the land and the original dwelling), which was $980,000.

Using these figures, Maia calculates that $23,234.70 of the total interest incurred of $33,000 is for the land:

$$\frac{\$690{,}000}{\$980{,}000} \times \$33{,}000 = \$23{,}234.70$$

The new build land exemption applies to 35% of the land (the percentage of the total land that is for the second dwelling). On this basis, Maia calculates that $8,132.15 of the interest attributable to the unimproved land is for new build land:

$$\frac{35}{100} \times \$23{,}234.70 = \$8{,}132.15$$

Therefore, the interest limitation rules do not apply to $8,132.15 of the interest under loan 1, because this is the interest incurred under that loan which is for new build land. The amount of $8,132.15 is deductible, provided a deduction is not denied under the MuA rules or the ring-fencing rules.

The balance of the interest under loan 1 ($24,867.85) is the proportion of interest Maia has paid for the area of the land with her main home (including the main home and its appurtenances). Maia's main home is excepted residential land. Excepted residential

[52] The exemption from the interest limitation rules will apply to the second dwelling until 20 years after the issue of the code of compliance.

[53] While the new build exemption will apply to the second dwelling from 31 March 2024, Maia's interest for the second dwelling will be deductible from 1 April 2024 as that is when she started renting the dwelling out.

land is not DRP and the interest limitation rules therefore do not apply to the $24,867.85. However, Maia cannot deduct any of the interest of $24,876.85 as she has no income-earning use of the area of the land with her main home – it is only used privately.

The MuA rules

The MuA rules do not apply to the interest (or other expenses) incurred in providing the short-stay accommodation because there has been no private use of the second dwelling.

The standard deductibility rules

Because the second dwelling is rented out or available for rent for the whole income year, Maia does not need to apportion the deductible interest of $18,425 under loan 2 and $8,132.15 under loan 1 (or other expenses) further. If Maia had periods of private use of the second dwelling (but the MuA rules did not apply) or periods where the second dwelling was not available for rent, the standard deductibility rules, as explained in QB 19/05 would apply to reduce her allowable interest (and other) deductions accordingly.

The ring-fencing rules

The ring-fencing rules do not apply to the deductible interest for the second dwelling ($18,425 under loan 2 and $8,132.15 under loan 1). This is because the main home exclusion to the ring-fencing rules applies. This is because more than 50% of the total land area (of 1,000m^2) is used for most of the year as Maia's main home (650 m^2 / 1000m^2 = 65%).

Example | Tauira 5 – Main home and short-stay dwelling on the same land

This example follows on from Example 4.

On 1 April 2026, Maia sells her property to Tom for $1.5m. Tom funds the purchase using a bank loan of $650,000 and $850,000 from the sale of his former home. In April 2024, after Maia added the second dwelling to the property, the local authority issued a rating valuation for the property with a capital value of $1.475m.

In the income year ending 31 March 2027, Tom uses the original dwelling as his main home and uses the second dwelling to provide short-stay accommodation. He incurs interest expenditure of $40,000 and derives income from the second dwelling of $27,500. There is no private use of the second dwelling, and it is rented out or available for rent for the whole income year.

How the taxation laws apply

Income from land use

Tom has assessable income of $27,500 from the second dwelling.

Deductions for interest

The interest limitation rules

The interest limitation rules do not apply to interest incurred for the second dwelling because the new build land exemption applies to the dwelling. The exemption applies because the code of compliance, evidencing that dwelling has been added to the land, was issued on 31 March 2024 – so after the relevant date of 27 March 2020.[54]

Tom must apportion the property to determine the proportion of the land to which the new build land exemption applies. Using a land area methodology, he determines that the area of the second dwelling (including its appurtenances) is 35% of the total land area.

The new build land exemption applies to 35% of the land (the percentage of the total land that is for the second dwelling). On this basis, Tom calculates that $14,000 of the total interest of $40,000 he incurred is apportioned to the second dwelling:

$$\frac{35}{100} \times \$40{,}000 = \$14{,}000$$

Therefore, $14,000 of the interest Tom incurred is deductible, subject to the possible application of the MuA rules and the ring-fencing rules.

The interest limitation rules do not apply to the interest of $26,000 apportioned to the original dwelling. This is because the original dwelling is Tom's main home and so is excepted residential land. The interest limitation rules do not apply to excepted residential land. However, Tom cannot deduct any of the interest of $26,000 as he has no income-earning use of his main home land – it is only used privately.

The MuA rules

The MuA rules do not apply to the interest (or other expenses) incurred in providing the short-stay accommodation because there has been no private use of the second dwelling.

The standard deductibility rules

[54] The exemption from the interest limitation rules will apply to the second dwelling until 20 years after the issue of the code of compliance.

Because the second dwelling is rented out or available for rent for the whole income year, Tom does not need to apportion the deductible interest of $14,000 (or other expenses) further. If Tom had periods of private use of the second dwelling (but the MuA rules did not apply) or periods where the second dwelling was not available for rent, the standard deductibility rules, as explained in QB 19/05 would apply to reduce his allowable interest (and other) deductions accordingly.

The ring-fencing rules

The ring-fencing rules do not apply to limit the deductions that are allocated to the 2026-27 income year because the main home exclusion to the ring-fencing rules applies. This is because more than 50% of the total land area (of 1000m^2) is used for most of the year as Tom's main home (650m^2 / 1000m^2 = 65%).

Example | Tauira 6 – Main home and short-stay dwelling on the same land

This example follows on from Example 5.

On 1 April 2030, Tom sells the property to Chris for $1.6m. Chris funds the purchase using a bank loan of $800,000 (loan 1) and $800,000 from an inheritance. On 1 July 2030, the local authority issues a rating valuation for the property, with a capital value of $1.8m.

In the income year ending 31 March 2031, Chris decides to renovate the second dwelling which has become tired due to its use to provide short-stay accommodation. He undertakes the work himself. He borrows $75,000 from the bank (loan 2) to fund the renovations.

To maintain his rental income (which Chris needs to help repay his mortgage) while he is undertaking the renovation work, Chris uses the second dwelling as his main home and uses the original-dwelling to provide short-stay accommodation.

He incurs interest expenditure of $50,000 for loan 1 and $4,875 for loan 2 and derives income from the original dwelling of $42,000. When the original dwelling is not in use by guests, Chris' son uses it free of charge, as he is looking for a rental property after the break-up of his marriage and is moving between friends and family's places in the meantime. The original dwelling is vacant for fewer than 62 days in the income year.

The renovation work on the second dwelling is completed by the end of the income year.

On 1 April 2031, Chris moves back into the original dwelling and uses it as his main home again, and uses the second dwelling to provide short-stay accommodation.

How the taxation laws apply

Income from land use

In the income year ending 31 March 2031, Chris has assessable income of $42,000 from the original dwelling.

Deductions for interest

The interest limitation rules

The interest limitation rules do not apply to interest incurred for the second dwelling because the new build land exemption applies to the dwelling. The exemption applies because the code of compliance, evidencing the second dwelling was added to the land, was issued on 31 March 2024 – so after the relevant date of 27 March 2020.[55]

Chris must apportion the property to determine the proportion of the land to which the new build land exemption applies. Using a land area methodology, he determines that the area of the second dwelling (including its appurtenances) is 35% of the total land area.

Loan 1

The new build land exemption applies to 35% of the land (the percentage of the total land that is for the second dwelling). So Chris calculates that $17,500 of the total interest of $50,000 he incurred under loan 1 is apportioned to the second dwelling:

$$\frac{35}{100} \times \$50{,}000 = \$17{,}500$$

However, Chris cannot deduct any of the interest of $17,500 apportioned to the second dwelling, as he has no income-earning use of that dwelling – it is his main home for the income year and it is only used privately.

The remaining $32,500 (65% x $50,000) is apportioned to the original dwelling.

The interest limitation rules apply to the interest of $32,500 apportioned to the original dwelling. This is because:

- The new build land exemption does not apply to the original dwelling (because a code compliance certificate, evidencing the dwelling was added to the land or converted into a residence or abode, has not been issued on or after 27 March 2020).
- The original dwelling is not Chris's main home for any of the income year and it is therefore not excepted residential land.

[55] The exemption from the interest limitation rules will apply to the second dwelling until 20 years after the issue of the code of compliance.

Loan 2

The new build land exemption applies to the $4,875 of interest incurred under loan 2 for the renovations to the second dwelling. However, Chris cannot deduct any of this $4,875 interest, as he has no income-earning use of the second dwelling – it is his main home for the income year and it is only used privately.

The MuA rules

The MuA rules do not apply to the interest incurred under loan 1 that is apportioned to the original dwelling ($32,500). This is because the original dwelling is vacant for fewer than 62 days in the income year. There are therefore not the minimum of 62 non-use days required for the MuA rules to apply.

The standard deductibility rules apply

Chris' son's use of the original dwelling free of charge is considered private use. As the MuA rules do not apply, the standard deductibility rules would apply to reduce Chris' allowable interest deductions (and any other deductions not relating solely to the use of the dwelling to derive income) because of the private use.

The standard deductibility rules are explained in QB 19/05.

The ring-fencing rules

The ring-fencing rules potentially apply to limit the total deduction allocated to the 2030-31 income year.

The ring-fencing rules apply when a person owns residential land and has expenditure that relates to the land for which they are allowed a deduction. The property is residential land, and Chris is allowed deductions for the property as he has used it (partly) for income-earning.

If Chris' total deduction for the property (or for a portfolio of residential properties if he has one) exceeds his income from the property (or portfolio), the amount of deduction allocated to the income year will be limited to the income from the property (or portfolio).

Short-stay dwelling on a separate property that is used only to provide short-stay accommodation

154. This scenario is the provision of short-stay accommodation in a short-stay dwelling when the short-stay dwelling is the only dwelling (residence or abode) on the land (described in a record of title) and the dwelling is used only to provide short-stay accommodation. That is, the short-stay dwelling is not used for any other purpose

(such as private use). An example would be an apartment used exclusively to provide short-stay accommodation.

155. The interest limitation rules apply to interest to the extent to which it is incurred for DRP. The statutory definition of DRP is discussed in detail in the appendix from [A2].

156. Relevantly (in the context of short-stay accommodation), DRP is land in New Zealand to the extent to which it has a place configured as a residence or abode. It includes any appurtenances belonging to or enjoyed with the place.

157. Your short-stay dwelling is DRP because it is land with a place configured as a residence or abode. The interest limitation rules apply to the interest incurred for your short-stay dwelling unless the dwelling is new build land.

158. In general terms, new build land is land to the extent to which it has a place configured as a self-contained residence or abode and a code compliance certificate has been issued on or after 27 March 2020 evidencing that the place was added to the land or converted into a residence or abode. The new build land exemption is discussed in more detail in the appendix from [A8].

159. If your short-stay dwelling is not new build land, see from [161]. If your short-stay dwelling is new build land, see from [170].

If the short-stay dwelling is not new build land

160. The table below (figure 8) provides an overview of the rules relevant to interest deductibility for your short-stay dwelling.

Figure | Hoahoa 8 – Short-stay accommodation provided in a dwelling on a separate property used only to provide short-stay accommodation and the dwelling is not new build land – overview of rules relevant to interest deductibility

Interest limitation rules	Ring-fencing rules
The interest limitation rules apply. Interest deductions are not allowed – subject to partial deductibility in the phase-out period[56] if you have a grandparented transitional loan.[57] Keep track of denied interest deductions if the sale of the property could be taxed (eg, under the bright-line test), as denied interest may become deductible in the future.	The ring-fencing rules will apply to limit your total deduction for the income year if the rental activity for the property[58] is loss-making.

[56] The phase-out period is 1 October 2021 to 31 March 2025.

[57] A grandparented transitional loan is a loan drawn down before 27 March 2021 or a loan that refinances such a loan.

[58] Or a portfolio of rental properties if you have one.

The interest limitation rules apply

161. Since your short-stay dwelling is not new build land, the interest limitation rules apply. The way the interest limitation rules apply depends on whether the interest you incurred for the dwelling is grandparented residential interest.

162. Grandparented residential interest is interest paid under a grandparented transitional loan (that is, a loan drawn down before 27 March 2021 or a loan that refinances such a loan). Grandparented transitional loans and grandparented residential interest are discussed in detail in the appendix from [A22].

163. If the interest you incurred for the dwelling:

- is grandparented residential interest, you will be able to deduct a portion of the interest during the phase-out period (from 1 October 2021 to 31 March 2025) and interest deductions will be fully denied from 1 April 2025;
- is not grandparented residential interest, you will be denied a deduction for the interest.

164. Whether you have grandparented residential interest or not, if the future disposal of your short-stay dwelling is taxable, interest incurred in prior years that would have been allowed had it not been denied under the interest limitation rules is recognised in the year of disposal. The way in which it is recognised depends on which land sales provision the disposal is taxed under (see [40] to [43]).

165. If the future disposal of our short-stay dwelling could be taxable (for example under the bright-line test), you should keep track of interest you have incurred for the property that you have been denied a deduction for under the interest limitation rules. This means you will readily be able to determine the total amount of interest that can be recognised if a future disposal of the land is taxable.

The ring-fencing rules may apply if the property (or portfolio) is loss-making

166. The ring-fencing rules[59] may apply to limit your total deduction (including interest) for the short-stay dwelling in the income year. However, given the interest limitation rules apply to deny interest deductions for the short-stay dwelling, it is unlikely the ring-fencing rules would limit your deduction other than:

- potentially during the phase-out period, or
- if the property is part of a portfolio for which interest is deductible.

[59] Subpart EL contains the ring-fencing rules.

167. This is because the ring-fencing rules only limit the deduction allocated to the income year if the rental activity of the property or portfolio is loss-making – which it is not likely to be if interest is not deductible.

168. The ring-fencing rules are discussed in more detail in the appendix from [A48].

If the short-stay dwelling is new build land

169. The table below (figure 9) provides an overview of the rules relevant to interest deductibility for your short-stay dwelling.

Figure | Hoahoa 9 – Short-stay accommodation provided in a dwelling on a separate property used only to provide short-stay accommodation and the dwelling is new build land – overview of rules relevant to interest deductibility

Interest limitation rules	Ring-fencing rules
The interest limitation rules do not apply. Interest is deductible subject to the following columns.	The ring-fencing rules will apply to limit your total deduction (including interest) for the income year if the rental activity for the property[60] is loss-making (see from [171]).

The interest limitation rules do not apply

170. Since your short-stay dwelling is new build land, the interest limitation rules do not apply to interest incurred for the dwelling because the new build land exemption applies.

The ring-fencing rules may apply if the property (or portfolio) is loss-making

171. While the interest limitation rules do not apply to the interest for your short-stay dwelling, the ring-fencing rules may apply to limit the total deduction you can allocate to an income year.

172. The ring-fencing rules apply to "residential rental property". "Residential rental property"[61] is residential land for which a person who owns the land is allowed a deduction relating to the use or disposal of the land. "Residential land" [62] includes land that has a dwelling on it, unless the land is farmland or is used predominantly as a business premises. The business premises exclusion will not apply if the land is used predominantly as business premises for a business of supplying accommodation and it is not the main home for the owner (or other relevant person if the property is held in

[60] Or a portfolio of rental properties if you have one.

[61] See section EL 3 for the definition of "residential rental property".

[62] "Residential land" is defined in section YA 1.

a trust). Because your short-stay dwelling is used only to provide short-stay accommodation and is not used as your main home, the business premises exclusion cannot apply. The ring-fencing rules do not apply to a person's residential land for an income year if the MuA rules apply to the land for that income year.[63]

173. There is a main home exclusion from the ring-fencing rules. However, because your short-stay dwelling is used only to provide short-stay accommodation (and is not used as your main home), the main home exclusion rule cannot apply.

174. If the ring-fencing rules apply, the total deduction for expenditure incurred for your short-stay dwelling that you can allocate to the income year is limited to the income derived from the dwelling in that income year.[64]

175. If your deduction is limited under the ring-fencing rules, the excess deduction not allocated to the income year is suspended and carried forward to a future income year in which you derive income from a residential rental property and added to the amount of the deduction or loss for that later year.

176. The ring-fencing rules are discussed in more detail in the appendix from [A48].

Example | Tauira 7 – Short-stay dwelling on a separate property used only to provide short-stay accommodation

On 1 April 2022, Akeno purchased an apartment, built in the 1990s, for $625,000, using a bank loan of $300,000 and $325,000 of his own money. He purchased the apartment for the purpose of providing short-stay accommodation. Akeno does not own any other rental properties.

For the income year ending 31 March 2023, Akeno incurs interest expenditure of $18,750 under the loan, other expenditure for the apartment of $4,500, and derives income of $25,100. There is no private use of the apartment, and it is rented out or available for rent for the whole income year.

How the taxation laws apply

Income from land use

Akeno has assessable income of $22,100 from the apartment.

Deductions for interest

[63] Section EL 12.

[64] Or, if your short-stay dwelling is part of a portfolio of residential rental properties you own, your deduction for expenditure incurred on your portfolio of properties for the income year is limited to the income derived from your portfolio in that income year.

The interest limitation rules

The interest limitations rules apply to the interest incurred by Akeno. This is because the apartment is DRP, the new build land exemption does not apply (because the apartment was added to the land before 27 March 2020), and the apartment is not excepted residential land because it is not Akeno's main home.

Akeno's interest deductions are fully denied (not phased out), because his loan is not a grandparented transitional loan – it was drawn down after 27 March 2021.

No apportionment required

Because there is no private use of the apartment and it is rented out or available for rent for the whole income year, Akeno does not need to apportion his deductible (non-interest) expenditure under the MuA rules or standard deductibility rules.

The ring-fencing rules

The ring-fencing rules do not apply to limit the deductions that are allocated to the 2022-23 income year because Akeno's income from the apartment of $25,100 exceeds his deductible expenditure of $4,500 incurred in relation to the apartment, and he does not own any other rental properties (so does not have a rental portfolio). The ring-fencing rules apply to limit the total deduction allocated to a residential rental property (or portfolio of properties) only when expenditure from the property (or portfolio) exceeds the expenditure derived from the property (or portfolio).

Short-stay accommodation provided on your farm or lifestyle block

Is your land farmland?

177. If you provide short-stay accommodation on your farm or lifestyle block, the first matter to consider is whether the land is "farmland".

178. This is because the interest limitation rules apply to interest to the extent to which it is incurred for DRP, and DRP does not include land to the extent to which it is "excepted residential land". Farmland, including any place configured as a residence or abode on the land, is excepted residential land and is not DRP. Consequently, the interest limitation rules do not apply to interest incurred for farmland (including interest incurred for any short-stay dwelling on farmland).

179. "Farmland" is defined in the Act as land that is being worked in the farming or agricultural business of the land's owner or land that, due to its area and nature, is capable of being worked as a farming or agricultural business.[65]

180. The expression "lifestyle block" is not used in the Act. The Collins English Dictionary (online ed) defines the term as meaning "a semi-rural property comprising a house and land for small-scale farming".

181. For the Act, what is relevant is whether land is "farmland" (as defined in the Act) and not whether the land is a "lifestyle block".

182. Due to their small size, lifestyle blocks are generally unlikely to be used, or capable of being worked, in farming or agricultural businesses, so will not be farmland. If this is the case, the farmland exception from DRP will not apply.[66]

183. In considering whether your short-stay dwelling is on farmland, it is only the legal title (called a record of title) that the dwelling is on that is relevant. If, for example, your short-stay dwelling is on a land that adjoins your farmland, but the farm and the land the dwelling is on are in separate legal titles, you only consider the land in the legal title for the dwelling.

184. If your short-stay dwelling is on farmland, see from [185]. If the property is not farmland, see from [198].

If your land is farmland

185. The table below (figure 10) provides an overview of the rules relevant to interest deductibility for your short-stay dwelling.

Figure | Hoahoa 10 – Short-stay accommodation provided on your farmland – overview of rules relevant to interest deductibility

Interest limitation rules	Apportionment rules	Ring-fencing rules
The interest limitation rules do not apply. Interest is deductible subject to the following columns.	If there is private use of the short-stay dwelling, interest and most other expenses will need to be apportioned (so will be partially deductible). Apportionment is under either the MuA rules or standard deductibility rules (see from [187]).	The ring-fencing rules will not apply to limit your total deduction (including interest) for the property as it is farmland.

[65] Section YA 1.

[66] See QB 18/17: Income tax – bright-line test – farmland and main home exclusions – sale of lifestyle blocks, which provides guidance on the meaning of farmland, when activities carried out on land will be a farming or agricultural business, and when a lifestyle block will be farmland.

Interest limitation rules do not apply

186. If the land with your short-stay dwelling is farmland the interest limitation rules do not apply to interest incurred for the dwelling. As mentioned, this is because farmland is excepted residential land and the interest limitation rules do not apply to interest incurred for excepted residential land.

Apportionment for private use – mixed-use asset rules or standard deductibility rules

187. Although the interest limitation rules will not apply to the interest incurred for your short-stay dwelling, if you have used the short-stay dwelling both privately[67] and for earning income in an income year, you will need to apportion your deductible expenses for the dwelling (including interest) between those different uses. Your deduction for these expenses will be limited based on the extent to which you used the property to earn income.

188. You will need to apportion your expenses either under either the mixed-use asset rules (the MuA rules) or based on general apportionment principles (the standard deductibility rules), depending on your circumstances. A dwelling can move in and out of the MuA rules from one year to the next, so you need to consider which rules apply each income year.

189. If you use the short-stay dwelling partly for income-earning purposes and partly for private purposes, and it is also not used for at least 62 days in the income year, the MuA rules will apply. This is unless you opt out of the rules, which you can do in two situations – see [193] to [194].

190. For the MuA rules, private use is when you or a person associated with you (for example, close relatives such as your children, grandchildren, siblings, or in-laws), use the dwelling. It is irrelevant whether you are paid for that use. Private use also includes use of the dwelling by a guest who pays less than 80% of the market value amount for the use of the dwelling.

191. If the MuA rules apply, they apportion your interest (and other expenditure for the dwelling) between income-earning use and private use by using a prescribed formula. This determines the deduction you are allowed. The formula apportions relevant expenditure based on the number of income-earning days relative to total days the property is physically used.

192. If the MuA rules do not apply,[68] your expenses for the dwelling will be apportioned based on the standard deductibility rules. Generally, this would involve time and

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[67] This may include use by you or your family, or use by friends who are not charged full market rent.
[68] Other than because you opted out of the MuA rules.

space-based apportionment, with potential deductibility for days the dwelling is not used privately and is available for rent.[69]

193. The two situations in which you can choose to opt out of the MuA rules (if they would otherwise apply) are where:

- If the amount of income you derive for the income year from your short-stay dwelling is less than $4,000.
- Your rental activity for the short-stay dwelling for the year is loss-making (that is, the expenses you could deduct for the year under the MuA rules exceed the income) and your income from renting out the dwelling during the income year is less than 2% of the relevant portion of the property's value.[70]

194. If you opt out of the MuA rules, the income from your short-stay dwelling for that year is treated as exempt income and all interest (and other expenses) incurred for the dwelling will be non-deductible.

195. Comprehensive explanations of how to determine which apportionment rules apply to short-stay dwellings and how those rules are applied are contained in:

- QB 19/06: What income tax rules apply if I have a dwelling that I sometimes rent out as short-stay accommodation and sometimes use myself? *Tax Information Bulletin* Vol 31, No 6 (July 2019): 12.
- QB 19/07: How do the mixed-use asset income tax rules apply to a dwelling that I sometimes rent out as short-stay accommodation and sometimes use privately? *Tax Information Bulletin* Vol 31, No 6 (July 2019): 16.
- QB 19/08: How do the standard income tax rules apply to a dwelling that I sometime rent out as short-stay accommodation and sometimes use privately? *Tax Information Bulletin* Vol 31, No 6 (July 2019): 22.

196. As noted at [5], the above items pre-date the interest limitation rules and the ring-fencing rules. Therefore, the explanation of the deductibility of interest in this item supersedes the explanations of the deductibility of interest in those earlier items.

[69] See QB 19/08: How do the standard income tax rules apply to a dwelling that I sometime rent out as short-stay accommodation and sometimes use privately? *Tax Information Bulletin* Vol 31, No 6 (July 2019): 22.

[70] The value to use in determining if you are under the 2% threshold is: the most recent capital value or annual value set by your local authority or, if you purchased the property after the most recent local authority valuation, the purchase price you paid for the property (unless you acquired it from an associated person – in which case the market value at the time you acquired the property). You then need to apportion that value between the land area used for the short-stay dwelling and the rest of the property, and test the 2% threshold against the value of the land used for the short-stay dwelling.

The ring-fencing rules do not apply

197. The ring-fencing rules do not apply to limit your total deduction (including interest) for the property in the income year, because the land is farmland.

If your land is not farmland

198. If your land is not farmland, the rules that apply depend on your circumstances.

199. If your short-stay dwelling is the only dwelling on the land, and the dwelling is not your main home, the discussion from [24] on short-stay accommodation provided in a holiday home is relevant, treating your short stay-dwelling as the holiday home.

200. If your main home is the only dwelling on the land, and you provide short-stay accommodation in your home, the discussion from [72] on short-stay accommodation provided in your main home is relevant.

201. If your main home is on the land, and you provide short-stay accommodation in a separate dwelling on the land, the discussion from [84] on short-stay accommodation provided on the same land as your main home is relevant.

Example | Tauira 8 – Short-stay dwelling on a lifestyle block

Marama and Dave own a 10-acre block of rural land as tenants in common in equal shares (50:50). Approximately 4 acres of the land is regenerating indigenous forest. The existing cottage on the land was built in the 1920s. Marama and Dave use the cottage as a weekender and a holiday home. They run 20 sheep on the unforested part of the land to assist with controlling grass growth. The only other land Marama and Dave own is their main home, which is in the city.

In June 2022, Marama and Dave borrowed $180,000 to purchase a tiny home to put on the property and provide short-stay accommodation in. The tiny home has a bathroom, potable water, and cooking facilities. The tiny home's wastewater system is connected to a septic tank and drip lines. The potable water is rainwater collected in an external 10,000 litre tank, which is treated by a water filtration and UV system (located inside the tiny home).

Under the district plan of the local authority, Marama and Dave were required to obtain building consent for the tiny home. A code compliance certificate (evidencing the tiny home was added to the property) was issued on 1 February 2023. From 1 April 2023, Marama and Dave commence using the tiny home to provide short-term accommodation.

In the income year ending 31 March 2024, Marama and Dave incur interest expenditure of $8,600 and other expenditure of $2,000 relating to the tiny home. They

derive income from the tiny home of $16,000. There is no private use of the tiny home, and it is rented out or available for rent for the whole income year.

How the taxation laws apply

Income from land use

Marama and Dave each have assessable income of $8,000 from the tiny home (the income of $16,000 is split between them equally as it is derived by them equally as 50:50 owners of the land).

Deductions for interest

The interest limitation rules

The interest limitation rules do not apply to the interest incurred for the tiny home because the new build land exemption applies to the tiny home.

The tiny home is new build land because it is configured as a self-contained residence or abode and a code compliance certificate, evidencing that the tiny home was added to the land, was issued on or after 27 March 2020.

Therefore, none of the interest deduction is disallowed by the interest limitation rules.

No apportionment required

Because there is no private use of the tiny home and it is rented out or available for rent for the whole income year, Marama and Dave do not need to apportion their interest or other deductible expenditure under the MuA rules or standard deductibility rules.

Therefore, Marama and Dave can each deduct $4,300 of the interest and $1,000 of the other expenses for the tiny home. These deductible expenses are split between them equally as they are incurred 50:50 by Marama and Dave.

The ring-fencing rules

The ring-fencing rules do not apply to limit the deductions that are allocated to the 2023-24 income year because Marama and Dave's income from the tiny home ($8,000 each) exceeds their deductible expenditure ($5,300 each) incurred in relation to the tiny home, and they do not own any other rental properties (so do not have a rental portfolio). The ring-fencing rules apply to limit the total deduction allocated to a residential rental property (or portfolio of properties) only when expenditure from the property (or portfolio) exceeds the income derived from the property (or portfolio).

Example | Tauira 9 – Short-stay dwelling on farmland

Stu and Suretha own a 250-hectare block of land as joint tenants. The block is used (together with other land they own) in their farming business. They have an existing loan of $300,000 in relation to the block (existing loan). They borrow a further $250,000 (new loan) to build a dwelling on the land to provide short-stay accommodation in.

In the income year ended 31 March 2023, they incur interest of $17,600 under the existing loan, interest of $15,000 under the new loan, and other expenditure of $2,000 relating to the dwelling. They derive income of $15,000 from using the dwelling to provide short-stay accommodation. There is no private use of the dwelling, and it is rented out or available for rent for the whole income year.

How the taxation laws apply

Income from land use

Stu and Suretha each have assessable income of $7,500 from the dwelling (the income of $15,000 is split between them equally as it is derived by them equally as joint tenants).

Deductions for interest

<u>*The interest limitation rules*</u>

The interest limitation rules do not apply to the interest incurred under the existing loan or the new loan. This is because the interest limitation rules apply to interest incurred for DRP and DRP does not include excepted residential land. Farmland, including any place configured as a residence or abode, is excepted residential land. Farmland is (relevantly) land that is being worked in the farming or agricultural business of the land's owner. Stu and Suretha are working the 250-hectare block in their farming business. The block is therefore farmland and excepted residential land.

Therefore, none of the interest deduction for either loan is disallowed by the interest limitation rules.

<u>*No apportionment required*</u>

Because there is no private use of the dwelling and it is rented out or available for rent for the whole income year, Stu and Suretha do not need to apportion their interest or other deductible expenditure under the MuA rules or standard deductibility rules.

The interest incurred under the existing loan is deducted as an expense of the farming business.

Therefore, Stu and Suretha can each deduct $7,500 of the interest and $1,000 of the other expenses for the dwelling. These deductible expenses are split between them equally as they are incurred by them jointly.

The ring-fencing rules

The ring-fencing rules do not apply to limit the deductions that are allocated to the 2022-23 income year. This is because the ring-fencing rules apply to residential land. Residential land does not include farmland and the block is farmland.

Example | Tauira 10 – Short-stay dwelling on farmland

Anetelea and Kenese own a 550-hectare block of land as joint tenants. The block is used (together with other land they own) in their farming business. The most recent capital value for the 550-hectare block is $5.5m, set by the local authority in 2022. Anetelea and Kenese's main home is on another block of land.

In 2021, Anetelea and Kenese borrowed $300,000 to build a dwelling on the land to provide short-stay accommodation in (the dwelling loan). The portion of the land used in relation to the short-stay dwelling is one hectare (0.18% of the total land area). When the dwelling is not being used by guests, Anetelea and Kenese's family use the dwelling as a holiday home. The dwelling was completed in May 2022. On completion of the build, Anetelea and Kenese obtained a valuation of $520,000 from a registered valuer for the potion of the land with the dwelling.

In the income year ended 31 March 2023, Anetelea and Kenese incur interest of $18,800 under the loan for the dwelling, other expenditure (not relating solely to the use of the dwelling to derive income) of $3,000 for the dwelling, and $2,000 of expenditure that relates solely to the use of the dwelling to deriving income and from which no personal benefit is received (eg, advertising costs and welcome chocolates for paying guests). The dwelling is used for 130 days to earn income of $22,100 from guests, is used for 30 days by Anetelea and Kenese's family, and not used for 205 days.

How the taxation laws apply

Income from land use

Anetelea and Kenese each have income of $11,050 from the dwelling (the income of $22,100 is split between them equally as it is derived by them equally as joint tenants).

As explained below, Anetelea and Kenese cannot opt-out of MuA rules and consequently, the income of $11,050 is assessable income.

Deductions for interest

The interest limitation rules

The interest limitation rules do apply to the interest incurred for the dwelling. This is because the interest limitation rules apply to interest incurred for DRP and DRP does not include excepted residential land. Farmland, including any place configured as a residence or abode, is excepted residential land. Farmland is (relevantly) land that is being worked in the farming or agricultural business of the land's owner. Anetelea and Kenese are working the 550-hectare block in their farming business. The block is therefore farmland and excepted residential land.

The MuA rules

Rules apply

The MuA rules apply.[71] This is because the dwelling is used partly for income-earning purposes and partly for private purposes and is not used for 205 days, which is more than the minimum 62 non-use days required for the MuA rules to apply.

Opting-out not possible

A person may elect to opt-out of the MuA rules if the income from the asset (in this case the dwelling) is less than $4,000 or if they have an amount of quarantined expenditure.

As Anetelea and Kenese each derive income of $11,050 from the dwelling, opting-out under the income threshold is not available.

Anetelea and Kenese will each have an amount quarantined expenditure if the income they each derive from the dwelling is less than 2% of the most recent capital (or annual value) value of the land.

Since different activities occur on the block (that is, farming and short-stay accommodation) and the block is in a single record of title, the value of the block must be determined in one of two ways for the purposes of applying the 2% threshold (s DG 16(1B)(c)).

The first is multiplying the value of land ($5.5m) by the percentage of area of the land that is used for the dwelling (0.18%). Under this approach, the value of the land is $9,900 (0.18% of $5.5m = $9,900). The income of $11,050 that Anetelea and Kenese each derive from the dwelling is greater than 2% of $9,900.

[71] QB 19/06 explains when the MuA rules apply.

The second approach is by a valuation of the portion of land with the dwelling. If this approach is used, the valuation must be made by a registered valuer no more than 3 years before the end of the income year (31 March 2023). Anetelea and Kenese have a current registered valuation of $520,000, made less than 3 years before the end of the income year. The income of $11,050 Anetelea and Kenese each derive from the dwelling is greater than 2% of $520,000 ($10,400).

Therefore, Anetelea and Kenese do not have quarantined expenditure and cannot opt-out of the MuA rules on that basis.

Apportionment

The expenses incurred in providing the short-stay accommodation are split between Anetelea and Kenese equally as they are incurred by them jointly. They are therefore each allocated $9,400 of interest, $1,500 of the other expenses not relating solely to the use of the holiday home to derive income, and $1,000 of the expenses that relate solely to the use of the dwelling to deriving income and from which no personal benefit is received.

As explained in QB 19/07, the expenses that relate solely to the use of the dwelling to deriving income and from which no personal benefit is received are fully deductible.

Anetelea and Kenese must each apply the MuA apportionment formula to the other expenses (totalling $10,900) to determine the amount of expenditure they each incur that is apportioned to income-earning use.

Applying the MuA apportionment formula, Anetelea and Kenese calculate the amount of their respective apportionable expenditure that is apportioned to income-earning use is $8,856.25.

Anetelea and Kenese are each allowed a deduction for $9,856.25 ($8,856.25 apportioned under the MuA rules plus $1,000 of fully deductible expenses). They are not allowed a deduction for the $2,043.75 apportioned to private use.

The ring-fencing rules

The ring-fencing rules do not apply. This is because the ring-fencing rules apply to residential land. Residential land does not include farmland and the block is farmland.

References | Tohutoro

Legislative references | Tohutoro whakatureture

Income Tax Act 2007

Subparts DG, DH and EL, ss CB 6A, CB 16A and the definitions of "farmland" and "residential rental property" in s YA 1.

Other references | Tohutoro anō

QB 18/17: Income tax – bright-line test – farmland and main home exclusions – sale of lifestyle blocks, *Tax Information Bulletin* Vol 31, No 1 (February 2019): 39.
https://www.taxtechnical.ird.govt.nz/questions-we-ve-been-asked/2018/qb1817-qb-1817-income-tax-bright-line-test-farmland-and-main-home-exclusions-sale-of-lifestyle-block

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https://www.taxtechnical.ird.govt.nz/questions-we-ve-been-asked/2019/download-qb19-05

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QB 19/08: How do the standard income tax rules apply to a dwelling that I sometime rent out as short-stay accommodation and sometimes use privately? *Tax Information Bulletin* Vol 31, No 6 (July 2019): 22.
https://www.taxtechnical.ird.govt.nz/questions-we-ve-been-asked/2019/download-qb19-08

QB 19/16: If property held in a trust is rented out by the trustees for short-stay accommodation, who should declare the income, and what deductions can be claimed? *Tax Information Bulletin* Vol 32, No 1 (February 2020): 65.
https://www.taxtechnical.ird.govt.nz/questions-we-ve-been-asked/2019/qb-1916-if-property-held-in-a-trust-is-rented-out-by-the-trustees-for-short-stay-accommodation-who-s

About this document | Mō tēnei tuhinga

Interpretation Statements are issued by the Tax Counsel Office. They set out the Commissioner's views and guidance on how New Zealand's tax laws apply. They may address specific situations we have been asked to provide guidance on, or they may be about how legislative provisions apply more generally. While they set out the Commissioner's considered views, Interpretation Statements are not binding on the Commissioner. However, taxpayers can generally rely on them in determining their tax affairs. See further Status of Commissioner's advice *(December 2012)*. It is important to note that a general similarity between a taxpayer's circumstances and an example in an Interpretation Statement will not necessarily lead to the same tax result. Each case must be considered on its own facts.

Appendix: Additional detail on some aspects of the interest limitation rules and the other rules that may apply

A1. As noted at [6] in the Interpretation Statement, this appendix provides additional detail on some aspects of the interest limitation rules and the other relevant tax rules that may apply, depending on your circumstances. This appendix provides additional detail on:

- The definition of "disallowed residential property" – see from [A2].
- The definition of "excepted residential land" – see from [A6].
- The new build land exemption from the interest limitation rules – see from [A8].
- "To the extent to which" (apportionment) – see from [A17].
- Grandparented transitional loans and grandparented residential interest – see from [A22].
- Grandparented transitional loans that cannot reasonably be traced – see from [A28].
- Grandparented transitional loans and the high water mark rule – see from [A39].
- The ring-fencing rules – see from [A48].
- Situations where the future disposal of a property with someone's main home and a short-stay dwelling on it might be taxable – see from [A66].

Definition of "disallowed residential property"

A2. Key terms used in the interest limitation rules are defined in s DH 5.

A3. The key term "disallowed residential property" (DRP) is defined in s DH 5(2):

DH 5 Key terms

…

Disallowed residential property

(2) Disallowed residential property—

(a) means land in New Zealand to the extent to which—

(i) it has a place configured as a residence or abode, whether or not it is used as a place of residence or abode, including any appurtenances belonging to or enjoyed with the place:

(ii) the owner has an arrangement that relates to erecting a place there, configured as a residence or abode, whether or not that place is or is to be used as a place of residence or abode, including any appurtenances belonging to or enjoyed with the place:

(iii) it is bare land that, under rules in the relevant operative district plan, may be used for erecting a place there, configured as a residence or abode, whether or not that place is or is to be used as a place of residence or abode, including any appurtenances belonging to or enjoyed with the place:

(b) does not include land to the extent to which it is excepted residential land.

A4. Relevantly (in the context of short-stay accommodation), DRP is land in New Zealand to the extent to which it has a place configured as a residence or abode, and it includes any appurtenances belonging to or enjoyed with the place. It does not matter whether the place is used as a residence or abode.

A5. Land with a short-stay dwelling on it is DRP because it is land that has a place (the dwelling) configured as a residence or abode. The interest limitation rules will apply to interest incurred for the short-stay dwelling unless:

- the short-stay dwelling is on land that is excepted residential land (for example, farmland), or
- the new build land exemption applies.

Definition of "excepted residential land"

A6. The key term "excepted residential land" is defined in s DH 5(3) and means land to the extent to which it is described in sch 15.

A7. Schedule 15 states:

Schedule 15

Excepted residential land

1. Business premises, except if the business premises—
   (a) are used or available for use in a business of supplying accommodation; and
   (b) are not land described in clause 7.
2. Farmland, including any place configured as a residence or abode, whether or not it is used as a place of residence or abode, including any appurtenances belonging to or enjoyed with the place.
3. A hospital, convalescent home, nursing home, or hospice.
4. A boarding establishment.
5. A hotel, motel, inn, hostel, or camping ground.
6. A rest home or retirement village.
7. For the relevant person (person A), land that has been used predominantly for a place configured as a residence or abode, including any appurtenances belonging to or enjoyed with the place, if that place is the main home for 1 or more of the following people:
   (a) person A;
   (b) a beneficiary of a trust, if person A is a trustee of the trust and—
      (i) a principal settlor of the trust does not have a main home; or
      (ii) if a principal settlor of the trust does have a main home, the place is their main home.
8. Student accommodation.
9. For the relevant person, employee accommodation.
10. Māori excepted land.

New build land exemption from the interest limitation rules

A8. Section DH 4 contains exemptions from the interest limitation rules, including the new build land exemption.

A9. The new build land exemption provides that the interest limitation rules do not apply to interest incurred by a person to the extent to which it is incurred in relation to new build land and in a 20-year period starting from a specified date.[72]

A10. The exemption applies to every owner of the new build land during the 20-year exemption period.

A11. The phrase "to the extent to which" recognises that in some cases only part of a single parcel of land will be new build land and that apportionment will be required. Apportionment is discussed from [A17].

A12. The term "new build land" is defined in s DH 5(7).

A13. The following sets out the types of new build land and the date the 20-year exemption period starts for each:

- Land to the extent to which it has a place that is configured as a self-contained residence or abode, if a code compliance certificate has been issued on or after 27 March 2020 evidencing that the place was added to the land or converted into a residence or abode. This includes land exclusively used by residents of the place and also a reasonable portion of shared areas of land, appurtenant to the place. In this case, the 20-year exemption period starts on the date on which the code compliance certificate is issued.
- Land for which there is an agreement that a place that is configured as a self-contained residence or abode will be added to the land and a code compliance certificate will be issued on or after 27 March 2020 evidencing that the place was added to the land. In this case, the 20-year exemption period starts on the date on which the code compliance certificate is issued.
- Land that has a place that was a hotel or motel, to the extent to which, by a conversion, it becomes places that are configured as self-contained residences or abodes, and the conversion is recorded in the records of a local authority or building consent authority as having been "completed" on or after 27 March 2020. In this case, the 20-year exemption period starts on the date that, in the records of the local authority or building consent authority, the conversion is recorded as having been completed.
- Land to the extent to which it has a place that is configured as a self-contained residence or abode, if the place was removed from the earthquake prone buildings register on or after 27 March 2020, and—
    - a code compliance certificate has been issued on or after 27 March 2020 evidencing that building work to remediate the place is complete:

[72] Section DH 4(1).

  - the completion of the building work to remediate the place is recorded in the records of a local authority or building consent authority as having been "completed" on or after 27 March 2020 and as having been verified by a suitably qualified engineer.

  In this case, the 20-year exemption period starts either on the date on which the code compliance certificate is issued or on the date that, in the records of the local authority or building consent authority, the remediation is recorded as having been completed (as applicable).

- Land to the extent to which it has a place that is configured as a self-contained residence or abode, if the place was not previously weather-tight and a code compliance certificate has been issued on or after 27 March 2020 evidencing that at least 75% of the place's cladding has been replaced. In this case, the 20-year exemption period starts on the date on which the code compliance certificate is issued.

A14. However, in the case of a code compliance certificate issued subject to a building consent waiver or modification under clause B2.3.1 of the Building Code under the Building Act 2004, the 20-year exemption period starts from the date the relevant building work is entered into the records of the local authority or building consent authority as "substantially completed".

New build must be a self-contained residence or abode

A15. The definition of new build land requires that the new place (or converted place) is a "self-contained residence or abode". This phrase is not defined in the Act. However, its ordinary and plain meaning requires that a place has the necessary facilities, such as a kitchen, bathroom, toilet, and electricity, to enable it to be used as a residence or abode. A dwelling will not be self-contained if it uses essential facilities that are shared with another dwelling (for example, the main home). A sleepout used to provide short-stay accommodation will not be new build land if it is not self-contained.

A16. Although the interest limitation rules will not apply to your short-stay dwelling to the extent to which it is new build land, the ring-fencing rules may apply. The ring-fencing rules are discussed from [A48].

"To the extent to which" (apportionment)

A17. The phrase "to the extent to which" is used in the Act to indicate that apportionment may be required, depending on the facts.

A18. The phrase is used in various parts of the interest limitation rules. For interest incurred for a dwelling used to provide short-stay accommodation, the phrase is used in the following relevant ways:

- DRP is defined as land in New Zealand "to the extent to which" it has a place (dwelling) configured as residence or abode, including any appurtenances belonging or enjoyed with that place.
- The new build land exemption provides that the interest limitation rules do not apply to interest incurred by a person "to the extent to which" it is incurred for new build land.
- Land is excluded from definition of DRP "to the extent to which" it is excepted residential land.
- Excepted residential land is defined as land "to the extent to which" it is described in sch 15.

A19. The interest limitation rules do not specify the apportionment method that is to be used and therefore the existing principles from case law apply. These principles provide that the onus is on the taxpayer to establish that their preferred method is the one that should be adopted and that it achieves the objective of a fair and reasonable assessment. Whether a particular method is fair and reasonable depends on the facts and circumstances of each case.

A20. To illustrate:

- DRP is land to the extent to which it has a place configured as a residence or abode. However, DRP does not include land to the extent to which it is excepted residential land. Business premises are excepted residential land, unless it is a business of supplying accommodation in a dwelling that is not the person's main home.[73]
- If your business premises (for example, a retail shop) and your short-stay dwelling are on the same land (record of title) and you incur interest for the land, you will be required to apportion the land to determine the proportion of the land that is the business premises and the proportion that is the short-stay dwelling. The interest limitation rules will apply only to the interest apportioned to the short stay-dwelling (unless an exemption such as the new build land exemption applies).
- A percentage of total land area apportionment method is likely to be appropriate. Under this method, if the land area of your short-stay dwelling (including appurtenances) is 60% of the total land area, then 60% of the interest

[73] Or the main home of a beneficiary of a trust, if the owner of the property is a trustee, provided no principal settlor of the trust has a different main home.

you incur for the land is apportioned to your short-stay dwelling and subject to the interest limitation rules.

A21. In other circumstances, a different apportionment approach might be appropriate to achieve the objective of a fair and reasonable assessment – for example, apportionment based on valuation of different parts of the land.

Grandparented transitional loans and grandparented residential interest

A22. If your short-stay dwelling is DRP and you acquired the dwelling before 27 March 2021 with a grandparented transitional loan, your deductions for grandparented residential interest (that is, interest incurred on the principal of a grandparented transitional loan) are progressively denied in the transitional period from 1 October 2021 to 31 March 2025. From 1 April 2025, you will not be allowed any deductions for interest.

A23. A grandparented transitional loan is a New Zealand denominated loan for DRP first drawn down:

- Before 27 March 2021.
- On or after 27 March 2021, if an estate or interest in the DRP was acquired before 27 March 2021 (for example, under a binding agreement for sale and purchase).
- On or after 27 March 2021, if the acquisition of the DRP resulted from an offer made on or before 23 March 2021 that could not be revoked by the purchaser before 27 March 2021.
- On or after 27 March 2021, if the following three requirements are satisfied:
    - A previous owner of the DRP (the original owner) had a loan under one of the three preceding bullet points.
    - A bright-line rollover provision applies to every transfer of the DRP from the original owner to any intermediate owner to the current owner (the taxpayer).
    - The taxpayer's loan amounts are equal to or less than the amount of the original owner's loan at the time the original owner transferred the DRP.

A24. A grandparented transitional loan does not include any re-drawings or additional borrowings under the same loan facility on or after 27 March 2021.

A25. If you have a grandparented transitional loan for your short-stay dwelling (and the dwelling is DRP) and you take out a new loan to refinance that loan, the new loan will be treated as a grandparented transitional loan. The interest you incur on the new

loan, to the extent to which it is for the short-stay dwelling, will be progressively denied from 1 October 2021 to 31 March 2025.

A26. The percentages of the deduction for grandparented residential interest progressively denied in the transitional period are:

Figure | Hoahoa 11 – Transitional period interest denial percentages

Period that grandparented residential interest is incurred	Percentage denied
1 October 2021 to 31 March 2022	25%
1 October 2022 to 31 March 2023	25%
1 October 2023 to 31 March 2024	50%
1 October 2024 to 31 March 2025	75%
On and after 1 April 2025	100%

A27. If you have an amount of grandparented residential interest for your short-stay dwelling, you will need to consider whether the ring-fencing rules apply to limit the amount of your deduction.

Grandparented transitional loan that cannot reasonably be traced

A28. The tracing approach is generally used to identify whether interest you incur is for DRP.

A29. In some rare cases, you may have used a grandparented transitional loan to purchase both a short-stay dwelling (that is DRP) and other property that you use to derive income (for example, a commercial building) and the portion of the loan used for the dwelling cannot be reasonably determined (an untraceable loan). In this situation, a special rule applies to treat a portion of the untraceable loan (the notional loan principal) as having been used to purchase the dwelling. Interest on the notional loan principal is treated as grandparented residential interest, and deductibility of that interest is progressively denied over the transitional period from 1 October 2021 to 31 March 2025. Interest on the remaining portion of the grandparented transitional loan is not subject to the interest limitation rules, and deductibility of that interest is determined under the general (or other applicable) deduction rules.

A30. The special rule only applies when the portion of a grandparented transitional loan used for DRP "cannot reasonably be determined". This will be a question of fact and degree in each case. You must answer this question objectively. This means you determine whether a reasonable person could not, in the circumstances of the case,

reasonably determine the portion of the loan that was used for DRP. Whether the necessary information to calculate the portion is available, or can be reasonably obtained, is likely to be a highly relevant factor for the "cannot reasonably be determined" question. If information needs to be obtained from a third party (such as a bank, accountant, or lawyer) and they charge for the information, this would not in itself mean the portion of the loan used for DRP cannot reasonably be determined.

A31. If you have an untraceable loan, you need to apply the following formula to determine the notional loan principal of the loan:

outstanding borrowings – allowed property

A32. In the formula:

- Outstanding borrowings is the amount of the untraceable loan on 26 March 2021 (excluding any amount not used for either DRP or allowed property).
- Allowed property is the total value of your property on 26 March 2021, excluding DRP and ignoring property not used to derive assessable income. However, the value of DRP held on 26 March 2021 to which an exemption applies (for example, the new build exemption) is included in allowed property.

A33. You must apply the following valuation rules to determine the value of your allowed property:

- For land, including new build land but excluding land acquired for a s CB 7 business relating to land and land subject to an undertaking or scheme involving development, division or building to create new build land:
  - the most recent capital value or annual value set by a local authority, or
  - if the land was acquired after the most recent local authority valuation, its acquisition cost or, if acquired from an associated person, its market value.
- For all other property, its tax book value or, if you prepare financial accounts according to relevant accounting standards or legislative standards, the financial accounts' valuation.

A34. If the result of the formula is positive, interest on the positive amount is grandparented residential interest and is progressively denied over the transitional period from 1 October 2021 to 31 March 2025. If the result is negative, it is treated as zero and no amount of interest is treated as grandparented residential interest.

A35. The formula, in effect, treats an untraceable loan as being used to acquire allowed property before acquiring DRP. If the value of your allowed property on 26 March 2021 exceeds the value of your outstanding borrowings on 26 March 2021, none of the

interest on the outstanding borrowings will be subject to denial under the interest limitation rules.

A36. If you have an untraceable loan, for tax purposes you will in effect be treated as having two loans – the notional loan principal (treated as being used for DRP) and a remaining loan (treated as being used for allowed property). When you make a repayment reducing the balance of the untraceable loan, you need to apply special repayment rules to allocate the repayment to the reduction of either the notional loan principal or the loan for allowed property.

A37. The general repayment rule is that repayments are applied first against the notional loan principal. When the notional loan principal is reduced to zero, there will be no grandparented residential interest, and the interest limitation rules will no longer apply to the untraceable loan.

A38. The general rule is overridden when the source of the repayment is the disposal of allowed property that you owned on 26 March 2021. In this situation, only the amount (if any) of the repayment that exceeds the 26 March 2021 value of that allowed property is applied in reduction of the notional loan principal. If the repayment is less than or equal to the 26 March 2021 value of the disposed of item of allowed property, the repayment does not reduce the notional loan principal.

Grandparented transitional loan and the high water mark rule

A39. If your grandparented transitional loan for your short-stay dwelling is a variable balance loan (a grandparented transitional variable balance loan), such as a revolving credit facility or an overdraft, you can choose whether to apply the high water mark rule to simplify the calculation of your grandparented residential interest.

A40. The high water mark rule simplifies the calculation of grandparented residential interest for a grandparented transitional variable balance loan by making it unnecessary to trace each individual withdrawal and deposit to that loan between 27 March 2021 and 30 March 2025. Under the high water mark rule, the period from 1 October 2021 to 31 March 2025 is referred to as the affected interest period. Simplification is optimised if a grandparented transitional variable balance loan has only been used for DRP and the balance at any "instant" during the affected interest period does not exceed the initial loan balance.

A41. Under the high water mark rule:

- For a period in the affected interest period the amount of interest that is treated as grandparented residential interest is the total amount of interest for all "instants" in the "period" that are for, or traced to, DRP.

- A period in the affected interest period is a period in which grandparented residential interest is incurred. A period can be any period in the affected interest period (1 October 2021 to 31 March 2025). Since deductions for grandparented residential interest are denied at different specified percentages for the periods 1 October 2021 to 31 March 2022, 1 April 2022 to 31 March 2023, 1 April 2023 to 1 April 2024, and 1 April 2024 to 31 March 2025, a calculation for each of these periods will be required.
- An instant (in a period) is the duration of time that the balance of the loan remains unchanged.
- If the balance of the loan increases or decreases in a period, a new instant occurs, and an interest calculation is required for that instant.

A42. The amount of interest for an instant is calculated on the lesser of the initial loan balance and the affected loan balance.

A43. The initial loan balance is the amount of the grandparented transitional variable balance loan for the DRP on the start date. The start date is generally either:

- the end of 26 March 2021, if the loan was first drawn down before 27 March 2021, or
- the date the loan was first drawn down, if the first draw down is on or after 26 March 2021 and:
  - an estate or interest in the DRP was acquired before 27 March 2021, or
  - the acquisition of the DRP resulted from an offer made on or before 23 March 2021 that could not be revoked before 27 March 2021.

A44. The affected loan balance is the actual balance of the grandparented transitional variable balance loan at any instant. It is calculated using the following formula, which adjusts for further advances and repayments:

initial loan balance + (advances – repayments) – (unrelated advances – unrelated repayments)

A45. In the formula:

- The "initial loan balance" is calculated as described above.
- "Advances" is the total amount of debit entries from the start date to the date of the calculation.
- "Repayments" is the total amount of credit entries from the start date to the date of the calculation.

- "Unrelated advances" is the total amount of debit entries from the start date to the date of the calculation that have been applied to purposes that are not for the DRP that qualifies for grandparenting.
- "Unrelated repayments" are only relevant if your grandparented transitional variable balance loan is a grandparented transitional loan that cannot be traced. An unrelated repayment is a repayment, or portion of a repayment, that is not allocated to the reduction of the notional loan principal.[74]

A46. Although calculating interest for each instant for a grandparented transitional variable balance loan may appear to be complex, in many instances the calculation can be based on the interest charged by your lender. The application and effect of the high water mark rule is as follows:

- If your grandparented transitional variable balance loan has been applied only for DRP that qualifies for grandparenting and not for any other purpose, and the balance on the loan does not exceed the initial loan balance at any time during the affected interest period:
  - adjustments to calculate the affected loan balance will be equal to the debit and credit transactions to the account for the period in the affected interest period, and
  - all interest you incur for the loan for a period in the affected interest period will be grandparented residential interest.
- If your grandparented transitional variable balance loan has been applied for DRP that qualifies for grandparenting and for other purposes, and the affected loan balance during the affected interest period remains below the initial loan balance, the amount of grandparented residential interest is calculated on the affected loan balance. For a period in the affected interest period, interest calculations will be required for every instant. In this situation, it may be easier, as a practical matter, to calculate interest on the portion of the loan applied to other purposes and subtract this from the interest charged by the lender to determine the grandparented residential interest.
- If the affected loan balance exceeds the initial loan balance at any instant, regardless of whether the loan has been solely applied for DRP, the amount of grandparented residential interest is calculated on the initial loan balance.

A47. After you have calculated the amount of grandparented residential interest under the high water mark rule for a period, a deduction for the amount of that interest is then

[74] See [A37] and [A38], which explain how repayments of an untraceable grandparented transitional loan are allocated.

subject to progressive denial from 1 October to 2021 to 31 March 2025 at the percentages for the periods set out in the table at [A26].

Ring-fencing rules

A48. Although the interest limitation rules do not apply to interest you incur for a short-stay dwelling that is new build land, you will need to determine whether the ring-fencing rules apply in an income year to limit the deduction you can claim for the interest (and other expenditure) you incur for the new build land.

A49. The ring-fencing rules may also be relevant to land that is not new build land, but it is likely this would only be the case:

- during the phase-out period, or
- if the property is part of a portfolio for which interest is deductible.

A50. This is because the ring-fencing rules only limit the deduction allocated to the income year if the rental activity of the property or portfolio is loss-making – which it is not likely to be if interest is not deductible.

A51. The ring-fencing rules[75] apply to "residential rental property" which is "residential land for which a person who owns the land is allowed a deduction relating to the use or disposal of the land". The definition of "residential land" includes land that has a dwelling on it unless the land is farmland or is used predominantly as business premises. It also includes land that has a dwelling on it if the land is used by a person predominantly as a business premises for business of supplying accommodation and the dwelling is not the person's main home.[76]

A52. The ring-fencing rules apply in each income year a person is allowed a deduction for expenditure or loss incurred in relation to a residential rental property or a portfolio of residential rental properties. The default position under the rules is that they apply on a residential portfolio basis. A residential portfolio is one or more residential rental properties that a person holds in a portfolio. However, a person can elect to apply the ring-fencing rules on a property-by-property basis.

A53. The ring-fencing rules do not apply to residential land owned by a person for an income year if more than 50% of the land is used for most of the income year as a main home. The rules also do not apply to residential land to which the mixed-use

[75] A comprehensive explanation of the ring-fencing rules can be found in *Tax Information Bulletin* Vol 31, No 8 (September 2019): 53.

[76] Or the main home of one or more other persons referred to in s CB 16A(2).

asset rules (the MuA rules) apply or to residential land that is held on revenue account.[77]

A54. The main home exclusion is available (meaning the ring-fencing rules will not apply) for a particular income year if:

- more than 50% of the land is used for most of the income year by the owner as their main home, or
- the property is trust property and more than 50% of the land is used for most of the income year by a beneficiary of the trust as their main home and no principal settlor of the trust has a separate main home.

A55. The main home exclusion from the ring-fencing rules requires the land to be used for "most" of the income year by the owner[78] as a main home. The word "most" is not defined for the Act and has its ordinary meaning in context. The ordinary meaning of "most" is "greatest in amount or degree".

A56. A short-stay dwelling that is new build land is likely to be a residential rental property and subject to the ring-fencing rules unless it is a main home or the MuA rules apply. This is because the dwelling is residential land for which the person who owns the land is allowed a deduction for interest (and other expenditure) relating to the use of the land to derive income.

A57. The ring-fencing rules limit the amount of the deduction in the income year to the amount of residential income derived by the person from the property (or portfolio).

A58. If the default portfolio basis is used, "residential income" means the following amounts:

- Rental income from the portfolio.
- Income under the financial arrangements rules in relation to a loan, denominated in a foreign currency, to the extent to which the loan relates to the portfolio.
- Depreciation recovery income for the portfolio.
- The amount the person would have as net income for the year if their only income was income from the disposal of a residential rental property in the portfolio.

[77] Subject to the notification requirement in s EL 10(3) for land held on revenue account other than under s CB 7.

[78] Or a beneficiary of the trust, if applicable.

- The amount that the person would have as net income for the year if their only income was from residential land that is outside the rules because it is held on revenue account and falls within the exclusion in s EL 10.

A59. If the property-by-property basis is used, "residential income" means the above amounts for only the particular residential rental property. In this case, the last bullet point above will not be relevant.

A60. Deductions for excess expenditure are suspended in the year incurred and carried forward as an excess amount to a later income year in which the person derives residential income and added to the person's deductions for the residential rental property, or portfolio, in that later income year. If in that later income year there is an excess amount, it is carried forward to a later income year in which the person derives residential income. Carry forward continues until excess amounts are used.

A61. The effect of ring-fencing a person's excess amounts to income they derive from a residential property, or portfolio, is that excess amounts cannot be offset against the person's other assessable income.

Disposal of residential rental property

A62. If a person has used the property-by-property basis and the disposal of a residential rental property is taxable, any unused excess amount relating to the property is released (unfenced) on disposal and allowed as a deduction against the person's other income. However, the amount that is unfenced is reduced if, and to the extent, an excess amount has previously been transferred to the property. The transferred amount remains subject to treatment under the ring-fencing rules.

A63. If the disposal of the residential rental property is not taxable, the unused excess amount is carried forward to a later income year in which the person derives residential income from another residential rental property and is transferred to that property.

Disposal of portfolio

A64. If a person has used the portfolio basis and the disposal of each property in the portfolio is taxable, any unused excess amount relating to the portfolio after the disposal of the last property in the portfolio is released (unfenced). However, the amount that is unfenced is reduced if, and to the extent, an excess amount has previously been transferred to the portfolio from the disposal of a property not in the portfolio and the disposal of that property was not taxable. The transferred amount remains subject to treatment under the ring-fencing rules.

A65. If the disposal of any property in the portfolio is not taxable, any unused excess amount that remains after the disposal of the last property in the portfolio is carried

forward to a later income year in which the person derives residential income from another residential rental property and is transferred to that property.

Situations where the future disposal of a property with someone's main home and a short-stay dwelling on it might be taxable

A66. If your interest deductions are denied (or partly denied) by the interest limitation rules, then you only need to consider how much of your interest would have been deductible under either the MuA rules or the standard deductibility rules if a future disposal of the land with your main home and short-stay dwelling could be a taxable disposal.

A67. While it would not be common for property with a person's main home and a short-stay dwelling on it to be taxable on disposal, there are some situations where this could be the case, such as:

- Where the relevant residential or main home exclusion from the applicable land sales provision cannot be used for some other reason. For example, the land area requirements in s CB 16[79] are not met, or the land has not been used for most of the bright-line period for the person's main home (relevant for the main home exclusion from the 5-year bright-line test).[80]
- The main home exclusion from the bright-line test has already been used twice in the last two years or there is a regular pattern of transactions that mean the relevant exclusion cannot be used.[81]

A68. However, a future taxable disposal is most likely to arise under the 10-year bright-line test, when the main home exclusion to that test does not apply. This is because of the way the main home exclusion from the 10-year bright-line test operates – it is not an "all or nothing" exclusion like the main home exclusion from the 5-year bright-line test. Because this is the most common scenario that property with a person's main home and a short-stay dwelling could be taxable on disposal, the main home exclusion from the 10-year test is explained below.

A69. Under the 10-year bright-line test, an amount derived by a person from disposing of residential land[82] is income of the person if the disposal occurs within 10 years of the date of acquiring the land.[83] For the bright-line test, residential land includes land that

[79] The residential exclusion from ss CB 6 to CB 11.

[80] Section CZ 40.

[81] Relevant for the main home exclusions from both the 5-year and 10-year bright-line tests (ss CZ 40(3) and CB 16A(3)).

[82] The 10-year test generally applies to land acquired on or after 27 March 2021. It does not apply to the extent the land is new build land (a 5-year bright-line period applies in that case).

[83] Subject to an exclusion or roll-over relief applying.

has a dwelling on it. The land with your main home and short-stay dwelling is residential land because it has a dwelling on it.

A70. The 10-year bright-line test does not apply to a disposal of residential land if the main home exclusion applies to the land. This exclusion applies if all the days in the bright-line period are "exempted predominant main home days" for one or more main home persons:

- A day will be an "exempted predominant main home day" if the land has been used on that day "predominantly" for a dwelling that is the main home for one or more main home persons.
- Land is used "predominantly" for a dwelling that is the main home if the area of the land used for the dwelling that is the main home is larger than the area of the land used for any other purpose.
- A main home person is the owner of the land. If the owner of the land is a trustee of a trust, a main home person also includes a beneficiary of the trust, provided no principal settlor of the trust has a different main home (ie, either no principal settlor has a main home, or the land is their main home as well as being the beneficiary's main home).
- A day will also be an "exempted predominant main home day" even if it is a day in a period in which the land has not been used predominantly for a dwelling that is a main home by a main home person, provided that period is equal to or shorter than the "exempt home period limit", which is 365 days. The effect of this is that there is a grace period of up to a year where a day in that period will be an "exempted predominant main home day" even though on that day the land is not being used as a main home by a main home person. This ensures that the main home exclusion is not lost when a main home person temporarily ceases using the dwelling as a main home (for example, if the person is overseas on secondment). However, for the grace period to apply it must take place immediately before or after a period where the land is being used as a main home by a main home person. If the period in which the land is not being used as a main home exceeds the 365-day exempt home period limit, the main home exclusion will not apply.

A71. For example, if the 10-year bright-line test is relevant, the main home exclusion from the 10-year bright-line test will apply if you dispose of your land (with both your main home and short-stay dwelling) within 10 years of acquisition and on each day from the acquisition date to the disposal date the home has been your main home, and the area

of the land used for the main home is larger than the area of the land used for your short-stay dwelling.[84]

[84] In the rare situation where the area of the land used for a short-stay dwelling is larger than the area of the land used for the main home dwelling, the main home exclusion will not apply.