

FACT SHEET | PUKA MEKA

Income tax – residential property moving from mixed-use asset rules to standard tax rules

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IS 25/08 FS 1

This fact sheet accompanies [IS 25/08: Income tax – implications of a residential property moving between the standard tax rules and the mixed-use asset rules](#) which considers situations where a person's use of their residential property has changed so that it moves from being under one set of income tax deduction rules to another. This fact sheet explains what happens when residential property moves from the mixed-use asset rules to the standard tax rules.

All legislative references are to the Income Tax Act 2007.

Key terms | Kīanga tau tāpua

mixed use asset rules	Refers to the rules for apportioning deductions if, during the income year, a property (or dwelling on a property) derives income, is used privately, and is unused for 62 days or more.
residential property ring-fencing rules	Refers to rules that limit the deductible expenses a person can claim in the current income year. To the extent the deduction exceeds the income, it is suspended and carried forward to a future income year.

standard tax rules

Refers to the rules for calculating deductible expenses incurred in deriving income from residential property if the mixed-use asset rules do not apply.

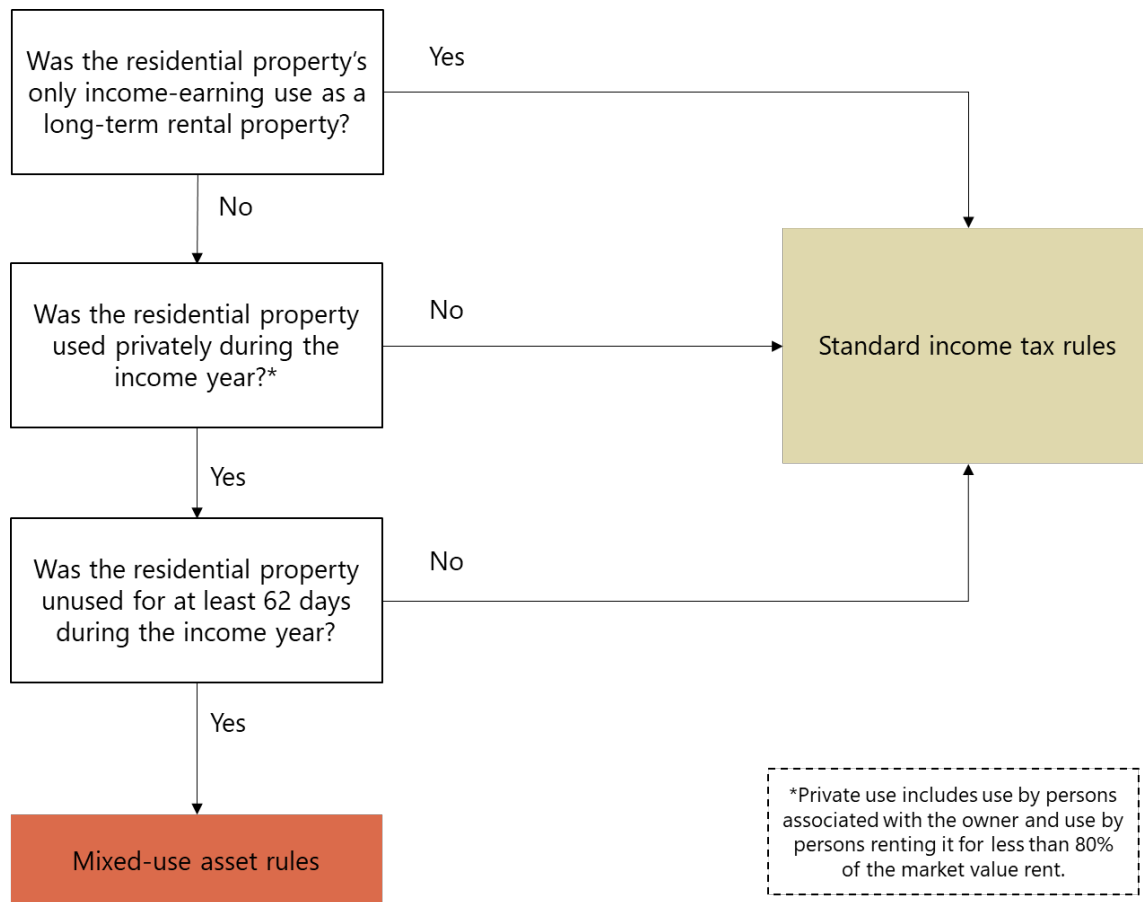
Introduction | Whakataki

1. IS 25/08: **Income tax – implications of a residential property moving between the standard tax rules and the mixed-use asset rules** considers situations where a person's use of their residential property has changed so that it moves from being under one set of income tax deduction rules to another.
2. This fact sheet provides an overview of the consequences of moving from the mixed-use asset rules to the standard tax rules. A move from one set of rules to another may occur in a number of different situations such as when a person stops renting out their holiday home on a casual basis and makes it available for rent on a fulltime basis (for example, as short-stay accommodation or long-term rental). For further detail, see IS 25/08.

Determining what income tax deduction rules apply

3. If a person derives income from a residential property, they calculate their deductible expenditure under either the mixed-use asset rules or the standard tax rules.
4. Figure | Hoahoa 1 provides guidance on how a person can work out which income tax deduction rules apply in an income year. A person must keep track of the use of the residential property during the income year to determine which income tax deduction rules apply for that income year.

Figure | Hoahoa 1 – Determining which income tax deduction rules apply



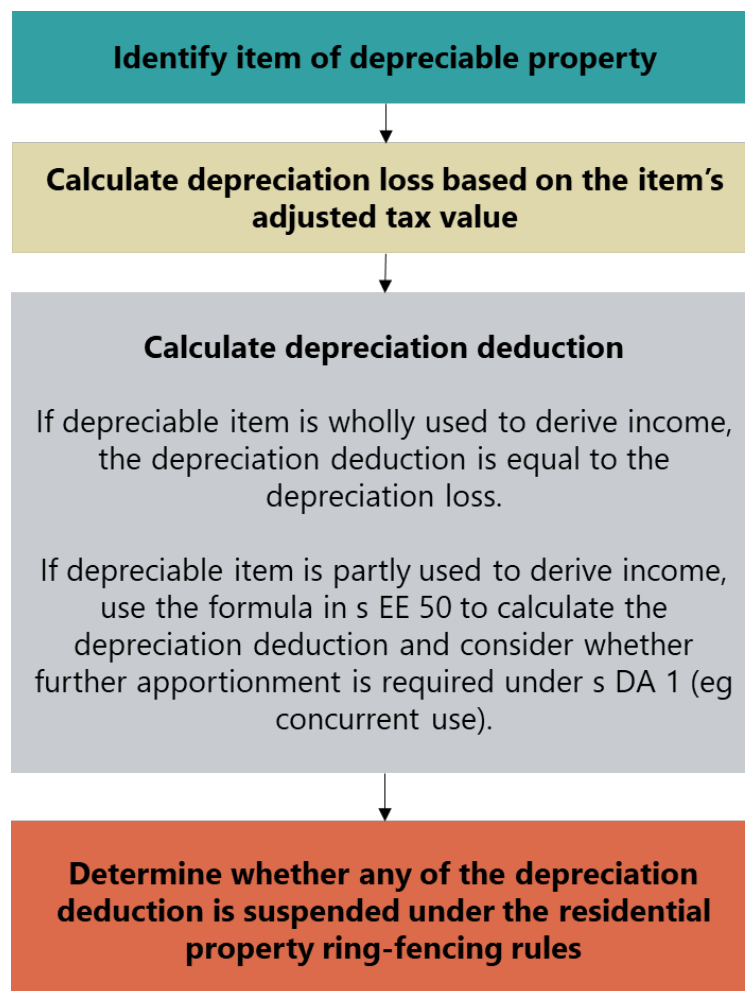
5. This fact sheet considers how a person applies the standard income tax rules to their residential property. For information on a person's tax treatment if the mixed-use asset rules apply, see IS 25/08 FS 2.

Applying the standard tax rules

6. Any income a person receives from renting out a residential property is taxable income.
7. A person must determine what deductions they can claim for expenditure incurred in deriving the rental income (see [46] to [51] of IS 25/08). A person can deduct expenditure to the extent it is incurred in deriving taxable income. In general terms (and subject to any specific limitations):
- any expenses that relate solely to a person's private use are non-deductible;

- any expenses that relate solely to the person's income-earning activity are fully deductible; and
 - to the extent an expense relates to both a person's income-earning and private use of the property, it will be only partly deductible and will need to be apportioned.
8. There are specific rules for calculating depreciation on items of depreciable property used in the residential property. Figure | Hoahoa 2 provides guidance on how a person can work out their depreciation deduction under the standard tax rules.

Figure | Hoahoa 2 – Determining depreciation deductions under the standard tax rules



9. The calculation for the depreciation loss is based on the depreciable property's adjusted tax value (ATV). The ATV is the item's cost less any deductions for amounts of depreciation loss that the person **would have been allowed** if the item of depreciable property was wholly used in deriving taxable income. This means any apportionment

under the mixed-use asset rules in the prior year does not change how the ATV is calculated (see [100] to [104] of IS 25/08).

10. When a person sells an item of depreciable property, they must calculate their depreciation recovery income or depreciation loss on sale (see from [105] of IS 25/08).
11. If the residential property ring-fencing rules apply to the residential property in the income year of sale, a person can offset unused excess deductions to the extent that they derive income from the residential property (including depreciation recovery income).

Residential property ring-fencing rules may limit amount of deduction

12. If a person uses the standard tax rules to calculate their deductions (including their depreciation deduction), they must also consider whether the residential property ring-fencing rules apply to suspend or limit the deduction in the current income year (see [96] to [99] of IS 25/08).
13. The residential property ring-fencing rules apply unless the residential property has been used as the person's main home for most of the income year (see [55] to [57] of IS 25/08).
14. Generally, the residential property ring-fencing rules apply on a portfolio basis. However, a person can elect to apply the rules on a property-by-property basis instead (see [77] – [78] of IS 25/08).
15. The residential property ring-fencing rules operate to prevent a person from offsetting deductions incurred for residential properties against other sources of income (for example, salary or wages). This means if the person's rental activity makes a loss, they cannot claim the excess deductions in that income year.
16. Any excess deductions are not permanently forfeited but are suspended and may be offset against future income derived from residential property when the standard tax rules apply.
17. A person cannot use any excess deductions against income derived from the residential property if the mixed-use asset rules apply in an income year. This is of relevance if there is a subsequent change of use of the residential property.

Unable to use prior year quarantined expenditure

18. The person may have mixed-use asset quarantined expenditure carried forward from a prior income year (see [42] to [45] of IS 25/08). The person cannot offset the quarantined expenditure if the standard tax rules apply to the residential property in the income year. The quarantined expenditure is not forfeited but carried forward to a future income year.
19. Example | Tauira 1 illustrates how the above tax rules apply where a residential property has moved from the mixed-use asset rules to the standard tax rules.

Example | Tauira 1 – Changing from mixed-use asset rules to standard tax rules

Te Ariki owns a three-bedroom property in Christchurch. In the 2022–23 income year the Christchurch property was a mixed-use asset and Te Ariki used the mixed-use asset rules to calculate his net income from the Christchurch property. Te Ariki had quarantined expenditure from the 2022–23 income year of \$3,000.

In January 2023, Te Ariki decides to rent his Christchurch property to long-term tenants and the tenants continue to rent the Christchurch property throughout the 2023–24 income year. In the 2023–24 income year, the Christchurch property was not vacant or used privately.

The Christchurch property is not a mixed-use asset in the 2023–24 income year. The standard tax rules apply to the Christchurch property for the 2023–24 income year.

Te Ariki charges his tenants \$600 per week (a total of \$31,200 in the 2023–24 income year). Te Ariki incurred the following expenses (total \$42,000) relating to the property:

- interest – \$36,000
- local authority rates – \$2,500
- house insurance – \$2,600
- repairs and maintenance – \$900

Te Ariki can claim a deduction for expenditure to the extent it is incurred in deriving taxable income from renting his Christchurch property, provided none of the general limitations (for example, the capital limitation) apply. However, due to the interest

limitation rules, his deduction for interest costs is limited to 80% (\$28,800) in the 2023–24 income year.¹

The Christchurch property is partly furnished. Te Arika prepares a tax fixed asset register for the 2024 income year:

Asset	Cost	Opening Adjusted Tax Value	Depreciation Loss	Closing Adjusted Tax Value
Washing Machine	\$1,600	\$1,120	\$336	\$784
Dryer	\$1,250	\$875	\$262.50	\$612.50
Fridge / freezer	\$1,800	\$1,350	\$337.50	\$1,012.50

As the items of depreciable property are wholly used to derive rental income, Te Arika can claim a deduction for the entire depreciation loss (\$936 total) unless the residential property ring-fencing rules apply and suspend a portion of the depreciation deduction in the 2023–24 income year.

In the 2023–24 income year, the Christchurch property is subject to the residential property ring-fencing rules as no exclusions apply.

In the 2023–24 income year, Te Arika's rental activity is as follows:

Residential income	Deductible expenditure	Expenditure deductible in 2023–24 income year	Excess deductions carried forward to future income year
\$31,200	\$35,736	\$31,200	\$4,536

In the 2023–24 income year, Te Arika can claim \$31,200 of the expenses incurred for his Christchurch property. He has \$4,536 of unused excess deductions to carry forward to the 2024–25 income year.

¹ From 1 April 2025, interest deductibility will be fully restored, and a person will be able to claim 100% of the interest incurred.

Te Ariki also has \$3,000 of mixed-use asset quarantined expenditure relating to his Christchurch property to carry forward to future income years.

About this document | Mō tēnei tuhinga

Some of the Tax Counsel Office's longer or more complex items are accompanied by a fact sheet that summarises and explains an item's main points. While it summarises the Commissioner's considered views, a fact sheet should be read alongside the full item to completely understand the guidance. Fact sheets are not binding on the Commissioner. See further [Status of Commissioner's advice](#) (Commissioner's statement, Inland Revenue, December 2012).