Inland Revenue
Te Tari Taake

20 May 2019

Before you read this QWBA

This QWBA is one of a series covering the tax rules for short-stay accommodation hosts. Check Overview – Short-stay accommodation items to make sure it's the item that's relevant to your circumstances.

QUESTION WE'VE BEEN ASKED

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?

This "Question We've Been Asked" (QWBA) explains how the income tax rules apply to a dwelling you sometimes rent out as short-stay accommodation (eg, through Airbnb, Bookabach and Holiday Houses) and sometimes use privately, where the dwelling is subject to the mixed-use asset rules.

Before you use this QWBA, you need to work out if the mixed-use asset rules apply to the dwelling. 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? will help you work that out.

Question

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?

Answer

If the mixed-use asset rules apply, rental income from the dwelling will generally be taxable. However, some income will be exempt – for example, income from renting the dwelling to family members or to others at "mates' rates".

The mixed-use asset rules set out how to determine the costs you may deduct against your income from providing the short-stay accommodation.

Key provision

Income Tax Act 2007 – subpart DG

Key terms

Guest means a person provided with short-stay accommodation in return for payment.

Mixed-use asset means an asset that is used both privately and to earn income, and is also unused for at least 62 days in the year. This would include many baches.

Short-stay accommodation means accommodation provided for up to four consecutive weeks in a dwelling that is not the guest's ordinary residence. It doesn't include accommodation provided to residential tenants, boarders or care home residents, and it doesn't include student or emergency accommodation.

Costs that are solely related to renting out the dwelling are fully deductible. Costs that are solely related to your private use of the dwelling are not deductible. Other costs are partly deductible – the deductible amount is based on the number of rental nights relative to the total number of nights the dwelling is used.

If you make a loss from renting out the dwelling, you may not be able to deduct all of your expenses that year – some might be carried forward to future years.

Explanation

1. If you have a dwelling that you sometimes rent out as short-stay accommodation and also sometimes use yourself, you will need to work out which income tax rules apply, so you can meet your tax obligations. The dwelling could be a holiday home, or a separate dwelling on the same property you live on (eg, a sleep-out or cottage).

2. Depending on your circumstances, the dwelling will either fall under the "mixed-use asset" rules or the standard tax rules.

3. To work out which rules apply in your situation, see *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?* You'll need to revisit which rules apply each year.

4. This QWBA will be relevant if:

    - you've determined that for a particular income year the dwelling is a mixed-use asset; and
    - you haven't opted out of the tax rules.

      [You can only do this in certain circumstances – see *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?*]

Background

5. The mixed-use asset rules apply where assets are sometimes used privately, sometimes used to earn income, and are also unused for a significant period during the year. The rules ensure an appropriate proportion of the expenses that relate to the "unused" period is deductible. The proportion that's deductible is based on the amount of income-earning use relative to the total use of the asset.

What do I do if the mixed-use asset rules apply to the dwelling?

6. Once you've determined that the mixed-use asset rules apply to the dwelling for a particular income year (see *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?*), you'll need to work out:

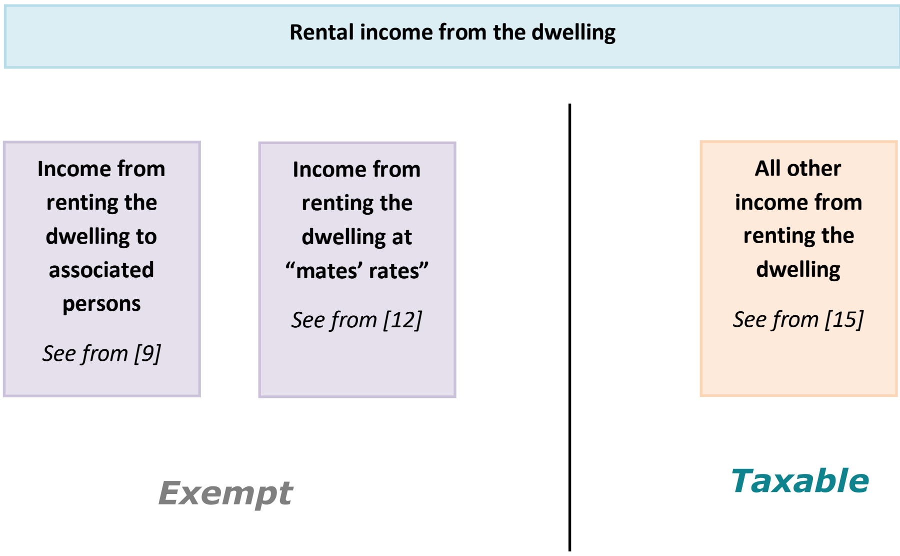
    - what rental income is taxable;
    - what income is exempt; and
    - what proportion of your expenses is tax deductible.

7. This QWBA covers each of those issues.

What income is taxable and what income is exempt?

8. Income you receive from renting out the dwelling is generally taxable. However, there are two situations where it will be exempt. Where you have exempt income, you don't pay tax on the amount you receive, and you can't deduct expenses for those days. Figure 1 summarises what you need to consider when working out whether your rental income is taxable or exempt.

Figure 1: Determining whether rental income is taxable or exempt



Exempt income: renting out the dwelling to an associated person

9. The first situation where income you receive from renting out the dwelling is exempt is where you rent it out to a natural person who's associated with you.

10. This covers income from renting out the dwelling to natural persons you're associated with (eg, close relatives such as your children, grandchildren, siblings or in-laws).

11. If a trust, partnership or company owns the dwelling, this would cover income from the dwelling being rented to associated natural persons (eg, for a trust, the settlors and beneficiaries).

> Inland Revenue guide IR620 can help you work out if someone is associated with you. It can be found on Inland Revenue's website.
>
> If a company owns the dwelling, in addition to the normal rules about association, the company will be associated with anyone who has a share in the company that gives them the right to use the dwelling.

Exempt income: renting out the dwelling at "mates' rates"

12. The second situation where income you receive from renting out the dwelling is exempt is where you rent it out for less than 80% of the market value rent.

13. This covers income from renting the dwelling to friends at "mates' rates" of less than 80% of the market value rent.

14. It doesn't include income from renting the dwelling at a lower price because it's off-peak season, a longer-term rental, or other similar reasons. This is because in those situations the market rate is the lower price.

Taxable income

15. Other than the two situations above, any amounts you receive from renting out the dwelling are taxable. The activity doesn't need to be run as a business for the amounts you receive to be income.

16. You'll be able to deduct expenses related to the dwelling. We explain below how to work out what proportion of expenses is deductible.

What portion of my expenses can I claim deductions for?

17. You'll be able to claim deductions for 100% of expenses that relate solely to your rental activity. Any expenses that relate solely to your private use of the dwelling are not deductible. But many of your expenses will relate to both your income-earning and private use of the dwelling, so will be only partly deductible.

18. If the dwelling is owned by a close company (eg, a family company), there are special rules for interest deductions. These rules aren't covered in this QWBA, but you can read about them in Inland Revenue's Special Report on mixed-use assets (14 August 2013), which is on Inland Revenue's website. The following paragraphs explain how the general rules work.

Expenses that are fully deductible

19. You may claim deductions for 100% of some expenses. To be fully deductible, the expense (which can't be a capital expense) must:

(1) relate solely to the use of the dwelling to derive income (not including exempt income); and

(2) meet either or both of the following:

(a) be expenditure that you wouldn't reasonably expect to receive a personal benefit from (or if a company owns the dwelling, no associate of the company would be reasonably expected to receive a personal benefit from);

and / or

(b) be expenditure that you must reasonably incur to meet a regulatory requirement to be able to use the dwelling to derive income, and you wouldn't have incurred the expenditure otherwise.

20. These expenses would include things like:

- advertising costs, including any commission or fee you pay to an advertising platform or transaction facilitator (this does not include any service fee the guests pay the platform – just fees you pay);
- supplies used solely by your paying guests;
- cleaning costs for the rental periods;
- any additional insurance premium you pay (over what you would otherwise pay) because you rent out the property; and

- any additional rates you pay (over what the normal residential rates would be) because you rent out the property.

21. You may also deduct 100% of the cost of repairing damage to the property that occurred when it was being used to earn income. This doesn't include when it's used to earn exempt income (which is in the two situations mentioned from [8]). It also doesn't include damage that's the result of ordinary wear and tear, as that occurs during both periods the dwelling is rented and periods it's used privately.

Expenses that are non-deductible

22. Any expenses that relate solely to the private use of the dwelling are not deductible. Private use includes use by you, by natural persons you're associated with, and by anyone for "mates' rates" of less than 80% of the market value rent. For example, if you use the dwelling for a month over the summer and you can identify actual usage charges that are a component to some of your expenses (eg, power), you can't deduct any of the usage component for that period as it relates solely to your private use of the dwelling. Similarly, any consumables you use at the dwelling are not deductible.

Expenses that are partly deductible

23. All of your other deductible expenses must be apportioned between the income-earning use of the dwelling, and the private use. This would be the case for expenses such as:
    - power bills;
    - internet expenses;
    - interest on your home loan;
    - property insurance (or what the insurance premium would be if you have to pay more because you rent out the property);
    - repairs and maintenance;
    - depreciation on chattels; and
    - rates (or what the normal residential rates would be if you have to pay more because you rent out the property).

24. There's a formula to use to apportion these expenses, so you know what proportion is deductible.

25. Under the formula, the proportion of expenses that are deductible reflects the income-earning use of the dwelling relative to the private use. Only days the dwelling is actually used are counted, so days it is available to be rented out but isn't actually rented out don't alter the proportion of expenses you may deduct.

26. For example, if you stayed at the dwelling for 30 nights a year, and rented it out for 25 nights, you could deduct 45.45% of your expenses (25 income-earning nights out of a total of 55 nights the dwelling was used).

27. The formula (in s DG 9 of the Income Tax Act 2007) refers to "days", but if a different unit of measure would give a more appropriate apportionment, you use that measure instead. For accommodation, "nights" would be the measure you would use. Therefore, the formula would be:

$$\text{your expenditure} \times \frac{\text{income-earning nights}}{\text{income-earning nights} + \text{counted nights}}$$

28. "Income-earning nights" are:

- **Nights the dwelling is used to earn income, <u>other than exempt income</u>**

  So nights you rent out the dwelling to someone who's associated with you or for "mates' rates" (less than 80% of the market value, as discussed from [12]) are **not counted** as "income-earning nights".

- **Nights you use the dwelling to repair damage caused by a renter**

  This **doesn't include** nights you stay at the dwelling to repair damage caused by renters you get exempt income from (which is in the two situations mentioned at [8] – associates and people paying "mates' rates"). It also **doesn't include** nights you stay at the dwelling to repair damage that's the result of ordinary wear and tear.

  Your use of the dwelling to carry out the repairs must be necessary for you to be able to count those nights as "income-earning nights". Therefore, you may only count the nights you need to stay at the dwelling to complete the repairs from damage caused on an "income-earning night".

- **Nights the dwelling was reserved by someone who didn't end up using it**

  These nights may be counted as "income-earning nights" if the dwelling isn't available for use because the person who'd reserved it didn't end up using it. For example, a no-show, or a cancellation close to the reserved date which means the dwelling can't be used by someone else.

29. "Counted nights" are:

- **Nights the dwelling is used, but aren't "income-earning nights"**

  This includes nights you use the dwelling, nights someone associated with you uses the dwelling, and nights the dwelling is rented out for less than 80% of the market value rent.

<table>
<tr><th colspan="2">Examples of "income-earning nights' and "counted nights"</th></tr>
<tr><th>Income-earning nights</th><th>Counted nights</th></tr>
<tr><td>
• You rent the property to a non-associated person at market rates.
• Guests damage the property:
  - You stay there for two nights and spend the whole weekend repairing the damage
    ➢ these are both income-earning nights
  - After a tiring weekend of repairs, you decide to stay for an extra 2 nights
    ➢ Only the nights you had to stay for the repairs are income-earning nights – the extra nights are "counted nights"
• A guest cancels on the first day of their 3-night booking and no-one else books the place for those nights.
</td><td>
• You stay at the property for a holiday.
• You rent the property to your in-laws at market rates.
• You rent the property to your best friend for "mates' rates" of $50 a night rather than the usual price of $100.
• Your in-laws or friend who stayed at "mates' rates" damage the property and you stay there for two nights to spend the weekend repairing the damage.
• The paint in the bedrooms is looking shabby, so you stay at the property for a week re-painting.
• A non-associated guest paying market rates damaged the property, but the damage is only minor and you fix it in a couple of hours on your next family holiday at the property.
</td></tr>
</table>

30. Example 1 at [37] shows how the apportionment formula works.

31. If you don't want to do the calculations yourself, there's a calculator on the Inland Revenue website that you can use to work out how much you may deduct for the expenses that need to be apportioned (eg, the expenses listed at [24]).

32. Remember, if the dwelling is owned by a close company, there are special rules for interest deductions, which aren't covered here. See [18] for where to find out more about those special rules.

Losses and the expenditure quarantine rules

33. If you make a loss from renting out the dwelling (that is, the deductible expenses for the year exceeded the rental income), you might not be allowed to deduct all of your expenses for that year. These rules are called the "expenditure quarantine rules", and if they apply, you may only deduct your expenses up to the amount of the rental income from the dwelling. Any deductions in excess of that are carried forward to future income years until they're able to be offset against any future profits from the dwelling (whether the mixed-use asset rules or the standard tax rules apply in the year that you make a profit from the dwelling).

34. If the expenditure quarantine rules apply, the effect is that the allowable deductions in excess of the income from the dwelling can't be offset against your income from other sources (eg, your salary and wage income).

35. The expenditure quarantine rules apply if:

- your income from renting out the dwelling during the income year was less than 2% of the property's value; and
- you made a loss from renting out the dwelling (that is, the deductible expenses for the year exceeded the income).

36. In working out if your income was less than 2% of the property's value, you **don't include** exempt income (described Figure 1 at [8]). It's your taxable income from the dwelling that has to meet the 2% threshold. This is illustrated in Example 1.

Example 1: Using the apportionment formula

Matt's holiday home has a rating value of $300,000. He bought the holiday home before the last time the rating value was reset. Matt rented out his holiday home for 20 nights in the income year, at $200 a night. All of the rental nights were to people he isn't associated with, and at full market rate. Matt used the holiday home for 35 nights, and his brother (an associated person) used it for 12 nights.

Matt's fully deductible expenses (which relate solely to the rental use of the holiday home) for the year were $230 for advertising, and a total of $500 for cleaning services after each guest (not including associates or friends paying "mates' rates"). The expenses Matt has that relate to both the rental activity and the private use of the holiday home total $20,000 (which includes home loan interest, rates, insurance, utility bills and general maintenance). Matt does not have any expenses that relate only to his private use of the holiday home.

Using the apportionment formula, Matt calculates that he may deduct $5,970.15 of those expenses:

$$\$20{,}000 \times \frac{20}{67} = \$5{,}970.15$$

So the total amount Matt may deduct is $6,700.15 ($230 + $500 + $5,970.15).

His total income from renting out the holiday home was $4,000 (20 nights × $200).

Therefore, Matt therefore has a net loss of -$2,700.15.

Two percent of the property value for the holiday home is $6,000. Because Matt's income from renting the holiday home ($4,000) is less than that, he may only deduct expenses up to the amount of income – so $4,000 worth. The remaining deductible expenses ($2,700.15) are carried forward to the next income year.

37. The property value you use to measure the 2% threshold against is generally the local rating value. However, if you bought the property from someone you aren't associated with since the rates value was last set, you use the purchase price.

> ***Note:*** *If you would otherwise have quarantined expenditure for an income year, you may instead choose to opt out of the mixed-use asset rules. This is discussed 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?*
>
> *If you do this, all of the income from renting out the dwelling is classed as exempt income and you can't claim any related expenses as deductions. However, this QWBA is about how the mixed-use assets rules apply if you haven't opted out of them.*

Who should declare the income?

38. The income belongs to the owner of the land (including leasehold land) and they must declare it to Inland Revenue. If there is more than one owner, the income needs to be split appropriately between them.

39. If the dwelling is owned in a trust, the rules about who has to declare the income are more complicated, and we recommend you see a tax advisor to help you with your affairs.

40. If you lease the property from a relative (other than a trust) and use it to earn income, you should ensure you're paying an adequate amount of rent for the property to the extent of the income-earning use. If you don't, the Commissioner can deem there to be adequate rent paid. This is to ensure that property can't be leased between relatives for low or nominal rent to shift income for a tax benefit (see s GC 5 of the Income Tax Act 2007).

What records do I need to keep?

41. Because the dwelling may or may not fall within the mixed-use asset rules (remember, you'll need to work out each year whether it does), you'll need to keep good records so you can apply the income tax rules correctly either way. This includes records of:

- the number of nights you rent out the dwelling at market value, and how much income you receive for this;
- the number of nights you rent out the dwelling at "mates' rates", and how much income you receive for this;
- the number of nights you, or people you're associated with, used the dwelling;
- when the dwelling was available to be rented out (this will be relevant if the standard rules apply);

- any expenses you want to claim deductions for; and
- any quarantined expenditure you have in respect of the dwelling.

Provisional tax

42. If the tax you have to pay at the end of the year is more than $2,500, you'll have to pay provisional tax the next year – which means you pay tax instalments during the year. There's information about provisional tax on the Inland Revenue website.

References

Subject references

bach
holiday house
income tax
mixed-use asset
short-stay accommodation

Legislative references

Income Tax Act 2007 – ss CC 1 and GC 5, and subpart DG

Other references

IR620 – Associated persons definitions for income tax purposes (April 2017)
Overview – Short-stay accommodation items (Inland Revenue)
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? (Inland Revenue)
Special Report on mixed-use assets, Inland Revenue (14 August 2013)