

May 2018

A special report from
Policy and Strategy, Inland Revenue

Extension of the bright-line test to five years

Sections CB 6A, CB 16A, DB 18A, DB 18AB, FB 3A, FC 9, FO 10, FO 17, GB 52, GB 53, and RL 1 of the Income Tax Act 2007; section 54C of the Tax Administration Act 1994

The Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018 introduced changes to the administration of employment and investment income information.

This special report provides early information on an extension to the bright-line test in the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018, enacted on 29 March 2018, and precedes full coverage of the new legislation in the June 2018 edition of the *Tax Information Bulletin*.

The bright-line test, recently extended from two to five years, determines whether tax should be paid when capital gain is realised when residential property (with some exemptions) is sold.

Background

As part of Budget 2015, the Government announced that it would introduce a bright-line test for the sale of residential property. This requires tax to be paid on any gains from the sale of residential property that is bought and sold within two years, with limited exceptions, including the sale of the main family home. The two year bright-line test came into effect for properties acquired on or after 1 October 2015.

Key features

The Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018 extends the period of the bright-line test to five years.

The amendments extend the two-year bright-line period to five years while maintaining the other policy settings supporting the bright-line test.

The bright-line test requires income tax to be paid on the gains from residential property bought and sold within five years, subject to some exemptions including the sale of the main home.

The result is that the following features of the two-year bright-line test will continue for the five-year bright-line test:

- The definition of “residential land” covered by the bright-line test includes land that has a dwelling on it, land where the owner has an arrangement to build a dwelling on it, and bare land that may be used for erecting a dwelling under the relevant operative district plan. Residential land does not include business premises or farmland.
- The current exemptions (that is, the main home, transfers upon death, or a transfer under a relationship property agreement) will continue to apply.
- The definition of main home includes a dwelling that has been used predominantly, for most of the time the person owns the land, as the person’s main home.
- The main home exclusion is available to properties held in trust. However, people cannot use the main home exclusion for multiple properties held through trusts.
- The main home exemption cannot be used if it has already been used twice in the two year period preceding the date of disposal, and also cannot be used by a person who has a regular pattern of buying and selling their main home.
- Residential land withholding tax will apply to taxable sales by offshore persons (that is, vendors who are living outside New Zealand).
- Specific anti-avoidance rules remain to counter companies and trusts being used to circumvent the bright-line test.
- Vendors will continue to be allowed deductions for property subject to the bright-line test according to ordinary tax rules.
- Losses arising from the bright-line test will remain ring-fenced so they may only be used to offset taxable gains from other land sales.

The two-year bright-line test will continue to apply to residential land if a taxpayer first acquired an interest in the land on or after 1 October 2015, but before 29 March 2018.

Application date

The five-year bright-line test applies to residential land if a taxpayer first acquires an interest in the land on or after 29 March 2018.