

# THE BRIGHT-LINE TEST THREE YEARS ON

The Bright-Line Test was promoted by the Government as a simple tool to tax property speculation, but even a simple tool can have complications. Thankfully, Inland Revenue has recently provided some clarification on some of the more complex scenarios.



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As most people know, the Bright-Line Test originally applied from 1 October 2015, taxing residential properties sold within the stipulated period of two years. That two-year period has since been extended to five years (if acquired on or after 29 March 2018).

The family's 'main home' has been excluded, but otherwise, the taxpayer's use of the residential property is irrelevant. This universal approach has made the rules simpler, but what has not been very clear is how the rules apply to the subdivision of land originally forming part of the undivided section of the family's main home. Doubt has also existed regarding where the boundary lies between residential land and 'farmland', which is excluded from the Bright-Line Test, in the context of lifestyle blocks. Further, there are some remaining issues that are still problematic.

### SALE OF SUBDIVIDED SECTION

Inland Revenue's guidance explains how the Bright-Line Test applies when there is a subdivision of land that has been used as part of the family's main home. It confirms that the main home exclusion can apply where:

- more than 50% of the area of the subdivided section has been used for a dwelling that was the seller's main home; and
- the seller used that land in that manner for more than 50% of the time since the undivided land was acquired.

The guidance provides an example where a subdivided section was used as the backyard for the dwelling for most of the time the land was owned. In that situation, the exclusion could apply. However, if the subdivided section was a construction site for a new investment property for most of the time the land was owned, the exclusion would not apply.

### LIFESTYLE BLOCKS

The Bright-Line Test only applies to 'residential land' and expressly excludes 'farmland'. In the context of a sale of a lifestyle property, there could potentially be residential and rural components.

Take the example of a 4ha section that consists of a house and curtilage in one corner, with the remainder of the property used for cattle grazing. If the property is sold, does the Bright-Line Test apply to the whole property, or just the house and curtilage? If it does apply to the whole property, can the main home exclusion have application to the whole property?

### WHETHER THE BRIGHT-LINE TEST APPLIES

In regard to the above example, Inland Revenue says in its guidance that the owner needs to demonstrate certain attributes, either:

- the bare-land was being worked in a farming or agricultural business, or
- due to its area and nature, it is capable of being worked as a farming and agricultural business.

Inland Revenue makes it clear that it will be difficult to satisfy the first limb, because the relevant test is based on

the traditional tests of what constitutes a 'business' activity. Equally, it will be difficult 'to show a lifestyle block is capable of being worked as a farming or agricultural business if the area of the block means it would not be 'capable of producing a profit when used for the proposed activity'.

In short, it seems in most cases the bare-land portion of a lifestyle property will be subject to the Bright-Line, except to the extent that the main home exclusion can be applied.

### CAN THE MAIN HOME EXCLUSION APPLY TO A LIFESTYLE BLOCK?

Inland Revenue's guidance confirms that the main home exclusion can apply to the home and curtilage on a lifestyle block where:

- more than 50% of the area of land has been used for the seller's main home; and
- the land has been used in that manner for more than 50% of the time the seller owned it.

The area used for the seller's main home includes the curtilage around the residence and other land used for residential purposes. Based on this, we consider the exclusion should apply in many common situations where the property has for most of the ownership period been used for hobby farming, pets, native plantings, and growing vegetables etc.

### OTHER ISSUES

We believe Inland Revenue's guidance is useful. However, there still remains some other aspects of the Bright-Line Test that require clarification or legislative attention.

### CONSTRUCTION PERIOD – MAIN HOME EXCLUSION

There is an issue where a main home has been recently constructed. While the owner may have resided in the family home for the whole time since it was completed, the relevant test period for residing is the entire ownership period, including any construction time. That test period might mean the owner does not qualify as having used the property as a main home for most of the time they owned it.

### ASSOCIATED PARTY RESTRUCTURES

The rules allow for relationship property transfers. But there can be other instances where a residential property would be transferred between associated entities. It seems unfair that the Bright-Line Test may be triggered even though ultimate control of the property remains the same.

### CONCLUSIONS

A simple tax rule is usually a good tool, but the weakness of any simple rule is that it can also be a blunt tool that can apply unfairly in marginal situations. We believe these few remaining issues could be resolved without adding undue complexity.

*If you have any questions regarding the application of the Bright-Line Test, contact Mike McDruery at [mmcdrury@srchch.co.nz](mailto:mmcdrury@srchch.co.nz), or your usual advisor before taking action.*