Inland Revenue
Te Tari Taake

EXPOSURE DRAFT - FOR COMMENT AND DISCUSSION ONLY | HUKIHUKI HURANGA - MŌ TE TĀKUPU ME TE MATAPAKI ANAKE

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QUESTIONS WE'VE BEEN ASKED | PĀTAI KUA UIA MAI

Is a cash incentive payment income for a borrower who is a cash basis person?

Issued | Tukuna: XX

QB XX/XX

This question we've been asked explains the income tax treatment of a cash incentive payment (also known as a cashback payment) that a bank pays to a borrower who is a cash basis person under the financial arrangements rules. It explains when a cash incentive payment will not be taxable and will not give rise to any tax obligations for the borrower who receives it. It also explains when a cash incentive payment will be taxable and the time at which it must be accounted for when it is.

Key provisions | Whakaratonga tāpua

Income Tax Act 2007 – ss EW 3, EW 4(4), EW 12, EW 13, EW 29(3), EW 31(3), EW 31(4), EW 31(7), EW 55(2), EW 57

All legislative references are to the Income Tax Act 2007 (ITA 2007).

Question | Pātai

How is a bank cash incentive payment (CIP) paid to a borrower who is a cash basis person under the financial arrangement rules (FA rules), treated for income tax purposes?

Answer | Whakautu

If the borrower uses their loan for a private purpose, such as buying a home to live in, the CIP will not be income of the borrower and will not give rise to any income tax obligations for them.

Most bank loans are financial arrangements and subject to the FA rules.

A borrower who receives a CIP will only have income tax obligations if they use their loan for an income earning purpose, such as buying a rental property. Where this is the case, the CIP is taken into account in the final year of the borrower's loan, not in the year it is received. In that year, the borrower must include the CIP in a base price adjustment calculation (BPA). The BPA determines the tax consequences of the borrower's loan in the final year. In an ordinary case, the CIP is effectively offset against the deductible interest the borrower pays in the final year. The result is either an interest deduction or taxable income. Which outcome applies depends on the amount of the CIP and the amount of interest paid. If the amount of the CIP is more than the amount of interest paid, the difference is taxable income. If it is less, the difference is deductible interest.

For example, if a borrower received a $10,000 CIP and paid $7,000 of interest in the final year of their loan, they will have taxable income of $3,000. If, however, the borrower paid $15,000 of interest in the final year, they will have an interest deduction of $5,000.

A different result may apply in some circumstances. They include the borrower being denied interest deductions during the term of their loan, the borrower receiving more than one CIP, and the borrower being required to repay a CIP, either in full or in part. These situations are discussed in this item. The provisions of the ITA 2007 that determine if a borrower is a cash basis person are also discussed as are the provisions that determine the tax consequences that arise when a cash basis person receives a CIP. Additionally, there are examples that set out in full the BPA calculation a borrower must perform and there is commentary on why there are no tax consequences for a borrower who uses their loan for a private purpose.

Explanation | Whakamāramatanga

Introduction

1. This question we've been asked (QWBA) considers how CIPs paid to cash basis borrowers, who do not choose to apply a spreading method, are treated for income tax purposes.

2. In this QWBA, the expressions cash basis person and cash basis borrower refer to a person who has chosen not to apply a spreading method under the FA rules.

3. CIPs are payments that banks pay to attract new customers or retain existing ones. Generally, they are paid to customers who take out loans to purchase owner occupied or residential rental properties. However, they may also be paid when borrowings are used for other purposes. CIPs are not paid for a particular purpose, so a customer who receives a CIP may choose how they apply it.[1]

4. A borrower who receives a CIP will usually have an obligation to keep their loan with their bank for a fixed period. If the borrower does not meet this obligation, they may have to repay all or a part of the CIP. The amount of a CIP is typically calculated as a percentage of the amount borrowed.

5. For income tax purposes, most bank loans are financial arrangements.[2] The income tax consequences of a CIP depend on how the financial arrangement rules apply to the loan under which the CIP is paid and the purpose of the loan.

6. A loan may have a private purpose - such as when it is acquired to purchase a family home, or it may have a purpose connected with earning income, such as when it is acquired to purchase a residential rental property.

7. How the FA rules apply to a bank loan, a CIP paid in connection with the loan, and the borrower under the loan depends on whether the borrower is a cash basis person and,

[1] Since CIPs are not paid for any specified purpose, if a borrower uses a CIP to acquire capital contribution property (for example, an item of depreciable property) the CIP will not be a capital contribution. This is because for an amount to be a capital contribution it needs (amongst other requirements) to be paid under the express terms and conditions of an agreement as a contribution for capital property - see s CG 8 and definitions in s YA 1 of "capital contribution" and "capital contribution property".

[2] A bank loan will not be a financial arrangement if it is an excepted financial arrangement under s EW 4(4). In certain circumstances a revolving credit facility will be an excepted financial arrangement (see footnote 3). Ordinary term mortgage loans in New Zealand dollars are not excepted financial arrangements.

if so, whether they choose to apply a spreading method. Most borrowers who receive a CIP will be cash basis persons and will not choose to apply a spreading method.

8. This QWBA does not consider:

- How the spreading methods apply to cash basis persons who choose to apply a spreading method.
- Persons who carry on business and receive CIPs under business loans.
- CIPs under loans denominated in currencies other than New Zealand dollars.
- The income tax treatment of CIPs under revolving credit facilities that are excepted financial arrangements.[3]

The financial arrangement rules

9. Broadly, a financial arrangement is an arrangement under which a person receives money now in consideration for paying money at a later time such as occurs under a loan agreement.[4] Most bank loans are financial arrangements. Because CIPs are paid under financial arrangements, a borrower who receives a CIP needs to consider the FA rules.

10. The FA rules determine the timing and quantification of income and expenditure under a financial arrangement. For this purpose, a party to a financial arrangement is either a cash basis person or a non-cash basis person.

11. A person who is not a cash basis person must apply a spreading method. A person who is a cash basis person does not have to apply a spreading method but may choose to do so.[5] A spreading method calculates and allocates income and expenditure under a financial arrangement in all years except the year in which a BPA is calculated.

12. A cash basis person calculates their income and expenditure on a cash basis. This means they account for their income when they receive money and their expenditure when they pay an expense in money. In the final year of a financial arrangement, a

[3] Under the FA rules, an excepted financial arrangement (EFA) is not a financial arrangement (s EW 4(3). A variable principal debt instrument (VDPI), for example a revolving credit facility, is an EFA if the total value of all such instruments of the borrower on every day in an income year is $100,000 or less (s EW 5(25). Unless a borrower chooses otherwise (s EW 8), the FA rules do not apply to a VPDI that is an EFA (unless the EFA is part of a wider financial arrangement (ss EW 6(3)).

[4] Section EW 3.

[5] Sections EW 12 and EW 13.

cash person must perform a BPA.[6] The BPA is a final wash-up calculation and determines the tax consequences of a financial arrangement in that year.

13. Paragraphs [14]–[19] discuss how to determine if a borrower is a cash basis person.

Determining if someone is a cash basis person

14. A person must determine if they are a cash basis person on a year-by-year basis by applying the threshold tests in s EW 57. In summary, a person will be a cash basis person if they satisfy one or both of the following threshold tests:[7]

    - the total of the absolute values[8] of the person's income and expenditure under all their financial arrangements in the relevant income year is $200,000 or less (s EW 57(1)) [9]
    - the total of the absolute values of all the person's financial arrangements is $2 million or less on every day in the income year (s EW 57(2))

15. To determine whether the threshold in s EW 57(1) is exceeded, a person adds together the absolute values of all income and all expenditure they have under their financial arrangements.

16. To determine whether the threshold in s EW 57(2) is exceeded, a person adds together the absolute values of all financial arrangements they are a party to.

17. The above thresholds apply for the 2025-26 and later income years. For prior years, the thresholds in s EW 57(1) and (2) were, respectively, $100,000 and $1 million. In addition, a $40,000 deferral threshold applied.[10]

18. The Commissioner's interpretation statement **IS 22/05: Cash basis persons under the financial arrangement rules** considers the tests in detail.[11] However, IS 22/05 was published before the deferral threshold was removed and the threshold amounts in ss

[6] Sections EW 29(3) and EW 55(2).

[7] Section EW 54(1).

[8] The term "absolute value" is defined in s YA 1 to mean the value irrespective of whether the value's sign is positive or negative. For example, the absolute value of -500 is 500, the negative sign in front of the number is ignored.

[9] When applying this threshold test, income and expenditure are calculated on an accrual basis.

[10] The deferral threshold was set out in s 57(3) and associated definition sections EW 57(4)-(9). These provisions were repealed with effect from 1 April 2025.

[11] IS 22/05: Cash basis persons under the financial arrangement rules *Tax Information Bulletin* Vol 34, No 8 (September 2022): 38.

57(1) and (2) were increased. Consequently, IS 22/05 needs to be read subject to the new threshold amounts and the repeal of the deferral threshold.

19. The application of the threshold tests in s EW 57 is illustrated in Example | Tauira 1 and in Example | Tauira 2.

How does a cash basis person account for a CIP?

20. A cash basis person accounts for income receipts when they are received. A cash basis person must also account for capital receipts. This is because the financial arrangement rules require that all gains obtained under a financial arrangement are brought to tax, regardless of whether they are income or capital.[12] However, unlike an income receipt, a cash borrower must account for a capital receipt in the final year of their loan when they include it in the BPA they are required to perform in that year.

21. An amount is income if it is income under a provision in Part C.[13] A CIP will not be income under any of the provisions in Part C that apply to specific types of income because CIPs do not arise in the circumstances described in those provisions. This includes s CC 4, which provides that "interest derived by a person is income of the person". A CIP is not interest under s CC 4. This is because it is not an amount paid in exchange for an amount of money that has been lent. A CIP is paid by a bank as consideration for a person borrowing money on the terms specified in the applicable loan agreement.[14]

22. Section CA 1(2) is a general provision that applies to an amount if it is income under ordinary concepts. A CIP will not be income under s CA 1(2) because CIPs do not have the characteristics of ordinary income. This is because a CIP:

- is not part of a flow of money or money's worth arising from the ownership of property or capital, from labour, or from a combination of those things.[15]
- is not a gain from an adventure deliberately entered into with a view to profit.[16]
- does not have the quality of regularity or recurrence such that a person relies on it to pay their living expenses.[17]

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[12] The parties to a financial arrangement are required to disregard any distinction between capital and revenue amounts (s EW 1(3)(b)).
[13] Section CA 1(1).
14 This is consistent with the Commissioner's view that a negative interest payment is not interest under s CC 4. See QB 21/02: Whether "negative interest" payments are subject to withholding taxes.
[15] *A Taxpayer v CIR* (1997) 18 NZTC 13,350 (CA).
[16] *Wattie v C of IR* (1998) 18 NZTC 13,297 (CA).
[17] *Reid v CIR* (1985) 7 NZTC 5,176 (CA).

23. As a CIP is not income under Part C, a cash basis borrower is not required to account for the CIP when it is received but must instead account for it by including it in a BPA in the final year of their loan.

Calculating a base price adjustment

24. The BPA captures any consideration and any expenditure not accounted for in years prior to the final year and includes all consideration paid to a borrower "for or under [their] financial arrangement".[18] A CIP comes within this wording because it is an amount a borrower receives under the terms of their loan.

25. The BPA formula is:[19]

BPA = consideration − income + expenditure + amount remitted.

26. For a borrower whose receipts consist of principal and one or more CIPs and whose repayments consist of principal and interest, the amounts in the formula will be:

- consideration – all amounts of consideration payable to the borrower (ie, loan principal and CIPs) less all amounts of consideration payable by the borrower (ie, loan principal, interest and CIP repayments (if any));[20]
- income – all income that the borrower derived in previous years (generally nil);
- expenditure – all expenditure that the borrower incurred in previous years (ie, all interest paid in those years); and
- amount remitted: an amount the borrower has been released from paying by the lender or by law.[21]

27. If the result of a BPA is negative, it is treated as expenditure incurred in the final year of the borrower's loan and is deductible under ss DB 6 to DB 8 or s DB 11 if the requirements of those sections are met.[22] Section DB 6 allows a person a deduction for interest incurred provided the general permission in s DA 1 is satisfied and none of the general limitations prohibits the deduction.[23] The capital limitation cannot prohibit

[18] Section EW 31(7).

[19] Section EW 31(5).

20 Consideration does not include non-contingent fees. See s EW 31(7).

[21] An amount remitted will be included in the lender's BPA but not in the borrower's.

22 Section EW 31(4).

[23] The general permission allows the borrower a deduction for expenditure they incur in deriving their assessable income or in carrying on a business for the purpose of deriving their assessable income.

the deduction as it is explicitly overridden by s DB 6. For the purposes of s DB 6, interest includes expenditure incurred under the FA rules.[24]

28. If the result of a BPA is positive, it is assessable income except to the extent that it arises from expenditure incurred under a financial arrangement in previous years and for which a deduction was denied.[25]

Result of BPA when a loan is connected with earning income

29. If a borrower used their loan exclusively for an income-earning purpose such as buying a rental property and the BPA is negative, a full deduction in the amount of the BPA will generally be available under s DB 6. In an uncomplicated case, the amount of the deduction will be equal to the interest the person incurs in the final year of their loan less the value of their CIP. Example | Tauira 1 illustrates this situation in relation to a cash basis borrower.

30. If a borrower used their loan exclusively for an income-earning purpose such as acquiring a rental property and their BPA is positive, they will ordinarily have been entitled to deduct all of their interest in prior years. In such a case, the whole of their BPA will be assessable income in the final year. Example | Tauira 2 illustrates this situation in relation to a cash basis borrower.

31. In the 2022-2025 income years, interest limitation rules in subpart DH applied to deny a person deductions for interest if the interest was "grandparented residential interest". Those rules have now been repealed. However, if a person was denied a deduction under those provisions their BPA, if positive, will be reduced by the amount of the deduction that was denied.

Example | Tauira 1 – Cash basis person who has a negative BPA

Facts

During the 2026-27 income year Mark borrowed $1 million from Bank Ltd under a 20-year table loan and used the loan to buy a residential rental property. Mark received a $10,000 CIP when he drew his loan down. He sold the property and repaid the loan during the 2034-35 income year.

[24] Section YA 1 definition of "interest".

[25] Section EW 31(3).

From the drawdown date until the end of the 2033-34 income year, Mark paid $466,994 of interest. In the 2034-35 income year, he paid $23,776 of interest. In each year of the loan, the amount of interest Mark paid was less than $200,000.

Mark is not a party to any other financial arrangements.

Application – cash basis person

Mark applies the threshold tests in s EW 57(1)-(2) to determine if he is a cash basis person.

Mark determines that he does not exceed the threshold in s EW 57(1) because, in each year of the loan, his income and expenditure calculated on an accrual basis is less than $200,000.

Mark does not exceed the $2 million threshold in s EW 57(2) because the absolute value of his loan is $1 million when drawn down and from there reduces over time as he makes principal repayments.

Because Mark does not exceed the thresholds in s EW 57, he meets the requirements for being a cash basis person in all years of the loan. Mark chooses not to apply a spreading method.

Application – base price adjustment in year loan repaid

The interest Mark paid meets the requirements of the general permission because he incurred it deriving rental income. This means that in the first 8 years of the loan, Mark is entitled to deduct the interest under s DB 6 when it is incurred.

Mark's CIP is not an income receipt under any of the provisions in Part C of the ITA 2007. This means that Mark is not required to account for the CIP in the year he receives it. Instead, he must account for the CIP in the final year of his loan by including it in the BPA he performs in that year. The "consideration" component of the BPA is the difference between the consideration Mark received ($1 million of loan principal and a $10,000 CIP) and the consideration that he paid ($1 million of loan principal and $490,770 of interest). The expenditure component of the BPA is the total interest that Mark incurred in all years except the final year. Mark's BPA is calculated as follows:

Consideration	–	Income	+	Expenditure (years 1–8)	+	Amount remitted	=	BPA
(1,010,000 – 1,490,770)		0		466,994		0		–13,776

Mark has a BPA of –$13,776. Because the BPA is negative, it is treated as interest incurred. Mark is entitled to deduct the BPA under s DB 6 in the 2034-35 income year.

Mark's BPA is negative because the value of his CIP is less than the value of the interest he incurred in the final year of his loan.

Example | Tauira 2 – Cash basis person who has a positive BPA

Facts

During the 2026-27 income year, Jane borrowed $1,200,000 from Bank Ltd under a 15-year table loan. She used her loan to buy a residential rental property. Jane received a $10,000 CIP when she drew her loan down and received a further $4,000 CIP during the term of the loan. Jane refinanced her loan with another bank early in the 2036-37 income year. Jane was required to repay $2,000 of her second CIP because the repayment date occurred during the clawback period for the CIP.

From the drawdown date until the end of the 2035-36 income year Jane paid Bank Ltd $405,754 of interest. In the 2036-37 income year, she paid Bank Ltd $2,785 of interest.

Application – cash basis person

Jane applies the threshold tests in s EW 57(1)-(2) to determine if she is a cash basis person.

Jane determines that she does not exceed the threshold in s EW 57(1) because, in each year of her loan, her income and expenditure calculated on an accrual basis is less than $200,000.

Jane does not exceed the $2 million threshold in s EW 57(2) because the absolute value of her loan is $1.2 million when drawn down and from there reduces over time as she makes principal repayments.

Because Jane does not exceed either of the thresholds in s EW 57, she meets the requirements for being a cash basis person in all years of the loan. Jane chooses not to apply a spreading method.

Application – base price adjustment in year loan repaid

The interest Jane pays meets the requirements of the general permission because she incurred it deriving rental income. This means that in each of the 2027-2036 income years Jane is entitled to deduct the interest under s DB 6 when it is incurred.

The CIPs Jane receives are not income receipts under any of the provisions in Part C of the ITA 2007. This means that Jane is not required to account for the CIPs in the years they are received. Instead, she must account for them in the final year of her loan under the BPA she performs in that year. The "consideration" component of the BPA is the difference between the consideration Jane received ($1,200,000 of loan principal and $14,000 of CIPs) and the consideration that she paid ($1,200,000 of loan principal, $408,539 of interest and a $2,000 CIP repayment). The expenditure component of the BPA is the total interest that Jane incurred in all years except the final year. Jane's BPA is calculated as follows:

Consideration	–	Income	+	Expenditure (years 1–11)	+	Amount remitted	=	BPA
(1,214,000 – 1,610,539)		0		405,754		0		9,215

Jane has a positive BPA of $9,215. As she was entitled to deduct all of her interest in previous years, the whole of the BPA is assessable income in the 2036-37 income year.

Jane's BPA is positive because the net value of the CIPs she received is greater than the value of the interest she incurred in the final year of her loan.

Result of BPA when a loan is used for a private purpose

32. If a cash basis borrower uses a loan for a private purpose such as buying their family home, their CIP will not be assessable income in the year it is received as the money was not borrowed in connection with earning income.

33. The private limitation in s DA 2(1) will apply to deny the borrower deductions for interest in all years prior to the one in which a BPA is performed.

34. If the borrower has a negative BPA in the final year of their loan, they will be prohibited from deducting the BPA under ss DB 6 and DB 7 as those sections are subject to the private limitation in s DA 2(1). They will also be prohibited from deducting the BPA under s DB 11 as a negative BPA may only be deducted under that section to the extent that it arises from assessable income derived in previous years. Because the borrower used their loan for a private purpose, they will not have derived any income in prior years. Therefore, they will not be entitled to deduct a negative BPA.

35. If the borrower has a positive BPA in the final year of their loan, the BPA will be assessable income except to the extent that it arises from expenditure in previous years for which a deduction was denied. As the private limitation will have applied to deny deductions for interest in prior years, the borrower will only have assessable income to the extent that the difference between their BPA and the denied deductions is a positive amount. This is likely to be a theoretical possibility only, because in virtually all conceivable cases the value of the BPA is likely to be much smaller than the denied deductions.

36. Therefore, there will be no tax consequences for a borrower who receives a CIP when they use a loan for a private purpose such as acquiring a home to live in. Example | Tauira 3 illustrates this in relation to a cash basis borrower.

Example | Tauira 3 – Cash basis person who buys a private residence

Facts

The facts are the same as in Example | Tauira 2 except that, instead of using her loan to buy a rental property, Jane buys a home to live in.

Application – base price adjustment

Under the cash basis method, Jane must return income when she receives it and claim deductible expenditure when she incurs it, except in the final year when she performs a BPA. In the years before she repays her loan, Jane does not have any deductible expenditure because the interest she incurs is private expenditure prohibited from deduction by the private limitation. Jane also does not have any assessable income because the CIPs she received are capital receipts and are not assessable under any of the assessment provisions in the ITA 2007.

In the final year, Jane's BPA is the same as the one set out in Example | Tauira 2. Therefore, Jane has a positive BPA of $9,215.

A positive BPA is income except to the extent to which it arises from expenditure incurred in earlier income years for which a deduction was denied. The exception applies to Jane because she was denied deductions for all of the expenditure she incurred in prior years. The total amount of that expenditure is $405,754. As this amount exceeds Jane's positive BPA of $9,215, the BPA is not treated as assessable income. Therefore, there are no tax consequences for Jane.

Loan used for more than one purpose

37. A borrower may apply their loan to acquire a property that they use for a private purpose and an income earning purpose. An example is a loan used to acquire a home in which a borrower has a home office that they use for business purposes. In these circumstances, the borrower is entitled to deduct home expenses such as a rates, insurance and interest to the extent they are incurred maintaining the home office.[26] To determine the deductible portion, the borrower must apply an apportionment method that gives a fair and reasonable result in the circumstances. Alternatively, the borrower may apply the square metre method in s DB 18AA. The application of an apportionment method to a borrower who receives a CIP is demonstrated in Example | Tauira 4.

38. If the borrower uses their loan to acquire a property that is subject to the mixed use asset rules in subpart DG, the borrower will need to consider the apportionment rules in that subpart when determining the proportion of their expenditure they are entitled to deduct.

Example | Tauira 4 – Loan used for more than one purpose

Jeremy carries on business as an architect. He borrows money from Bank Ltd and uses the money to buy a home in which he has a home office that is used for business purposes. Jeremy's apportionment method establishes that he is entitled to deduct 5% of his home expenditure that is partly incurred maintaining the home office.

Jeremy repays his loan in the eighth year of the loan. Jeremy also performs a BPA in that year and includes in the BPA a CIP he received when he drew his loan down. The result of the BPA is -$8,000.

Jeremy is a cash basis person. In the first 7 years of his loan he deducts 5% of the interest he pays. In the final year he deducts 5% of the negative BPA i.e., $400.

Draft items produced by the Tax Counsel Office represent the preliminary, though considered, views of the Commissioner of Inland Revenue.

[26] To be deductible the expenditure must meet the requirements of the general permission and not be subject to any of the general limitations. In the case of a person who is an employee and who uses a home office in that capacity, the employment limitation in s DA 2(4) will apply to deny the person deductions for home office expenditure.

In draft form these items may not be relied on by taxation officers, taxpayers, or practitioners. Only finalised items represent authoritative statements by Inland Revenue of its stance on the particular issues covered.

Send feedback to | Tukuna mai ngā whakahokinga kōrero ki public.consultation@ird.govt.nz

References | Tohutoro

Legislative references | Tohutoro whakatureture

Income Tax Act 2007, ss CC 3, DA 1, DA 2, DB 6, DB 7, DB 8, DB 11, EB 2, EW 3, EW 4, EW 12, EW 13, EW 29, EW 31, EW 55, EW 55, EW 57, YA 1 ("interest")

Case references | Tohutoro kēhi

A Taxpayer v CIR (1997) 18 NZTC 13,350 (CA)

Reid v CIR (1985) 7 NZTC 5,176 (CA)

Wattie v C of IR (1998) 18 NZTC 13,297 (CA)

Other references | Tohutoro anō

IS 22/05: Cash basis persons under the financial arrangements rules *Tax Information Bulletin* Vol 34, No 8 (September 2022): 38
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IS 22/05

QB 21/02: Whether "negative interest" payments are subject to withholding taxes *Tax Information Bulletin* Vol 33, No 5 (June 2021): 15

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QB 21/02

About this document | Mō tēnei tuhinga

Questions we've been asked (QWBAs) are issued by the Tax Counsel Office. QWBAs answer specific tax questions we have been asked that may be of general interest to taxpayers. While they set out the Commissioner's considered views, QWBAs 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 (Commissioner's statement, Inland Revenue, December 2012*)*. It is important to note that a general similarity between a taxpayer's circumstances and an example in a QWBA will not necessarily lead to the same tax result. Each case must be considered on its own facts.