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The Bright-line test

Investing in bricks and mortar is as ingrained in the Kiwi psyche as the ability to fix anything with a bit of Number 8 wire and a 'she'll be right' attitude. For some, the connection between a rising housing market and the opportunity to turn a profit comes as a logical extension of that view, while for others the profit (or loss) through a transaction might come without intention or desire.

The Taxation (Bright-line Test for Residential Land) Act 2015 introduced amendments to the Income Tax Act 2007 and the Tax Administration Act 1994, and provides for a new income tax on capital gains realised through the sale or disposal of residential land within two years of purchase by way of a 'Bright-line test'.

Residential land for the purposes of the test includes:
- land with a dwelling;
- land where the owner has an arrangement to erect a dwelling; or
- bare land capable of having a dwelling built on it (within the relevant operative district plan)

but does not include business premises or farmland.

Although the finer details (and associated requirements) of the Bright-line test are an area perhaps better understood by industry specialists, having a basic understanding of the rules will be an advantage for those involved in property transactions where:
- land is owned for less than two years;
- more than one piece of residential land is owned; or
- where there is no dwelling on the residential land being sold.

In basic terms, if residential land was bought on or after 1 October 2015 and is sold within a two year period, a reporting requirement is triggered and the profit on the gain is subject to taxation as personal income of the vendor, unless it was their main home and the 'main home exclusion' (or other permitted exclusions) apply. To claim the 'main home exclusion' there must be a dwelling on the land that is mainly used as a residence by the owner or their family.

If you own one home and you live in it, the main home exemption will most likely apply unless you habitually buy and sell residential land or have used the exclusion more than twice in the previous two years.

If you own more than one home, and the one being sold has been used as your primary place of residence and more than 50% of your time is or was spent there (meaning it is the dwelling you are most connected with), the main home exemption will also likely apply. Something to be mindful of when buying a quick 'reno' or buying a crib on a rising market and selling it when you discover that you don't get in as much fishing as you planned.

In all transfers of bare land or transfers that are not of the main home, tax information must be provided. This circumvents the ability to purchase bare land in a development block or sign up an apartment yet to be completed while the market is rising in the hope of a sale prior to completion, in order to turn a quick profit without tax liability.

There are also rules that limit the ability to enter a contract to purchase in one name (nominator), and then nominate a subsequent party (nominee) to complete the transfer. An example would be 'off the plans' purchasing where registration of title takes place following the subdivision of land, as seen around Wanaka and Queenstown of late. In general terms, a small deposit secures an ability to purchase with a large payment due in a nominated time frame. If the 'ability' to purchase is transferred to a second party when the market has risen enough to provide a profit, this would now be caught by the Bright-line test, despite there being no transfer of title between nominator and nominee.

There are rules of association that can look through the alternative ownership structures that have traditionally been used to hold property for beneficial owners in New Zealand (i.e. Family Trusts or company structures. In these scenarios, any agreed lower than market sales price may be deemed to be 'at market value' introducing a potential tax liability. This extends to sales involving family members or people with close personal ties. The penalties for providing false or misleading information can be high. In these situations, seeking advice from a specialist is recommended.

In general, the Bright-line test covers the two year period from purchase to sale. In a family home or land with a dwelling scenario, this is from the date of registration of your name as registered proprietor on the Certificate of Title to the date you enter into an agreement to sell. For those wanting to have an extended contract to settlement period in an attempt to avoid tax on any gain, the Bright-line test captures these by creating a 'no-man's land' between the contract date and the subsequent transfer.

In a further blurring of the time lines, the start and end dates are different for different transfer scenarios. When a title is to be issued at a date some time after entering a contract to purchase bare land (in a buy and build package for example), the Bright-line period runs from the date of the entry into the

contract to purchase the land. A potential trap arises if the dwelling takes longer to build than planned and as a result it has not been used more than 50% of the time as the primary place of residence should it be sold within the two years of the entry to the land purchase contract. The end result being the main home exemption may not apply and a tax liability may exist despite the owner owning no other property.

Acquiring residential land through relationship property agreements and inheritance are treated slightly differently depending on the type of transfer of ownership. As a general rule there is an exclusion for relationship property agreements, and an exemption for transfers to executors or administrators of an estate. Subsequent sales by beneficiaries or those who have received residential land by way of relationship agreement may be included in the Bright-line period however. In situations of this nature seeking advice is advised.

The media attention surrounding the introduction of 'Capital Gains Tax' was surprisingly silent on the ability to off-set losses and costs against realised gains. The allowable deductions include rates and insurances incurred in the normal course of residential land ownership, to the extent that they are not private in nature. It is also important to note that while there are losses allowed as deductions against gains, unlike the American Federal taxation system that Donald Trump brought to global attention; losses are ring-fenced and can only be offset against taxable gains from the sale of other residential land rather than your personal taxable income. The gains however, must be reported as personal income and included in the reported income of the owners at the close of the financial year. Something to be mindful of should there be any income-based obligations such as child support or income tested benefits.

While the introduction of the legislation may not have been met with resounding applause 18 months ago, the purpose of the Bright-line test is not to catch out Mum and Dad on the sale of the family home. It is however intended to increase the national taxation revenues and resulting national fiscal position through the taxation of previously un-taxed personal gains. If you consider the big picture, all of us as members of society benefit from the taxation of others. So, if your goal is to make capital gains through property transactions, residential land transactions now have a little more skin in the game.

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