

22 July 2021

Design of the interest limitation rule and additional bright-line tests  
C/-Deputy Commissioner, Policy and Regulatory Stewardship  
Inland Revenue Department  
PO Box 2198  
Wellington 6140

Dear Sir/Madam

**Re: Design of the Interest Limitation Rule and Additional Bright-Line Tests**

I am writing to you regarding the issues paper, '*Design of the interest limitation rule and additional bright-line tests*' (referred to as "the Discussion Document"). While the Discussion Document canvasses a wide variety of related issues, BusinessNZ wishes to offer our broad thoughts on the proposed rules relating to interest deductibility and to comment on a few specific matters also of interest to this organisation.

**Background**

It would be fair to say the Government's announcement on 23 March 2021 regarding limiting the deductibility of interest on residential investment property, as part of its housing policy package, was a surprise to taxpayers, including the business community.

Deductibility of interest payments for business expenditure is a long-held principle of the New Zealand tax system. It is standard and accepted practice across the countries New Zealand typically compares itself to.

Consequently, any moves away from this accepted norm will automatically create a range of problems that will have to be addressed before any such limitation is implemented.

**Supply, not demand**

Overall, we agree that New Zealand has a long-standing housing affordability problem. Such problems can have far reaching consequences for many sectors of society. As an example, from a business perspective, being unable to buy a home,

combined with increasing rents, can have a significant impact on many businesses' ability to recruit/retain staff.

Therefore, we welcome the Government's examination of the regulatory tools and levers that can be used to address the housing affordability problem. However, what was announced in March principally involves measures to try to blunt demand rather than an attempt to deal seriously with supply-side issues.

Although, on balance, some of the Discussion Document's proposals are likely to be helpful, including those relating to greater investment, there is a significant difficulty over the lack of clarity when it comes to limits on interest deductibility. Any changes should be undertaken with a considerable degree of caution given their potential to increase the tax system's complexity while at the same time, failing to address the fundamental problem they are intended to solve.

#### Signal to investors

The legislation moves New Zealand away from standard tax policy practice, raising BusinessNZ's concerns about the signal being sent both to domestic and overseas investors. New Zealand's broad-based low-rate tax system has for many years been seen as predictable, something which in many quarters is viewed as an asset to the country's economic prosperity, particularly when it comes to future investment. Limiting interest deductibility challenges these views.

On balance, domestic investors typically have a good day-to-day understanding of the current state of the country, including its likely political path and economic shifts. However, the current Government's swift and unexpected change in policy means domestic investors are now likely to factor in other potential and/or unexpected adverse changes to investment rules in deciding whether to invest. Such a change in approach typically leads to a chilling of investment decisions.

Such chilling of investor behaviour will often be exacerbated for overseas investors, who do not have intimate knowledge of either New Zealand's political, or its economic, circumstances.

In previous tax submissions, BusinessNZ has highlighted the fact that the company tax rate is often seen as a headline global indicator when competing for overseas investors. In a similar vein, that New Zealand will now be an outlier in limiting the deductibility of interest payments for certain business expenditure does not send overseas investors the right initial signal. Instead, it raises the risk profile of New Zealand as a place to do business.

Therefore, BusinessNZ does not support limiting the deductibility of interest on residential investment property.

***Primary recommendation: That the Government does not proceed with its proposal to limit the deductibility of interest on residential investment property.***

Notwithstanding our primary view and recommendation above, BusinessNZ is concerned to ensure that if interest deductibility rules are to change, what replaces them should be as workable as possible.

Complexity of the topic

The Government's initial announcement came on 23 March 2021 with a period of just over six months to the proposed implementation date of 1 October 2021. For such a significant change to New Zealand's tax landscape, we believe that period to be woefully inadequate if the numerous and complex problems arising from the change are to be properly worked through by both the public and private sectors.

BusinessNZ notes that since the announcement, the Government has sought advice from private sector tax experts on several issues relating to the design of the interest limitation rules. While such steps are supported, the fact that the Discussion Document is 143 pages in length illustrates how complex the new rules remain. Other submitters will provide an in-depth view on a range of topics discussed in the Discussion Document but from BusinessNZ's perspective, getting to a point where a set of clear and concise set of rules can be put in place still seems a long way off.

Ongoing remedial work

In relation to the point above, one of our biggest concerns with such a short time-frame for consultation is that once the legislation applies, there will likely be significant and ongoing remedial work to be undertaken to address uncertainties and/or rules that seem in conflict both within the new legislation and with other tax legislation.

In turn, considerable Inland Revenue resources will likely be needed to work through such issues, as well as further consultative work undertaken that experts and private sector representatives will have to assist with/submit on. There will also be a cost for the many investors who will have to seek professional tax advice if they are unsure of certain aspects of the rules and this, over time, will represent a sizeable deadweight loss to the economy. Also, there will be opportunity costs associated with tax policy development that could otherwise have addressed different tax policy issues.

At the very least, we believe pushing out the consultation and implementation date for at least another six months would improve the chance of minimising ongoing remedial work.

***Recommendation: That the Government delays the implementation date of the changes so that the various details of the scheme can be properly worked through as part of the standard consultation process.***

#### Specific Comments

In addition to the broad comments above, BusinessNZ would also like to address three specific issues raised in the Discussion Document:

#### Business premises and dual-purpose buildings on the same title

Paragraphs 2.64-2.69 of the Discussion Document ask submitters whether an apportionment calculation allowing for interest deductions in relation to the business premises of a dual-purpose building may be preferable over an all-or-nothing approach. BusinessNZ agrees that a more nuanced apportionment approach is indeed preferable.

***Recommendation: That an apportionment calculation allowing for interest deductions in relation to the business premises of a dual-purpose building is preferred to an all-or-nothing approach.***

#### Employee accommodation

While we understand other submitters will provide detailed views on how employee accommodation is best handled within the structure of the interest limitation rules, overall, BusinessNZ agrees with the views expressed in paragraphs 2.70-2.74 of the Discussion Document that there should be some form of carveout for all employee accommodation.

***Recommendation: That within the context of interest limitation rules, some form of carveout for all employee accommodation should proceed.***

#### Exclusion for non-close companies

As outlined in paragraphs 3.1-3.9 of the Discussion Document, BusinessNZ supports the exclusion of certain non-close companies. There will be many companies that hold small amounts of residential investment property but are unlikely to contribute significantly to high house prices.

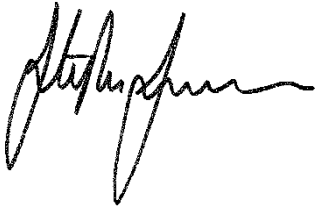
Paragraph 3.7 outlines a formula to ascertain whether a company would be classified as 'residential investment property-rich', namely comparing a company's residential investment property with its total assets. Any company that crossed the 50 percent threshold would be caught within the interest limitation deduction rules. However, we believe the formula is impractical because it will often be difficult to distinguish assets in the form of residential property from other business assets. Therefore, it is likely the formula will be taken to cover companies that would otherwise be excluded from its reach.

Instead, we would support the more practical options which other submitters will likely provide.

***Recommendation: That a more practical rule to establish whether a non-close company is 'residential investment property rich' is introduced.***

Thank you for your time, and we look forward to further developments.

Kind regards,

A handwritten signature in black ink, appearing to read 'Steve Summers', with a long, sweeping horizontal stroke at the end.

Steve Summers  
**Economist**  
BusinessNZ