Inland Revenue
Te Tari Taake

QUESTIONS WE'VE BEEN ASKED | PĀTAI KUA UIA MAI

When is the sale of a lifestyle block excluded from the bright-line test?

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QB 25/13

This question we've been asked (QWBA) explains when lifestyle blocks sold within 2 years will be excluded from the bright-line test. It will be of interest to sellers seeking to rely on the farmland or main home exclusion.

Key provisions | Whakaratonga tāpua

Income Tax Act 2007 – ss CB 6A, CB 16A and YA 1 definitions: "farmland", "residential land"

REPLACES (FOR DISPOSALS ON OR AFTER 1 JULY 2024):

- **QB 18/17:** Income tax – bright-line test – farmland and main home exclusions – sale of lifestyle blocks

All legislative references are to the Income Tax Act 2007 (the Act).

Question | Pātai

When is the sale of a lifestyle block excluded from the bright-line test?

Answer | Whakautu

The sale is excluded from the bright-line test when the farmland or main home exclusions apply.[1]

The farmland exclusion will apply where the land is being, or in its current state, could be, used for a farming or agricultural business carried on by the owner. Lifestyle blocks are generally not farmland. This is because they are generally not worked in a farming or agricultural business of the owner, and are generally not, due to their area and nature, capable of being worked as a farming or agricultural business.

The main home exclusion applies where both of the following conditions are met:

- **The land has been used predominantly for the seller's main home. This is usually met if more than 50% of the land is used by the seller for their main home. However, if the split between main home use of the land and other uses is close, the nature and importance of the different uses of the land may also be relevant.**
- **The land has been used in that manner for more than 50% of the bright-line period.**

Key terms | Kīanga tau tāpua

The bright-line test applies to tax sales of residential land occurring within a 2-year period.

Curtilage means an area of land attached to a dwelling and forming one enclosure with it, such as a yard or garden.

Farmland exclusion means the exclusion from the definition of "residential land" for farmland.

Main home means a dwelling that is mainly used as a home by the seller and, if the seller has more than one, the home with which the seller has the greatest connection.

[1] There is also an exclusion for business premises, referred to at [5], which is outside the scope of this QWBA. See further QB 25/14: When does the business premises exclusion to the bright-line test apply?

Explanation | Whakamāramatanga

The bright-line test

1. The bright-line test under s CB 6A may apply to tax the sale of residential land within a 2-year period.

2. The 2-year bright-line test may applywhen a person disposes of residential land on or after 1 July 2024, if their bright-line end date (which is typically the date the person enters into an agreement to sell the land) is within 2 years of their bright-line start date (which in typical land transactions is the date the transfer to the person was registered). The period beginning on the bright-line start date and ending on the bright-line end date is referred to as the bright-line period.

3. There are other bright-line tests that applied to land disposed of before 1 July 2024, but this QWBA concerns only the current 2-year bright-line test.

4. The bright-line test under s CB 6A applies only where none of the land taxing rules in ss CB 6 to CB 12 apply (eg, s CB 6, which applies to the sale of land acquired for a purpose or with an intention of disposal).

Scope of this QWBA

5. This QWBA concerns the circumstances in which the sale of a lifestyle block is excluded from the bright-line test. It considers the farmland and main home exclusions as these are the most relevant exclusions in this context. This QWBA does not discuss the business premises exclusion. For information on the business premises exclusion, see QB 25/14: **When does the business premises exclusion to the bright-line test apply?**

6. In this QWBA it is assumed:

   - there was a dwelling on the land that was the seller's main home;
   - none of the other land sale rules in ss CB 6 to CB 12 of the Income Tax Act 2007 apply to the sale of the land;[2] and
   - none of the exceptions to the main home exclusion apply (see [40]).

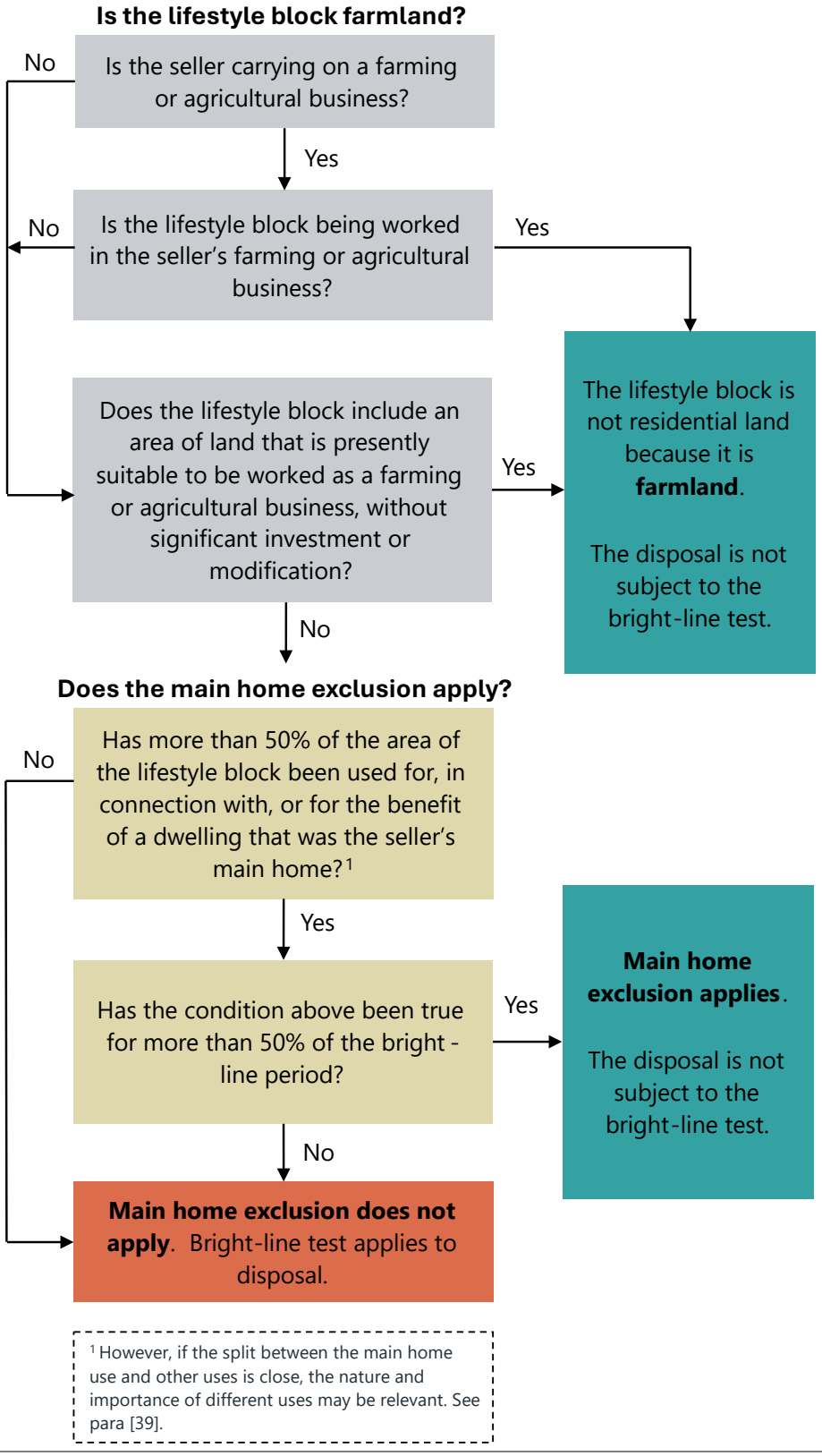
[2] This is because the bright-line test potentially applies only where the sale is not taxed under any of the other land sale rules.

7. Additionally, for simplicity this QWBA assumes the person disposing of the land is not the trustee of a trust.[3]

8. Figure | Hoahoa 1 on page 4 summarises the main steps for determining whether the bright-line test applies to the sale of a lifestyle block. These steps address whether the land is farmland and whether the main home exclusion applies. The flowchart assumes the lifestyle block is residential land if it is not farmland. If, applying the flowchart, the result is that the main home exclusion applies, you will still need to consider whether any of the exceptions to the main home exclusion apply. For a discussion of these exclusions, see QB 25/09: **When do I have a "regular pattern" of transactions that means I cannot use exclusions from the land sale rules for my residence or for my main home?**

[3] However, the main home exclusion may also be available, following the same principles, where the person disposing of the land is a trustee of the trust, if: (1) the dwelling was the main home of a beneficiary of the trust, and (2) no principal settlor of the trust has a main home, or if they do it is the home being disposed of.

Figure | Hoahoa 1: Flowchart of steps to determine whether the sale of a lifestyle block within 2 years is subject to the bright-line test



Is a lifestyle block "residential land"?

9. The bright-line test applies to sales and other disposals of "residential land".

10. The definition of residential land includes:

- land that has a dwelling on it;
- land for which the owner has an arrangement to build a dwelling; and
- bare land that is allowed to have a dwelling on it under the relevant council's district plan.

11. There are some exclusions from the definition of residential land, including for "farmland".

Is a lifestyle block farmland?

12. Because the definition of residential land excludes farmland, if a lifestyle block meets the definition of "farmland", it is not subject to the bright-line test.

13. "Farmland" is a defined term in s YA 1:

> **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

14. The first limb (para (a)) of the definition of farmland focuses on the actual use of the land, while the second limb (para (b)) focuses on the qualities of the land. Whether land is farmland is determined at the time the bright-line test applies; that is, when the land is sold.

15. Farmland can include land that has a dwelling on it. When determining if the land is farmland, there is no apportionment between the area of land used for the dwelling and the area of land used for farmland. That is, land is either farmland or not farmland. Therefore, if a lifestyle block is farmland, it is not subject to the bright-line test because it is not residential land – even if it has a dwelling on it.

When is a lifestyle block being worked in the farming or agricultural business of the seller?

16. Under the first limb of the definition, a lifestyle block will be farmland if it is being worked in a farming or agricultural business of the seller. This requires the seller to show that:

- they are carrying on a farming or agricultural business; and
- the lifestyle block is being worked in that business.

17. The Commissioner considers that in the context of the bright-line test and the definitions of residential land and farmland, a farming or agricultural activity is being carried on when a lifestyle block is being used for:

- cultivating and growing crops, including horticulture and viticulture;
- breeding or rearing livestock, including poultry and bee keeping; or
- forestry.

18. In addition, the farming or agricultural activity must be carried on as a business.

19. Section YA 1 defines "business" as including any profession, trade, or undertaking carried on for profit. The leading case on the meaning of "business" is *Grieve v CIR* (1984) 6 NZTC 61,682 (CA). *Grieve* concerned a farming activity that, ultimately, did not generate profits. Richardson J interpreted "business" as meaning an activity carried on in an organised and coherent way with an intention to make a profit. A person's intention to make a profit will be evidenced by their conduct. Factors that are relevant for determining if a person is carrying on a business include:

- the nature of the activity being engaged in;
- the period over which the activity is engaged in;
- the scale of operations;
- the volume of transactions;
- the commitment of time, money and effort;
- the pattern of activity; and
- the financial results.

20. Whether a lifestyle block is being worked in the seller's farming or agricultural business is a question of fact. Many owners of lifestyle blocks will keep animals or grow crops or trees on their land, but if the livestock or produce of the activity is not sold (or not intended to be sold), then there will be no business activity. Even if the livestock or

produce is sold, the owner may not be able to demonstrate that they are carrying on that activity in an organised and coherent way with the intention to profit from the activity, as is required for the activity to be a business. For many lifestyle block properties, the size and nature of the property will limit the scale of operations that can be carried on, which will make it difficult to satisfy the business test.

21. The first limb of the definition of farmland requires that the land is "being worked in the farming or agricultural business **of the land's owner**" [emphasis added]. This means the seller of the lifestyle block must be engaged in a farming or agricultural business and the land must be worked in that business. The first limb of the definition can be satisfied if the lifestyle block is being worked by the seller in their business, either on its own or in conjunction with other land that is owned or leased by the seller. However, it would not be satisfied where the land is being rented to someone else who carries on a farming or agricultural business.

When is a lifestyle block, because of its area and nature, capable of being worked as a farming or agricultural business?

22. The second limb of the definition of farmland includes land that, "because of its area and nature", is capable of being worked as a farming or agricultural business. It is necessary to consider both the area and the nature of the land together to determine if the land is capable of being worked as a farming or agricultural business.

23. The Commissioner considers, based on *CIR v Bruhns* (1989) 11 NZTC 6,075 (CA), that the words "is capable of being" in para (b) focus on the existing or present nature of the lifestyle block at the date of sale, rather than any unrealised potential in the lifestyle block. This means a lifestyle block that requires significant investment or modification to make it able to be worked as a farming or agricultural business does not have the present nature to make it capable of being used in that way, and the lifestyle block would not qualify as farmland.

24. The larger the area of a lifestyle block, the more likely it may be capable of being worked as a farming or agricultural business. This is because a larger area of land is more likely to allow for farming or agricultural activity on a scale that could constitute a business. A lifestyle block would not be capable of being worked as a farming or agricultural business if it was too small to be capable of producing a profit when used for farming or agricultural activities.

25. Whether the land being sold has an area and nature capable of being worked in a farming or agricultural business needs to be considered in isolation from other parcels of land. This means this requirement would not be satisfied if a person were selling a

parcel of land only capable of being worked in a farming or agricultural business in conjunction with other land (for example an adjoining parcel of land).

26. The seller must be able to show that at the date of sale the lifestyle block has an area and nature presently capable of being worked as a farming or agricultural business and is, therefore, farmland not subject to the bright-line test.

27. The second limb of the definition of farmland may be relevant in situations where the owner of the land lives in a dwelling on the land and leases most of the land to someone else to farm. In this situation, all of the land, including the dwelling, will be farmland if it can be shown that the parcel of land as a whole is capable of being worked as a farming or agricultural business, even if some parts of it (eg, the dwelling) are not being used in that way. In this situation, the second limb of the definition of farmland may potentially be satisfied whether or not the lessee's activity amounts to a business. However, it will clearly be satisfied if the lessee's activity on the land does amount to a business.

Can the main home exclusion apply to a lifestyle block?

28. Even if a lifestyle block is residential land (because it is not farmland), the main home exclusion from the bright-line test may apply. The main home exclusion will apply if the lifestyle block has been used predominantly, for most of the bright-line period, for a dwelling that was the seller's main home.[4]

29. The main home exclusion in s CB 16A(1) provides:

> **CB 16A Main home exclusion for disposal within 2 years**
>
> *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 bright-line period, 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) a principal settlor of the trust does not have a main home; or
>
> (ii) if a principal settlor of the trust does have a main home, it is that main home which the person is disposing of.

[4] Provided none of the exceptions to the main home exclusion apply – see QB 25/14.

> *Modified rule for constructing main home*
>
> (2) **For the purposes of determining** under subsection (1) **whether residential land has been used for most of the bright-line period predominantly for a dwelling that was the main home** of the person or a beneficiary of a trust, as described in subsection (1), **the period in which the dwelling was constructed is ignored**.
>
> [Emphasis added]

30. The land in the lifestyle block must have been used predominantly for a dwelling that was the seller's **main home** for more than 50% of the seller's bright-line period. As noted at [2], a person's bright-line period is the period beginning on their bright-line start date and ending on their bright-line end date for the land.[5] When determining whether this requirement is met, any period in which the dwelling was constructed is ignored.

31. Section YA 1 defines "Main home":

> **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

32. There are three points to note about the definition of main home:

- A person can have only one main home.
- For a dwelling to be a person's "main home", it must be mainly used as a residence (ie, a home) by the person.
- If the person has more than one home, the main home is the home with which the person has the greatest connection.

33. See QB 24/01**: If a person has two or more homes, which home is their main home for the purpose of the main home exclusion to the bright-line test?** for assistance in determining which property the seller has the greatest connection with.

34. Land that is "**used … for a dwelling**" is not limited to the land on which the dwelling is situated or to the surrounding curtilage (like a yard and garden). Land used for a

[5] In a typical land purchase and sale, this will be the period starting on the date the land was transferred to the person and ending on the date an agreement to sell the land was entered into. However, there are different bright-line start dates and bright-line ends dates in some situations. For more information, see QB 25/11: When is the bright-line start date for the 2-year bright-line test?

dwelling can also include other areas the seller uses frequently, repeatedly or customarily in connection with or for the benefit of the dwelling. In the Commissioner's view, for an area of land to be used for a dwelling, the land must be actually used for the dwelling. That is, it is the actual use of the land, rather than any intended use, that is relevant.

35. The extent to which residential land is used **in connection with or for the benefit of a dwelling** is a question of fact that turns on the circumstances of each case. Factors that may indicate land is being used in connection with or for the benefit of a dwelling include the land being:

- set aside exclusively for private residential purposes;
- used for an activity that complements or adds to the enjoyment of the dwelling;
- clearly identifiable as being used in connection with or for the benefit of the dwelling; and
- incidental to the enjoyment of the dwelling.

36. In the case of a lifestyle block, examples of land that is used for a dwelling (other than the house and curtilage) are:

- areas set aside for growing food for domestic use;
- areas for pet animals; and
- areas used to enhance the enjoyment or aesthetic value of the dwelling (eg, in the context of an average-sized (4-hectare) lifestyle block, a reasonable amount of park land or covenanted native bush that is used to provide a green vista, retaining or shelter would be an area that enhances the enjoyment of a dwelling).

37. Another example of land used for a dwelling is land used for hobby farming on a lifestyle block. For the purposes of this QWBA, hobby farming refers to a farming or agricultural activity undertaken by the seller on land that does not meet the definition of "farmland" (eg, because the area of the land used for the activity is too small to sustain a farming or agricultural business).

38. For the main home exclusion to apply, the land in the lifestyle block needs to have been **used predominantly** for a dwelling that was the seller's main home. This will generally involve comparing the physical area of land used for the dwelling and the total area of the land. If more than 50% of the total area is used by the seller for their main home, this will generally satisfy the "predominantly" requirement.

39. If the split between the seller's use of the land for their main home and other uses of the land is close, the nature and importance of the different uses may be relevant in determining which of the uses is the predominant use.

40. The leasing or licencing of part of the lifestyle block to another person does not necessarily mean that part is not used for the dwelling, so long as the other person's use of the land is complementary to the seller's enjoyment of the property (eg, where a neighbour has grazed some animals on the seller's land to keep the grass down) and the seller continues to use the land.

41. However, in some cases, the leasing or licensing of part of the lifestyle block may mean the seller is effectively excluded from using that part of the land. If that is the case, that part of the land would not be used for the seller's dwelling for the period of the lease or license.

42. The words "**for most of the time** the person owns the land" [emphasis added] require a comparison between the length of time the land was predominantly used for a dwelling by the seller and the length of time the seller owned the land. "Most" in this context means more than 50%.

Exceptions to the main home exclusion

43. There are two exceptions that may prevent the main home exclusion applying (see s CB 16A(3)).

44. QB 25/09 discusses these exceptions. Briefly, the exceptions are where:

- the seller has already used the main home exclusion twice within the 2 years immediately preceding the bright-line end date; or
- the seller has engaged in a regular pattern of acquiring and disposing of residential land that had their main home on it.

45. The regular pattern carve-out from the main home exclusion also applies to a group of persons who occupy all the relevant properties together. A group of persons can include a non-natural person like a company if one of the individuals in the group has significant involvement in, or control of, the activities of the non-natural person.

Examples | Tauira

46. The following examples assume that the property has been used as the seller's main home for all of the bright-line period and that the exceptions to the main home exclusion do not apply.

Example | Tauira 1 – Land that because of its area cannot be used as farmland

Marama has a 1-hectare property and sells it within 2 years of her bright-line start date. The property has a house that she uses as her main home. It also has a small area of grazing land and a larger area of native bush. Marama keeps a few sheep on the grazing land to keep the grass down.

The property is not farmland because:

- it is not being worked in a farming or agricultural business carried on by Marama – it is used as a hobby farm, rather than a business; and
- given the size of the property, it is not capable of being worked as a farming or agricultural business.

However, the main home exclusion is available to Marama because she uses the property entirely for the dwelling that is her main home. The grazing land is used for her hobby-farming activity, and the area of native bush is used to enhance her enjoyment and the aesthetic value of her dwelling. Therefore, the sale of Marama's property will not be taxed under the bright-line test.

Example | Tauira 2 – Plot of land that is farmland

Uri has a 5-hectare property that he uses for a commercial rose-growing business. He uses a small area of the land for his house and the garden around it.

The property is farmland because it is being worked in Uri's agricultural business. If Uri were to sell the property within 2 years of his bright-line start date, the sale of the property (including the house), would not be taxed under the bright-line test because the land is not residential land.

Example | Tauira 3 – Part of property leased to an avocado grower

Tom and Jess have a 2-hectare property that they sell within 2 years of their bright-line start date. The land includes 1.5 hectares of avocado trees with shelter belts. The balance of the land is used for a house that Tom and Jess use as their main home, as well as a flower garden, a vegetable garden and a paddock for grazing Jess's two horses. They lease the avocado trees to an avocado-growing company that looks after the trees, including spraying the trees, mowing between the rows of trees, and picking the fruit. The lease gives exclusive possession to the avocado-growing company and Tom and Jess do not go into the avocado orchard.

The property is not farmland because:

- it is not being worked in an agricultural business carried on by Tom and Jess (rather, it is being worked in the avocado-growing company's agricultural business); and
- given the size of the property, it is not capable of being worked as a farming or agricultural business. While the company is carrying on a business of growing avocados, it grows avocados on multiple parcels of land in the region. The avocado trees on Tom and Jess's property form only a small part of its business.

The main home exclusion is not available to Tom and Jess because only 25% of the area of the property is used for their dwelling. The dwelling, flower garden, vegetable garden and land for grazing the horses are all physically used for purposes in connection with the enjoyment of the dwelling, rather than for any other purposes. However, most of the land (75%) is leased to the avocado-growing company and is not used for Tom and Jess's dwelling. Therefore, the sale by Tom and Jess of the property within 2 years of their bright-line start date may be taxed under the bright-line test.

References | Tohutoro

Legislative references | Tohutoro whakatureture

Income Tax Act 2007, ss CB 6A, CB 6 to CB 12, CB 16A, YA 1 ("business", "farmland", "main home" and "residential land")

Case references | Tohutoro kēhi

CIR v Bruhns (1989) 11 NZTC 6,075 (CA)

Grieve v CIR (1984) 6 NZTC 61,682 (CA)

Other references | Tohutoro anō

QB 24/01: If a person has two or more homes, which home is their main home for the purpose of the main home exclusion to the bright-line test? *Tax Information Bulletin* Vol 36, No 6 (July 2024): 39
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