

# **Taxation (Bright-line Test for Residential Land) Bill**

Government Bill

As reported from the Finance and Expenditure Committee

## **Commentary**

### **Recommendation**

The Finance and Expenditure Committee has examined the Taxation (Bright-line Test for Residential Land) Bill and recommends by majority that it be passed with the amendments shown.

### **Introduction**

This bill seeks to amend the Income Tax Act 2007 and the Tax Administration Act 1994. It would introduce a “bright-line” test,<sup>1</sup> requiring income tax to be paid on any gains from the sale of residential land that is bought and sold within 2 years, with some exceptions.

A person’s main home would generally be exempt. There would also be exemptions for inherited property, and for property transferred under a relationship property agreement. Under some circumstances, trusts would qualify for the main home exemption.

The bright-line test would apply only to residential land. Farmland and business premises would remain subject to existing land sale rules, which make gains from sale taxable in certain circumstances.

The bright-line test would supplement the existing “intention” test in section CB 6 of the Income Tax Act 2007, which makes gains from the sale of land taxable if the land was bought with an intention to resell. A main objective of the new test is to create an easy to enforce rule for short-term residential land sales. The existing test is difficult

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<sup>1</sup> A bright-line test is a term used in law for a clearly-defined rule or standard, using objective factors, which is designed to produce predictable and consistent results.

to enforce because of the subjectivity involved in proving what a person intended at the time of purchase.

The new test would apply to sales of property acquired on or after 1 October 2015.

### **Coherence with other rules and tax reforms**

This bill is the second in a three-part package of reforms to the rules for taxation of residential land. The reforms were announced in Budget 2015, and are designed to ensure that those who buy residential property with the intention of selling for capital gain, including overseas speculators, pay their fair share of tax.

Royal assent has recently been given to the first part of these reforms: the Land Transfer Amendment Act 2015, and the Tax Administration Amendment Act 2015. Both of these Acts were derived from the Taxation (Land Information and Offshore Persons Information) Bill, which we considered and reported on in August 2015. The new legislation will allow better information to be gathered from buyers and sellers for use in ensuring tax compliance.

Public consultation is now taking place on proposals for a potential third bill, which would impose a withholding tax on sellers of New Zealand residential property who live overseas.

Submitters stressed to us the importance of ensuring that the reforms in the three bills form a coherent whole, and fit well into the existing body of tax legislation. We agree, and propose that when considering the third bill, both Parliament and officials should give careful thought to any adjustments that might be desirable to ensure that the rules work effectively together.

### **Alternative approach considered**

In response to submissions, we considered whether the bill's policy objective could be achieved by incorporating the bright-line test into the existing intention test, rather than having it supplement this intention test as a new section of the Income Tax Act. It was suggested to us that the intention test in existing section CB 6 could be amended to provide that, if land was sold within 2 years, it would be treated as if it were acquired with the intention of resale. The exemptions from existing land sale rules would continue to apply.

We do not favour this alternative approach, and believe the policy intent of the bright-line rule would be met better by having it as a separate section of the Act with specific exemptions that apply to it, as in the bill as introduced. As an example of our reasoning, we outline below the way the sale of a person's main home would be treated under the bill and the alternative.

#### **Main home exemption**

As introduced, the bill would exempt a person's main home from the bright-line test. Where a person has more than one home, the main home would be the one with which they have the greatest connection. A second home, such as a beach house or a

flat in town, would not be exempt. The majority of us believe this approach is appropriate for the policy intention of the bright-line rule.

The alternative approach would retain the “residential exclusion” in the existing land sales provisions of the Act. This would allow any dwelling used as a person’s residence to be exempt, including a holiday home. Multiple homes placed in trusts by a person could be exempt even if they did not live in them.

## **Recommended amendments**

We discuss in the following sections the main amendments we recommend to the bill as introduced.

We do not discuss minor or technical amendments. For example, proposed new clauses 4B, 4C, 10B, and 10C are recommended simply to insert cross-references, making it clear how the bill’s provisions fit into existing legislation.

## **Definitions and terms**

### **“Date of disposal”**

We recommend using the term “bright-line date” instead of “date of disposal” to avoid potential confusion with other “disposals” already in the Income Tax Act. This change mainly affects clause 4(1), new section CB 6A, and clause 15, section YA 1.

### **“Farmland”**

We recommend amending the definition of “farmland” in clause 15(7) to make it clear that the exemption from the bright-line rule is intended to apply to land used for a farming or agricultural business, but not to a lifestyle block or hobby farm. Under our proposed definition, a small parcel of land would be exempt if it were used in combination with other land for a farming business. The definition in the bill as introduced, using the concept of an economic unit, would have ruled out such a situation.

### **“Residential land”**

In the bill as introduced, “residential land” would be defined as including bare land that, “because of its area and nature is capable of having a dwelling erected on it”. We accept that most bare land would appear to meet this test, making the definition vague and difficult to apply. We recommend amending clause 15(11) so that “residential land” that is bare land would be defined by reference to the relevant land zoning rules.

### **Other terms**

For consistency and clarity we also recommend changes to some other technical terms. For example, clause 4, new section CB 6A(1)(b) would refer to registering an instrument to transfer land, instead of simply registering the land.

### **Start date for the two-year bright-line test**

Clause 4 would insert new section CB 6A in the Income Tax Act 2007, setting out the bright-line test that would apply to income derived from the disposal of residential land within 2 years of acquisition.

We considered carefully how the two-year bright-line period would be measured. Under the bill as introduced the start date would be when the transfer of title is registered, while the disposal date would be when an agreement for sale and purchase is signed.

We acknowledge that arguments can be made for using the date of signing an agreement for sale and purchase as the start of the two-year period, as well as its end. However, with one exception which we discuss next, we consider that the proposal in the bill as introduced should be retained. The only date recorded online by Land Information New Zealand for property transactions is the registration date. Use of this date should make the bright-line test easy to enforce—an important objective—and would therefore help with compliance.

### **Sales of contingent interests: “off the plan” sales**

We propose that a different start date be used to calculate the two-year period for the bright-line test in situations where a person acquires a property “off the plan” and only later receives registered title to the property. In this case, we recommend that the two-year period start on the date when the contract to purchase the property is signed. We recommend amending clause 4, inserting new section CB 6A(2C) to make this change.

Our reason for having a separate start date in such cases is that applying the standard bright-line rule could be confusing and unduly harsh for purchasers, given the length of time normally needed for development of a subdivision or construction of a multi-dwelling complex such as an apartment block.

We note that where a purchaser sold before title was issued, they would be liable for tax on any income earned from the sale, if within 2 years.

### **Leases with perpetual right of renewal**

In clause 4, we recommend inserting new section CB 6A(2B) to address the position of perpetually-renewable leases, commonly known as Glasgow leases. We note that because such leases have no defined term, they are more like a freehold estate. We propose a concession to the bright-line rules so that a leaseholder who bought the freehold title to their property would be treated as having owned the property from the beginning of their lease, rather than from the date of acquiring the freehold estate.

### **Relationship with other land rules**

We recommend amending clause 4 by adding subsection (3B) to new section CB 6A specifying the relative priorities as to how the bright-line test would fit into existing rules for the disposal of land. The new provision would make it clear that the bright-

line test would apply only when none of the rules in sections CB 6 to CB 12 applied. Sections CB 13 and CB 14 would apply only when the bright-line test did not apply.

### **Main home exemption**

As noted, the bright-line test would generally not apply to the sale of a person's main home. However, this exception (or "exclusion") could be used only twice in a two-year period. Income from a third sale would be taxable (clause 6, new section CB 16A(2)). We endorse this approach, as it supports the policy intention to ensure that speculators in residential property pay their fair share of tax. However, we do not believe it goes far enough, and could send the wrong message that gains from habitual trading could be tax-free if it was a person's main home.

We therefore recommend inserting subsection (2)(b) to specify that the exclusion would not be available if a person appeared to be a habitual trader in residential property by engaging in a regular pattern of acquiring and disposing of residential land. While such activity would be taxable under the existing intention test, we believe this addition would help to make that clear.

### **Exemption for trusts**

Clause 6 provides that a trustee of a trust could generally use the main home exclusion from the bright-line rule if the property was the main home of a trust beneficiary. They could not do so in some situations, for example if the principal settlor of the trust (that is, the person who had put the most money into the trust) owned a different main home.

We recommend some amendments in clause 6 (new section CB 16A(1)(b) and (3)) and clause 15(11B) to clarify aspects of this "principal settlor" rule.

### **Other potential exemptions**

We considered whether exceptions from the bright-line test should be allowed in cases of hardship or other circumstances where a property owner was forced to sell within 2 years for reasons outside their control. However, we do not consider that such exceptions would fit with the policy intent of the bill. They would entail subjective assessments and would add complexity to a rule that is meant to be objective, clear, and easy to enforce. Nevertheless, we have asked the Inland Revenue Department to monitor the effect of the legislation. We note that hardship provisions in existing tax administration law could be called on in some situations.

### **Ring-fencing of losses**

Under the proposed bright-line rule, if a property was sold within 2 years at a loss the losses would be "ring-fenced", and could only be used to offset tax owed from the sale of another property.

Several submitters pointed out that this would create an imbalance. In certain circumstances, losses might never be deductible although any gains from the same sale would have been taxable under the bright-line test. People could potentially be left

with a “black-hole” loss that they could not deduct against other income. We acknowledge that this is a possibility. However, we consider that the risk of losses is an inherent part of property investment, while the revenue risk of allowing unrestricted deductibility for losses could be significant. We therefore do not propose any change to this provision.

### **Land-rich companies and trusts**

Clause 14, new section GB 52, contains anti-avoidance provisions designed to address the risk that land-rich companies and trusts might be used to circumvent the bright-line test. We recommend some amendments to improve the clarity and workability of these provisions.

### **Non-active trusts**

Part 2 of the bill would amend the Tax Administration Act 1994. It would allow non-active trusts to be excused from filing tax returns. Again, we recommend some amendments to improve the clarity and workability of these provisions.

### **Minority views**

#### **New Zealand Labour Party**

The Labour Party believes that this bill has been exposed in the select committee process as a purely political response to the National Party’s failure to control speculation in the housing market. It is a token gesture when meaningful action is required. The fact that officials have said that implementation of the bright-line test will only raise an additional \$5 million per annum emphasises this point.

A number of submitters to the committee raised the concerns that the legislation will fail to capture the real speculators who will simply wait out the two-year period, and then continue to exploit the loopholes in the current intention test. We were told that those most likely to be captured by the new regime will be people who, because of unforeseen circumstances, will be forced to sell inside 2 years. We note that the Treasury advised the Government that if they were to undertake an initiative such as this there should be a five-year bright-line test. Such a length of time is common in other countries.

We are also concerned that this legislation fails the basic test for tax law to be clear and simple to implement. Several submitters raised concerns about this legislation being inconsistent with other property tax law in definition and coverage. This concern was exemplified by a senior partner at one of the major accounting firms who submitted to the committee that he was “professionally confused” by the legislation.

The legislation is beset with definitional difficulties, including a repeat of the very loose definition of the main home from the recent Taxation (Land Information and Offshore Persons Information) Bill, inconsistency with other legislation in terms of the dates of acquisition and disposal of land, and potential difficulty caused by the definition of residential land.

The Labour Party believes that the truncated select committee process, even though the legislation is already being implemented retrospectively, means that there will be mistakes in this bill. We are not confident that all of the implementation issues have been thought through, and it is inevitable that Parliament will need to amend this legislation in the future.

The goal of this legislation to take action to limit speculation in the property market is an important one; sadly this bill falls well short of what is needed.

### **Green Party of Aotearoa / New Zealand**

The Green Party supports the intention of this bill, to reduce pressure on the Auckland housing market by introducing a new tool to better enforce existing tax rules regarding property sales. However, we find this legislation to be insufficient in several respects. Many submitters on this bill raised the point that tax legislation should be simple, coherent, and comprehensive to be effective, and this bill is overly complex and leads to some inconsistencies. The curtailed period during which the select committee was able to consider the bill contributed to a less than ideal outcome, as officials, submitters, and members of the committee had significantly less time to consider the full implications of the legislation and options for improvement.

Firstly, the bill only applies to residential land, despite the fact the existing tax rules around property speculation apply to all land. Most submitters agreed that the rules would be simpler and easier to enforce if they applied to all land equally. The definition of “residential” versus other types of land in the bill may be difficult to apply and could result in a loophole by which some land being purchased and sold by speculators that may eventually be used for residential purposes is not captured by the rule. Additionally, the rule as drafted may have the unintended consequence of encouraging more speculation in non-residential land and the existing tax rules will still be difficult, if not impossible, to enforce.

Secondly, the two-year period is simply too short. It will still be relatively easy for speculators to avoid the rule by holding property just over 2 years. Most other OECD countries have a holding period of at least 5 years, some much longer. The Green Party would support a longer holding period of at least 5 years.

This bill takes some very tiny steps in the direction of closing the tax loophole on property, but as drafted it is unlikely to make a significant difference. The Green Party would prefer a comprehensive capital gains tax (excluding the family home) which would mean that income from purchasing and selling property is taxed like all other income. This would be fairer and also more effective at reducing the rate of house price inflation.

### **New Zealand First Party**

New Zealand First insists that this Government is deliberately avoiding the real issues involved in the Auckland housing market property bubble. There is a supply side issue, but more importantly it is a demand side issue that is not being addressed. Reserve Bank lending data conclusively highlights the large extent of New Zealand’s

growing property speculation problem. Their numbers tell us that 45 percent of all mortgage lending is going to property speculators or investors and only 12 percent is going to first-home buyers. Further, this is not a snapshot of the whole New Zealand market as cash buyers and offshore mortgage facilities are not included in these numbers.

There is already legislation in our statute books that would effectively deal with the speculation of property if only it was updated and enforced.

New Zealand First asserts in chorus with New Zealand tax specialists that speculators will simply change their behaviour. They will not be caught by the two-year bright-line period.

This then means that those who will be “caught” by the bright-line test will be those people who have been caught out by circumstance. Under the existing legislation they would be described as having no intention of profiteering from sale of residential property.

The draft bill only applies to residential land and even then the definition used in this bill is not consistent with the definition used in other property taxation bills.

This has been yet another truncated process that has undermined the ability of, not only concerned New Zealand citizens and tax specialists, but the IRD themselves to provide meaningful solutions to what was originally a poorly drafted piece of legislation. New Zealand First strongly urges this Government to go back to the drafting table. There is a need for a full review of the three stages of reforms.

New Zealand First opposed this bill from the start. The stated intentions are good, exemplary even. However, the piece of legislation before us adds confusion, complexity, has too many loopholes, and is literally a backwards step in the enforcement of profiteering from speculation.

## **Appendix**

### **Committee process**

The bill was referred to the committee on 8 September 2015. The closing date for submissions was 17 September 2015. We received and considered 10 submissions from interested groups, and heard orally from six of the submitters.

We received advice from the Inland Revenue Department and our specialist tax advisor, Therese Turner (Chartered Accountant).

### **Committee membership**

David Bennett (Chairperson)

Andrew Bayly

Chris Bishop

Hon Clayton Cosgrove

Julie Anne Genter

Stuart Nash

Rt Hon Winston Peters

Grant Robertson

Jami-Lee Ross

Alastair Scott

David Seymour



**Key to symbols used in reprinted bill**

**As reported from a select committee**

text inserted by a majority

~~text deleted by a majority~~



*Hon Todd McClay*

## **Taxation (Bright-line Test for Residential Land) Bill**

Government Bill

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**The Parliament of New Zealand enacts as follows:**

**1 Title**

This ~~is~~ Act is the Taxation (Bright-line Test for Residential Land) Act **2015**.

**2 Commencement**

This Act comes into force on the day on which this Act receives Royal assent, except **Part 1** comes into force on 1 October 2015. 5

**Part 1**

**Amendments to Income Tax 2007**

**3 Income Tax Act 2007**

This Part amends the Income Tax Act 2007.

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#### 4 New section CB 6A inserted (Disposal within 2 years: bright-line test for residential land)

- (1) Before section CB 6, insert:

##### CB 6A Disposal within 2 years: bright-line test for residential land

###### *Disposal within 2 years*

- (1) An amount that a person derives from disposing of residential land is income of the person, if the bright-line date~~date of disposal~~ for the residential land is within 2 years of—

- (a) the date on which the instrument to transfer the land to the person was registered—

- (i) under the Land Transfer Act 1952; or  
(ii) under foreign laws of a similar nature to the Land Transfer Act 1952, if the land is outside New Zealand; or

- (b) their date of acquisition of the land, if an instrument to transfer the land to the person is not registered on or before the bright-line date.

- ~~(b) their date of acquisition of the land, if the land is not registered as described in **paragraph (a)** at the date of disposal.~~

###### *Subdivision*

- (2) Despite **subsection (1)**, an amount that a person derives from disposing of residential land that results from the person subdividing other land (the **undivided land**) is income of the person, if the bright-line date~~date of disposal~~ for the residential land is within 2 years of—

- (a) the date on which the instrument to transfer the undivided land to the person was registered—

- (i) under the Land Transfer Act 1952; or  
(ii) under foreign laws of a similar nature to the Land Transfer Act 1952, if the land is outside New Zealand; or

- (b) their date of acquisition of the undivided land, if the land is not registered as described in **paragraph (a)** at the bright-line date~~date of disposal~~.

###### *Leases with perpetual right of renewal*

- (2B) Despite **subsection (1)**, an amount that a person derives from disposing of a freehold estate in land, acquired as the owner of a leasehold estate with a perpetual right of renewal, is income if the bright-line date for the freehold estate is within 2 years of the grant of the leasehold estate.

###### *Contingent interest*

- (2C) Despite **subsection (1)**, an amount that a person derives from disposing of a freehold estate in land, acquired as the result of the completion of a land development or subdivision, is income if the bright-line date for the freehold estate

is within 2 years of the person acquiring an interest, in relation to the land, that is contingent upon the completion of the land development or subdivision.

*Exception: disposal of land by executor, administrator, or beneficiary*

- (3) This section does not apply to an amount that an executor or administrator described in section FC 1(1)(a) (What this subpart does), or a beneficiary described in section FC 1(1)(b), derives from disposing of residential land that was transferred to them on the death of a person.

Relationship with subject matter

- (3B) This section applies if none of sections CB 6 to CB 12 apply.

*Some definitions*

- (4) In this section and **section CB 16A**,—

**bright-line date** means, for a disposal of residential land,—

- (a) the earliest of—

(i) the date that the person enters into an agreement for the disposal:

(ii) the date on which the person makes a gift of the residential land:

(iii) the date on which the person's residential land is compulsorily acquired under any Act by the Crown, a local authority, or a public authority:

(iv) if there is a mortgage secured on the residential land, the date on which the land is disposed of by or for the mortgagee as a result of the mortgagor's defaulting; or

- (b) if none of **paragraph (a)(i) to (iv)** apply, the date on which the estate or interest in the residential land is disposed of

**date of acquisition** means the latest date on which the person acquires ~~the~~an estate or interest in the residential land.

~~**date of disposal** means, for a disposal of residential land,—~~

- ~~(a) the earliest of—~~

~~(i) the date that the person enters into an agreement for the disposal:~~

~~(ii) the date on which the person makes a gift of the residential land:~~

~~(iii) the date on which the person's residential land is compulsorily acquired under any Act by the Crown, a local authority, or a public authority:~~

~~(iv) if there is a mortgage secured on the residential land, the date on which the land is disposed of by or for the mortgagee as a result of the mortgagor's defaulting; or~~

- ~~(b) if none of **paragraph (a)(i) to (iv)** apply, the date on which property in the residential land is disposed of~~

Defined in this Act: amount, bright-line date, date of acquisition, ~~date of disposal~~, dispose, estate, income, interest, land, mortgage, person, residential land, year

- (2) **Subsection (1)** applies to a person's disposal of residential land if the date that the person first acquires an estate or interest in the residential land is on or after 1 October 2015.

**4B Section CB 13 amended (Disposal: amount from major development or division and not already in income)**

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- (1) In section CB 13(1)(a), replace “sections CB 6” with “**sections CB 6A**”.
- (2) **Subsection (1)** applies to a person's disposal of residential land if the date that the person first acquires an estate or interest in the residential land is on or after 1 October 2015.

**4C Section CB 14 amended (Disposal: amount from land affected by change and not already in income)**

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- (1) In section CB 14(1)(a), replace “sections CB 6” with “**sections CB 6A**”.
- (2) **Subsection (1)** applies to a person's disposal of residential land if the date that the person first acquires an estate or interest in the residential land is on or after 1 October 2015.

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**5 Section CB 15B amended (When land acquired)**

- (1) In section CB 15B(1), replace “For the purposes of this subpart” with “For the purposes of this subpart except **section CB 6A**”.
- (2) **Subsection (1)** applies to a person's disposal of residential land if the date that the person first acquires an estate or interest in the residential land is on or after 1 October 2015.

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**6 New section CB 16A inserted (Main home exclusion for disposal within 2 years)**

- (1) Before section CB 16, insert:

**CB 16A Main home exclusion for disposal within 2 years**

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*Main home exclusion*

- (1) **Section CB 6A** does not apply to a person who disposes of residential land, if the land has been used predominantly, for most of the time the person owns the land, for a dwelling that was the main home for—
- (a) the person; or
- (b) a beneficiary of a trust, if the person is a trustee of the trust and—
- (i) ~~the person is a trustee of the trust; and~~
- (ii) ~~the~~ principal settlor of the trust does not have own a main home; ~~or and~~
- (iii) if ~~the~~ principal settlor of the trust does have as a beneficiary of a ~~trust that owns the principal settlor's~~ main home, it is that main home which the person is disposing of.

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|     |                                                                                                                                                                                                                                                                                                               |    |
|-----|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----|
|     | <i>When this section does not apply</i>                                                                                                                                                                                                                                                                       |    |
| (2) | The exclusion in <b>subsection (1)</b> does not apply to a person who disposes of residential land if—                                                                                                                                                                                                        |    |
|     | (a) the exclusion has been used by the person 2 or more times within the 2 years immediately preceding the bright-line date for the residential land;                                                                                                                                                         | 5  |
|     | (b) the person has engaged in a regular pattern of acquiring and disposing of residential land.                                                                                                                                                                                                               |    |
| (2) | <del>The exclusion from <b>section CB 6A</b> in <b>subsection (1)</b> does not apply to a person who disposes of residential land, if that exclusion has been used by the person 2 or more times within the 2 years immediately preceding the date of disposal of the residential land.</del>                 | 10 |
|     | <i>A definition</i>                                                                                                                                                                                                                                                                                           |    |
| (3) | <del>In this section, <b>principal settlor</b> means, for a trust, the 1 settlor that has settled the most property, by value, on the trust.</del>                                                                                                                                                            |    |
| (3) | <u>In this section, <b>principal settlor</b> means, for a trust, a settlor whose settlements for the trust are the greatest or greatest equal, by market value.</u>                                                                                                                                           | 15 |
|     | Defined in this Act: beneficiary, <u>bright-line date</u> , <del>date of disposal</del> , dispose, dwelling, <u>land</u> , main home, <del>own</del> , person, principal settlor, residential land, <u>settlement</u> , settlor, trustee, year                                                                |    |
| (2) | <b>Subsection (1)</b> applies to a person's disposal of residential land if the date that the person first acquires an estate or interest in the <u>residential</u> land is on or after 1 October 2015.                                                                                                       | 20 |
| 7   | <b>Section CB 23B amended (Land partially sold or sold with other land)</b>                                                                                                                                                                                                                                   |    |
| (1) | In section CB 23B, replace “CB 6” with “ <b>CB 6A</b> ”.                                                                                                                                                                                                                                                      |    |
| (2) | <b>Subsection (1)</b> applies to a person's disposal of residential land if the date that the person first acquires an estate or interest in the <u>residential</u> land is on or after 1 October 2015.                                                                                                       | 25 |
| 8   | <b>New sections DB 18A and DB 18AB inserted</b>                                                                                                                                                                                                                                                               |    |
| (1) | Before section DB 18, insert:                                                                                                                                                                                                                                                                                 |    |
|     | <b>DB 18A Ring-fenced allocations: disposal of residential land within 2 years</b>                                                                                                                                                                                                                            |    |
|     | <i>When this section applies</i>                                                                                                                                                                                                                                                                              | 30 |
| (1) | This section applies to an amount of a person's deductions ( <b>bright-line deductions</b> ) under section DB 23, for an income year, that relate to residential land for which the person derives income solely under <b>section CB 6A</b> (Disposal within 2 years: bright-line test for residential land). |    |
|     | <i>Basis for allocation of deductions: formula</i>                                                                                                                                                                                                                                                            | 35 |
| (2) | The amount of bright-line deductions allocated to an income year, including an amount that has been carried forward and allocated under <b>subsection (43)</b> , is no more than the amount calculated by the formula:                                                                                        |    |

bright-line income + land net income.

*Definition of items in formula*

- (3) In the formula,—
- (a) **bright-line income** is income derived solely under **section CB 6A**;
  - (b) **land net income** is the amount of net income for the year that the person would have if the only income they derived was from the disposal of land under sections CB 6 to CB ~~14~~<sup>15</sup> (which relate to income from land).

*Excess allocations: carried forward and re-instated next year*

- (4) Any excess deductions not allocated to the income year because of **subsection (2)** are carried forward and treated as—
- (a) deductions under section DB 23 that relate to residential land for which the person derives income solely under **section CB 6A**; and
  - (b) allocated to the next income year.

*Restriction on re-instating excess allocations: continuity for companies*

- (5) Despite **subsection (3)**, the excess is not allocated to the next income year, and no deduction is allowed or allocated to any income year for the excess, if sections IA 5 and IP 3 (which relate to the carrying forward of tax losses for companies) would not have allowed the excess to be carried forward to that next income year in a loss balance, treating the excess as a tax loss component arising on the last day of the income year.

Defined in this Act: deduction, dispose, income, income year, land, loss balance, net income, residential land, tax loss component

**DB 18AB Deduction cap: disposal of residential land within 2 years to associated persons**

*When this section applies*

- (1) This section applies to a person (**person A**) if, for an income year,—
- (a) person A derives income solely under **section CB 6A** (Disposal within 2 years: bright-line test for residential land) from disposing of residential land to an associated person; and
  - (b) person A has deductions for expenditure or loss in relation to the disposal of the land (**residential land deductions**).

*Deduction cap for person A and transfer to associated person*

- (2) The total residential land deductions that person A is allowed is no more than the amount of income they derive under **section CB 6A** from the disposal of the land. Deductions not allowed to person A under this section are treated as

~~expenditure that the associated person has in relation to acquiring the land under this subsection are not allowed or allocated to any income year.~~

Defined in this Act: associated person, deduction, dispose, income, income year, land, person, residential land

- (2) **Subsection (1)** applies to a person's disposal of residential land if the date that the person first acquires an estate or interest in the residential land is on or after 1 October 2015. 5

**9 Section DB 29 amended (Apportionment when land acquired with other property)**

- (1) In section DB 29, replace “CB 6” with “**CB 6A**”. 10
- (2) **Subsection (1)** applies to a person's disposal of residential land if the date that the person first acquires an estate or interest in the residential land is on or after 1 October 2015.

**10 New section FB 3A inserted (Residential land)**

- (1) Before section FB 3, insert: 15

**FB 3A Residential land**

*When this section applies*

- (1) This section applies for the purposes of **section CB 6A** (Disposal within 2 years: bright-line test for residential land) and Part D (Deductions) when residential land is transferred on a settlement of relationship property. 20

*Transfer at cost*

- (2) The transfer is treated as a disposal and acquisition for an amount that equals the total cost of the residential land to the transferor at the date of transfer.

*Date of acquisition*

- (3) The transferee is treated as having acquired property in the residential land on the relevant date, for the transferor's acquisition, in **section CB 6A(1)(a) or (b)**. 25

~~*Date of acquisition*~~

- (3) ~~The transferee is treated as having acquired property in the residential land on the date of acquisition for the transferor described in **section CB 6A**.~~ 30

Defined in this Act: ~~date of acquisition~~, date of transfer, dispose, residential land, settlement of relationship property

- (2) **Subsection (1)** applies to a person's disposal of residential land if the date that the person first acquires an estate or interest in the residential land is on or after 1 October 2015. 35

**10B Section FC 3 amended (Property transferred to spouse, civil union partner, or de facto partner)**

- (1) After section FC 3(2), insert:

|             |                                                                                                                                                                                                                   |    |
|-------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----|
|             | <i>Relationship with subject matter</i>                                                                                                                                                                           |    |
| (3)         | <b>Section FC 9</b> overrides this section for certain transfers of residential land.                                                                                                                             |    |
| (2)         | In section FC 3, in the list of defined terms, insert “residential land”.                                                                                                                                         |    |
| (3)         | <b>Subsection (1)</b> applies to a person’s disposal of residential land if the date that the person first acquires an estate or interest in the residential land is on or after 1 October 2015.                  | 5  |
| <b>10C</b>  | <b>Section FC 4 amended (Property transferred to charities or to close relatives and others)</b>                                                                                                                  |    |
| (1)         | After section FC 4(2), insert:                                                                                                                                                                                    |    |
|             | <i>Relationship with subject matter</i>                                                                                                                                                                           | 10 |
| (3)         | <b>Section FC 9</b> overrides this section for certain transfers of residential land.                                                                                                                             |    |
| (2)         | In section FC 4, in the list of defined terms, insert “residential land”.                                                                                                                                         |    |
| (3)         | <b>Subsection (1)</b> applies to a person’s disposal of residential land if the date that the person first acquires an estate or interest in the residential land is on or after 1 October 2015.                  | 15 |
| <b>11</b>   | <b>New section FC 9 inserted (<del>Residential land</del> Land transferred to executor, administrator, or beneficiary on death of person)</b>                                                                     |    |
| (1)         | After section FC 8, insert:                                                                                                                                                                                       |    |
| <b>FC 9</b> | <b><del>Residential land</del> Land transferred to executor, administrator, or beneficiary on death of person</b>                                                                                                 | 20 |
|             | <i>What this section applies to</i>                                                                                                                                                                               |    |
| (1)         | This section applies in the circumstances described in section FC 1(1)(a) or (b) when residential land is transferred on a person’s death and section FC 5 does not apply.                                        |    |
|             | <i>Residential land</i>                                                                                                                                                                                           | 25 |
| (2)         | <b>Section CB 6A</b> (Disposal within 2 years: bright-line test for residential land) does not apply to the transfer of the residential land, including any intervening transfer to an executor or administrator. |    |
|             | <i>Cost of residential land</i>                                                                                                                                                                                   |    |
| (3)         | If the residential land is transferred to a person who disposes of it, and the person derives income, the cost of the land to the person is—                                                                      | 30 |
|             | (a) the cost of the land incurred by the deceased person; and                                                                                                                                                     |    |
|             | (b) all other expenditure incurred by the person, the deceased person, or the administrator or executor of the deceased person, as applicable, for which no deduction has been allowed.                           | 35 |
|             | Defined in this Act: deduction, dispose, income, land, person, residential land                                                                                                                                   |    |

- (2) **Subsection (1)** applies to a person's disposal of residential land if the date that the person first acquires an estate or interest in the residential land is on or after 1 October 2015.

**12 Section FO 10 amended (When property passes on resident's restricted amalgamation)** 5

- (1) In section FO 10(6), replace “the 10-year rule in sections CB 9 to CB 11 and CB 14” with “the 2-year bright-line test or the 10-year rule in any of sections **CB 6A**, CB 9 to CB 11, and CB 14”.

- (2) **Subsection (1)** applies to a person's disposal of residential land if the date that the person first acquires an estate or interest in the residential land is on or after 1 October 2015. 10

**13 Section FO 17 amended (Land)**

Replace section FO 17(2) and (3) with:

*Disposal at market value*

- (2) The amalgamating company is treated as having disposed of the land to the ~~amalgamating~~amalgamated company at the market value of the land at the date of the amalgamation if— 15

- (a) the land is not revenue account property of the amalgamating company, and the disposal of the land would give rise to income for the amalgamated company under any of sections **CB 6A** to CB 14 (which relate to the disposal of land): 20

- (b) the land is revenue account property of the amalgamating company but not merely because of the ~~the~~ 2-year bright-line test or the 10-year rule in any of sections **CB 6A**, CB 9 to CB 11, and CB 14, and the land is, or may be, revenue account property of the ~~amalgamating~~amalgamated company because of the 2-year bright-line test or the 10-year rule in any of sections **CB 6A**, CB 9 to CB 11, and CB 14. 25

*Disposal of land within 2-year bright-line test or 10-year rule*

- (3) If the land is, or may be, revenue account property of the amalgamating company because of the 2-year bright-line test or the 10-year rule in any of sections **CB 6A**, CB 9 to CB 11, and CB 14, and the amalgamated company disposes of the land within the relevant 2-year or 10-year period after the amalgamating company acquired it, an amount derived from the disposal is income of the amalgamated company under whichever is applicable of sections **CB 6A** to CB 14. 30 35

**14 New heading and new sections GB 52 and GB 53 inserted**

- (1) After section GB 51, insert:

*Arrangements involving residential land***GB 52 Arrangements involving residential land: companies' shares***When this section applies*

- (1) This section applies when—
- (a) a company owns residential land directly or indirectly for which the relevant date in **sections CB 6A(1)(a) or (b)** (Disposal within 2 years: bright-line test for residential land) is within 2 years of a disposal of shares that **paragraph (c)** of this section applies to (company residential land); and 5
  - (b) ~~company~~-residential land owned directly or indirectly by the company makes up 50% or more, by market value, of the assets of the company; 10
  - (c) 50% or more of the shares in the company, by market value, are disposed of within a 12 month period, with a purpose or effect of defeating the intent and application of **section CB 6A** ~~(Disposal within 2 years: bright line test for residential land)~~. 15

*Disposal at cost, re-acquisition at market*

- (2) The company is treated as disposing of the relevant shareholder portion of company residential land to the relevant shareholder for an amount of consideration equal to the total cost to the company of the portion, and the shareholder is treated as acquiring the portion for that total cost and then disposing of it, back to the company, for an amount of consideration equal to the market value of the portion. The company is treated as re-acquiring the portion for the market value. 20

*Market value disposal*

- (2) ~~A shareholder is treated as disposing of the company residential land for an amount of consideration equal to the proportion of the market value of the land that the market value of their shares bear to the total value of the shares in the company.~~ 25

*A definition*

- (3) In this section, **shareholder portion** means the proportion that the market value of the shares disposed of by a shareholder bears to the total market value of the shares in the company. 30

Defined in this Act: company, dispose, residential land, share, shareholder

**GB 53 Arrangements involving residential land: trusts***When this section applies*

- (1) This section applies when—
- (a) the trustees of a trust own residential land directly or indirectly (**trust residential land**); and 35

- (b) trust residential land makes up 50% or more, by market value, of the assets of the trust; and
- (c) the trust's trust deed changes, a decision-maker under the trust deed changes, or an arrangement under the trust changes, with a purpose or effect of defeating the intent and application of **section CB 6A** (Disposal within 2 years: bright-line test for residential land). 5
- Market value disposal*
- (2) The trustees are treated as disposing of the trust residential land affected by a change described in **subsection (1)(c)** for an amount of consideration equal to the market value of the land at the time of the change. 10
- Defined in this Act: amount, arrangement, dispose, land, residential land, trustee
- ~~(2) **Subsection (1)** applies to a person's disposal of residential land if the date that the person first acquires an estate or interest in the land is on or after 1 October 2015.~~
- 15 Section YA 1 amended (Definitions)** 15
- (1) This section amends section YA 1.
- (2) Insert, in appropriate alphabetical order:
- bright-line date** is defined in **section CB 6A** (Disposal within 2 years: bright-line test for residential land) for the purposes of that section and **section CB 16A** (Main home exclusion for disposal within 2 years) 20
- ~~**date of acquisition** is defined in **section CB 6A** (Disposal within 2 years: bright line test for residential land) for the purposes of that section and **section CB 16A** (Main home exclusion for disposal within 2 years)~~
- (3) Insert, in appropriate alphabetical order:
- date of acquisition** is defined in **section CB 6A** (Disposal within 2 years: bright-line test for residential land) for the purposes of that section and **section CB 16A** (Main home exclusion for disposal within 2 years) 25
- ~~**date of disposal** is defined in **section CB 6A** (Disposal within 2 years: bright line test for residential land) for the purposes of that section and **section CB 16A** (Main home exclusion for disposal within 2 years)~~ 30
- (4) In the definition of **dispose**, in paragraph (a), replace “CB 6” with “**CB 6A**”.
- (5) In the definition of **dwelling**,—
- (a) in paragraph (b), replace “any of the following” with “any of the following, in whole or part”:
- (b) after paragraph (b), insert: 35
- (c) despite paragraph (b)(iii) and (v), for the purposes of **section CB 16A** (Main home exclusion for disposal within 2 years) and the definition of **residential land**—
- (i) includes a serviced apartment described in paragraph (b)(iii):

- (ii) does not include, in whole or part, a rest home or retirement village
- (6) Replace the definition of **estate** with:
- estate** in relation to land, **interest** in relation to land, **estate or interest in land**, **estate in land**, **interest in land**, and similar terms— 5
- (a) mean an estate or interest in the land, whether legal or equitable, and whether vested or contingent, in possession, reversion, or remainder; and
- (b) include a right, whether direct or through a trustee or otherwise, to—
- (i) the possession of the land (for example: a licence to occupy, as that term is defined in section 121A(1) of the Land Transfer Act 1952): 10
- (ii) the receipt of the rents or profits from the land:
- (iii) the proceeds of the disposal of the land; and
- (c) do not include a mortgage
- (7) Insert, in appropriate alphabetical order: 15
- farmland** means land that—
- (a) is being worked in the farming or agricultural business of the land's owner:
- (b) because of its area and nature, is capable of being worked as a farming or agricultural business 20
- ~~**farmland** means land that because of its area and nature is capable of being worked, as an economic unit as a farming or agricultural business~~
- (8) In the definition of **interest**, replace paragraph (d) with:
- (d) in relation to land, **interest in land**, **estate or interest in land**, and similar terms are defined under the definition of **estate** 25
- (9) Insert, in appropriate alphabetical order:
- main home** means, for a person, the 1 dwelling—
- (a) that is mainly used as a residence by the person (a **home**); and
- (b) with which the person has the greatest connection, if they have more than 1 home 30
- (10) Insert, in appropriate alphabetical order:
- principal settlor** is defined in **section CB 16A** (Main home exclusion for disposal within 2 years) for the purposes of that section
- (11) Insert, in appropriate alphabetical order:
- residential land**,— 35
- (a) means—
- (i) land that has a dwelling on it:

- (ii) land for which the owner has an arrangement that relates to erecting a dwelling:
- (iii) bare land that may be used for erecting a dwelling under rules in the relevant operative district plan~~because of its area and nature is capable of having a dwelling erected on it~~; but 5
- ~~(b) does not include land that is used predominantly as business premises or as farmland~~
- (b) does not include land that is—
- (i) used predominantly as business premises:
- (ii) farmland 10
- (11B) In the definition of settlement,—**
- (a) in paragraph (b), replace “the settlement” with “the settlement; but”:
- (b) after paragraph (b), insert:
- (c) in the definition of **principal settlor** in **section CB 16A(3)** (Main home exclusion for disposal within 2 years), does not include either 15  
services provided to a trust for less than market value, or a transfer of value except if that value is transferred by 1 or more of the following:
- (i) a beneficiary:
- (ii) a trustee:
- (iii) a person with power of appointment or removal of trustees: 20
- (iv) a person with a contingent interest in the trust property, in the case that the trust fails:
- (v) a decision-maker under the trust
- (11C) Insert, in appropriate alphabetical order,—**
- shareholder portion** is defined in **section GB 52** (Arrangements involving residential land: companies’ shares) for the purposes of that section 25
- (12) In the definition of **trading stock**, in paragraph (b)(v), replace “CB 6” with “**CB 6A**”.
- (13) In the definition of trust rules, replace paragraph (h) with:**
- (h) sections **43B**, 59, and 93B of the Tax Administration Act 1994 30

## Part 2

### Amendments~~Amendment~~ to Tax Administration Act 1994

#### **16A Section 3 of the Tax Administration Act 1994 amended (Interpretation)**

In section 3(1) of the Tax Administration Act 1994, insert, in its appropriate alphabetical order: 35

professional trustee, in **section 43B**, means a person whose profession, employment, or business is or includes acting as a trustee or investing money on behalf of others

**16 New section 43B of the Tax Administration Act 1994 inserted (Non-active trusts may be excused from filing returns)** 5

After section 43A of the Tax Administration Act 1994, insert:

**43B Non-active trusts may be excused from filing returns**

- (1) A trustee of a trust is not required to furnish a return of income for the trust for a tax year if—
  - (a) throughout that tax year; the trust is— 10
    - (i) a non-active trust; and
    - (ii) a complying trust as described in section HC 10 of the Income Tax Act 2007; and
  - (b) a trustee of the trust has made and furnished to the Commissioner, in a form approved by the Commissioner,— 15
    - (i) a declaration that the trust is a non-active trust, and that it will notify the Commissioner if it stops being a non-active trust; and
    - (ii) a statement of such other matters as the Commissioner may require; and
  - (c) the trust has not since the making of the declaration stopped being a non-active trust. 20
- (2) For the purposes of this section, a trust is a non-active trust for a tax year if, throughout that tax year, the trustee of the trust—
  - (a) has not derived or been deemed to have derived any income; and
  - (b) has no deductions; and 25
  - ~~(c) has not disposed of or been deemed to have disposed of any assets of the trust; and~~
  - (d) has not been a party to or perpetuated or continued with any transactions with assets of the trust which, during the tax year,—
    - (i) give rise to income in any person's hands; or 30
    - (ii) give rise to fringe benefits to any employee or to any former employee.
- (3) In determining whether a trust complies with the requirements of **subsection (2)**, no account shall be taken of any— 35
  - (a) reasonable fees paid to professional trustees to administer the trust; or
  - (b) bank charges or other minimal administration costs totalling not more than ~~\$200~~\$50 in the tax year; or

- (c) interest earned on trust assets in any bank account during the tax year, to the extent to which the total interest does not exceed \$200; ~~or the total of any charges or costs incurred by the trust to which **paragraph (b)** applies.~~
- (d) insurance, rates, and other expenditure incidental to the occupation of a dwelling owned by the trust and incurred by the beneficiaries of the trust. 5
- (4) Where at any time any paragraph of **subsection (2)** ceases to apply to a trust for which a declaration under this section has been made, a trustee of the trust must notify the Commissioner that the trust has ceased to be a non-active trust. 10
- (5) Despite **subsection (1)**, trustees of a non-active trust shall furnish a return of income if required by the Commissioner to do so.

### Legislative history

24 August 2015  
8 September 2015

Introduction (Bill 59–1)  
First reading and referral to Finance and Expenditure Committee