Inland Revenue
Te Tari Taake

FACT SHEET | PUKA MEKA

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

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IS 25/08 FS 2

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 standard tax rules to the mixed-use asset rules.

All legislative references are to the Income Tax Act 2007.

## Key terms | Kīanga tau tāpua

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|---|---|
| **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 |

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| | 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. |

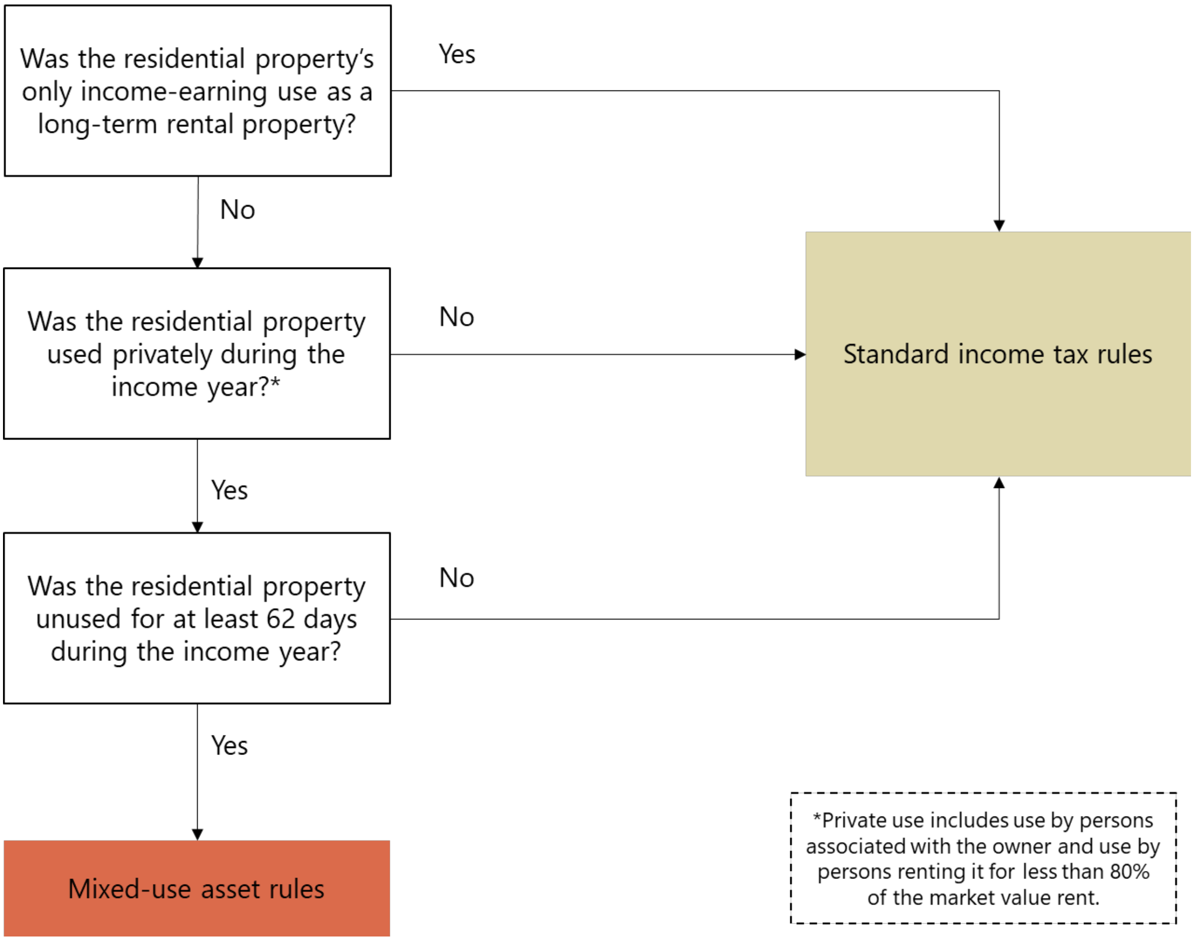
## Introduction | Whakataki

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 standard tax rules to the mixed-use asset rules. A move from one set of rules to another may occur in different situations such as when a property that has previously been used as short-stay accommodation is used as both the person's holiday home and short-stay accommodation in the next income year. 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 mixed-use asset rules to their residential property. For information on a person's tax treatment if the standard tax rules apply, see IS 25/08 FS 1.

## Applying the mixed-use asset rules

6. Any income a person receives from renting out a residential property will generally be taxable income.

7. If the residential property is a mixed-use asset, deductions can be claimed for expenses that relate solely to its rental activity. Any expenses that relate solely to the private use of the residential property are not deductible.

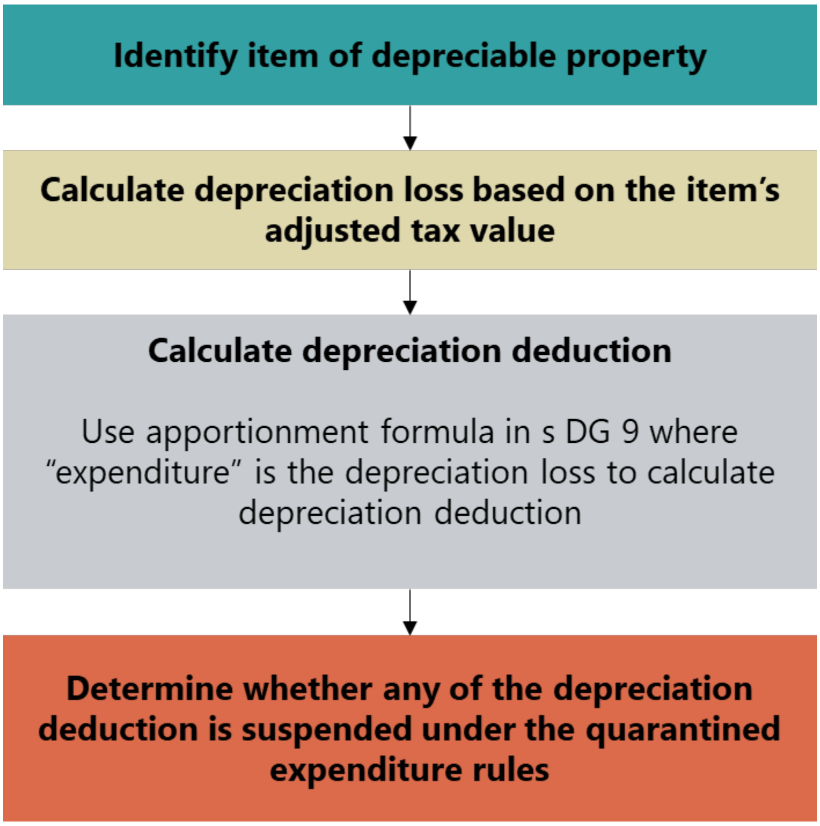
8. Expenses that relate to both the income-earning and private use of the residential property will be only partly deductible. The person must use the mixed-use asset

apportionment formula to calculate their deductible mixed-use asset expenditure. The effect of the formula is that the proportion of expenses that are deductible reflects the income-earning use of the mixed-use asset relative to the private use (see [39] to [40] of IS 25/08).

9. There are specific rules for calculating depreciation on items of depreciable property used in the residential property.

10. Figure | Hoahoa 2 provides guidance on how a person can work out their depreciation deduction where the mixed-use asset rules apply in the income year.

**Figure | Hoahoa 2 – Determining depreciation deductions under the mixed-use asset rules**




11. 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 or limitation under the residential property ring-fencing rules in a prior year does not change how the ATV is calculated (see [96] to [99] of IS 25/08).

12. 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). Mixed-use asset quarantined expenditure cannot be offset against depreciation recovery income.

## Quarantined expenditure rules may limit the amount of deduction

13. If a person's residential property is a mixed-use asset and the person makes a loss from the rental activities, they must determine whether the quarantined expenditure rules apply. If the quarantined expenditure rules apply, the person may only deduct their expenses up to the amount of the rental income they received from the mixed-use asset (see [42] to [45] of IS 25/08).
14. A deduction for quarantined expenditure is not permanently forfeited but is suspended and may be offset against future asset income derived from the residential property when the mixed-use asset rules apply.
15. A person cannot offset any quarantined expenditure against income derived from the residential property if the standard tax rules apply. This is of relevance if there is a subsequent change of use of the residential property.

## Unable to use unused excess deductions

16. The person may have unused excess deductions suspended under the residential property ring-fencing rules carried forward from a prior income year (see [52] to [54] of IS 25/08).
17. The person cannot offset the unused excess deductions against income derived from the residential property if the mixed-use asset rules apply in the income year. The unused excess deductions are not forfeited but carried forward to a future income year.

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

Jane owns a two-bedroom property in Hahei. Jane has let the Hahei property out as short-stay accommodation, and it has not been used privately. However, in the 2024–25 income year Jane decides to stay in the Hahei property for a six-week period (42 days) and let it out for short-stay accommodation for the remainder of the income year. The Hahei property is let out for short-stay accommodation for 223 days and vacant (unused) for the remainder of the 2024–25 income year.

In the 2023–24 and earlier income years, Jane used the standard tax rules to calculate her deductible expenditure from the Hahei property. Jane has $10,000 of unused excess deductions under the residential property ring-fencing rules to carry forward to future income years.

As the Hahei property has been used privately by Jane and was vacant for at least 62 days in the 2024–25 income year, the Hahei property will be a mixed-use asset in the 2024–25 income year.

Jane derived $45,000 from the Hahei property during the 2024–25 income year.

The Hahei property is fully furnished, and Jane prepares an itemised tax fixed asset register for the 2024–25 income year. The total amounts for the 2024–25 income year are:

| | **Opening adjusted tax value** | **Depreciation loss** | **Closing adjusted tax value** |
|---|---|---|---|
| 2025 | $16,200 | $4,860 | $11,340 |

In addition to the depreciation loss, Jane incurred the following expenses relating to the property in the 2024–25 income year:

- interest – $24,750
- local authority rates – $2,500
- house insurance – $3,000
- utilities – $4,000
- repairs and maintenance – $500

All the expenditure ($39,610) relates to both the private and income earning use of the Hahei property. Jane calculates her mixed-use asset expenditure using the following formula:

expenditure x income-earning days ÷ (income-earning days + counted days)

Expenditure = $39,610

Income-earning days = 223

Counted days = 42

Jane's mixed-use asset expenditure is $33,332.19.

In the 2024–25 income year Jane derived net income of $11,667.81 from the Hahei property:

| | |
|---|---|
| Rental income | $45,000 |
| Deductible expenditure | ($33,332.19) |
| | $11,667.81 |

Jane is unable to use the prior year unused excess deductions against the net income from the Hahei property. The $10,000 of unused excess deductions can be carried 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).