TaxMail

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Regular commentary from our experts on topical tax issues

Issue 2

Property bright-line test legislation introduced

Snapshot

In Budget 2015, the Government announced it would:

1. Collect IRD number and tax information from property buyers and sellers.
2. Tax residential land (other than the main home) bought and sold within 2 years.
3. Look at a withholding tax for non-resident sellers.

Draft legislation on the disclosure requirements (item 1) was introduced in June and has recently been through Parliamentary Select Committee scrutiny. Government yesterday introduced a Tax Bill containing the "bright-line" test (item 2). Both these changes will apply from 1 October, hence the need to legislate in haste. A withholding system for non-residents (item 3) is still under consideration.

Unfortunately, the bright-line test legislation retains a number of unwelcome features. The ring-fencing of losses and potential restrictions on deductibility remain. These are not justified from a policy perspective, in KPMG's view. We hope the Select Committee process will address these concerns.

It is disappointing that the draft legislation has not taken into account the various concerns about the bright-line test raised by KPMG and others during consultation in June

Unwelcome feature such as loss quarantining and potential restrictions on deductions remain. The Select Committee process is an opportunity to re-state those concerns

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What's in the draft legislation?

Bright-line test

The draft legislation is almost identical to the proposal consulted on in June. The detail of the bright-line proposal is in our June taxmail. The draft legislation does clarify a few features, which are outlined below.

Start and end dates for the bright line test

Bright line test period:	Start date	End date
Standard purchase	Registration date	Agreement for sale
Sales "off plan"	Contract to purchase	Agreement for sale
No registration or no contract to sell	Latest date property acquired	Latest date property disposed of
Subdivided land	Registration date of undivided land	Agreement for sale
Gifts	Registration date	Date of gift (generally registration date)
Compulsory acquisition or mortgagee sale	Registration date	Date of compulsory acquisition or disposal by mortgagee

Operation of the "main home" exemption

The main home exemption will not apply:

- to persons not residing in New Zealand; or
- if already used more than twice in the last two years.

For the exemption to apply, the property must be:

- predominantly used as a person's main home – most of the land area must be used for the home; and
- used for most of the time as their main home – used as their main home for more than 50% of the time the land is owned.

The main home exemption can be used for two properties in limited circumstances (i.e. where a person moves main homes within the 2 year period).

If a person owns more than one home, a "greatest connection" test must be used to determine their main home. This looks at the time each dwelling is occupied, where the immediate family live, where social and employment ties are strongest, and the location of personal property.

"Land rich" companies and trusts anti-avoidance rule

There is an anti-avoidance rule which applies if the intention is to avoid the bright-line test and:

- more than 50% of the value of a company is attributable to residential land and 50% or more of the shares in the company are disposed of within 12 months; or
- more than 50% of the value of the trust is attributable to residential land and the trust deed changes, a decision maker under the trust deed changes, or the arrangement under the trust deed changes.

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Disclosure requirements

From 1 October, buyers and sellers will need to provide their IRD numbers and other tax information, except where a sale relates to the main home. Persons classified as "offshore persons" will need to also maintain a New Zealand bank account. (Again, see our June taxmail for more detail on these requirements.)

The Finance and Expenditure Select Committee of Parliament, which scrutinised the draft legislation, has reported it back largely unchanged. In particular:

- The majority of the Select Committee recommended retaining the main home exemption from the disclosure requirements.
- The Select Committee recommended expanding the information required to be disclosed to also include:
  - whether a transfer relates to land that has a home on it; and
  - whether the buyer or seller, or a member of their immediate family, is a New Zealand citizen or resident visa holder and intended to live in the property.
- The Select Committee endorsed the use of immigration status, rather than tax residence, to determine who is an "offshore person". This will capture NZ citizens and resident visa holders who have not resided in New Zealand recently.

Our view

Only $5 million of additional revenue expected each year

Expected revenue from the bright-line test is minimal which strongly suggests Officials expect taxpayers to largely defer sales beyond the two year bright-line window. This rule will therefore largely capture those who have to sell.

However, taxpayers should not expect that deferral will safeguard against tax. Inland Revenue will have information on sales. We expect it will use this to target sales made shortly outside the two year bright-line window. Such sales should be taxable where the property was clearly purchased for resale.

Detailed design issues have not been addressed

It is disappointing that the draft legislation does not reflect the various concerns by KPMG and others. As noted in our June taxmail and submission on the bright-line proposal, these include:

- The date of registration, rather than the well-established contract date, to be used as the acquisition date of the land.
- The inability to deduct property holding costs, such as interest, if the cost is private in nature. This will be the case even though any gain will be taxable under the bright line test.
- Loss ring-fencing. Losses will remain deductible under the intention test. This will create incentives for taxpayers to argue the existing land rules apply to losses during the bright-line period. This is likely to lead to further disputes with Inland Revenue.
- The wide scope of the proposed land rich company and trust anti-avoidance rule. The anti-avoidance rule for changes in trust or decision makers of a trust, in particular, will need management. As currently drafted, it is unclear how this rule would apply in practice. For example, common reasons for a change in trust decision maker would be death, divorce or a change of lawyer.

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Disclosure requirements will increase compliance costs

The Select Committee report notes that a number of submitters recommended that all property transactions, including the main home, should be subject to the disclosure requirement. KPMG supports this view.

The Select Committee weighed up the additional administrative costs on Inland Revenue and Land Information NZ versus the compliance costs on taxpayers. We believe the administrative impact of removing the main home disclosure exemption is likely to be overstated. This information should be able to be collected and processed electronically. In contrast, there will be real compliance costs for taxpayers in determining if the exemption applies. Taxpayers could also be in the position of having incorrectly applied the main home exemption, for disclosure purposes, if reliance on the same exemption is successfully challenged by Inland Revenue under the bright-line test.

Interestingly, in circumstances where disclosure is needed, the Select Committee has recommended increasing the information to be collected from buyers and sellers to improve information available to policy makers. The trade-off, again, is additional compliance costs.

Publicly available information to determine tax status

A potentially significant change in approach is Officials willingness to rely on publicly available information to determine a taxpayer's status, for tax purposes, rather than subjective factors which are open to dispute. There are two examples. The use of title registration as this is publicly available and verifiable information and immigration status, rather than tax residence, in the "offshore person" definition.

This is an intriguing development. We note that, at least for title registration, this approach works in Inland Revenue's favour. It shortens the time for which a property is actually owned. There are many of examples of expenditure which cannot be deducted when recognised for financial reporting purposes. We suspect that Inland Revenue is less likely to take the same approach to these examples.

Next steps

We expect the draft legislation containing the bright-line test will be referred to the Finance and Expenditure Select Committee for submissions to be considered. If so, we strongly encourage those impacted to make their views known to ensure the rules are workable. Some of the practical concerns will need to be re-stated.

As both sets of changes will need to be enacted by 1 October this year, there is likely to be a shortened time frame for further comments on the bright-line test.

For further information

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