

TECHNICAL DECISION SUMMARY > PRIVATE RULING

WHAKARĀPOPOTO WHAKATAU HANGARAU > WHAKATAUNGA
TŪMATAITI

Sale of property and the bright-line test

Decision date | Rā o te Whakatau: 19 September 2023

Issue date | Rā Tuku: 11 April 2024

TDS 24/06

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Subjects | Kaupapa

Income tax: sale of properties; bright-line test

Taxation laws | Ture tāke

All legislative references are to Income Tax Act 2007 unless otherwise specified.

Facts | Meka

1. This ruling concerns the future sale of three sections of residential land (the **land**) currently owned by the Applicant.
2. The land had previously been owned as follows:
 - One section (**section one**) was originally acquired by the Applicant, their spouse and another co-owner as tenants in common. The Applicant's share in this land had decreased and then increased progressively over the years. At the time of the Applicant's spouse's death, this section was owned by the Applicant and their spouse as 50:50 tenants in common.
 - One section (**section two**) was acquired by the Applicant and their spouse as 50:50 tenants in common and continued to be owned as such until the time of the Applicant's spouse's death.
 - One section (**section three**) was acquired by the Applicant and their spouse as joint tenants and continued to be owned as such until the time of the Applicant's spouse's death.
3. On the death of the Applicant's spouse, the Applicant inherited the half share in each of section one and section two that had been owned by their spouse, in accordance with the spouse's will, and section three was transmitted to the Applicant as the surviving joint tenant.

Issues | Take

4. The main issues considered in this ruling were:
 - Whether the bright-line tests potentially apply to future sale of the land (s CB 6A and CZ 39):

- Whether the change affecting land/rezoning land provision would apply to the future dispositions of the land (s CB 14):
- Whether a deduction (s DB 28) is available if s CB 14 applies.

Decisions | Whakataua

5. The Tax Counsel Office (TCO) concluded:
 - Sections CB 6A and CZ 39 will not apply to the future sale of the land.
 - Section CB 14 will not apply to the future disposal of the land.
 - It was not necessary to consider s DB 28 as it was not relevant since it was concluded that s CB 14 will not apply.
6. The following conditions were included:
 - The Applicant will sell the freehold estates in fee simple in each of the sections their entirety.
 - None of the land was "tax-base property" as defined in s FC 1(2).

Reasons for decisions | Punga o ngā whakataua

Issue 1 | Take tuatahi: Bright-line test

7. The bright-line tests in ss CB 6A and CZ 39 potentially apply to the disposal of residential land within a certain timeframe. The different bright-line tests and their application dates are discussed in [11].

Preliminary issue

8. A preliminary issue considered was the question of whether there were disposals of the Applicant's half share each of section one and section two when that land was transferred to the Applicant's sole ownership. This was considered as while in common law a person cannot dispose of property to oneself, s 56 of the Property Act 2007 says that a person may dispose of property to themselves.

9. TCO noted that the definition of “dispose” for the land sale rules in the ITA is not comprehensive. However, it referred to IS 22/03¹ which considers the meaning of “disposal”/ “dispose” in the land sale rules. IS 22/03 concludes that “disposal” in the land sale rules does not include transfers to self (in the same capacity).
10. Therefore, TCO concluded there were no disposals of shares in sections one and section two that the Applicant owned prior to the death of their spouse when those sections were transferred to the Applicant’s sole ownership. These transactions therefore did not give rise to potential bright-line taxing events.

Bright-line tests application

11. Two bright-line tests potentially apply. The general application rules of the bright-line tests are:
 - The five-year bright-line period applies to residential land if the person first acquires an estate or interest in the land on or after 29 March 2018 (s CZ 39).
 - The 10-year bright-line period (or five-year period for new builds) applies to residential land if the person first acquires an estate or interest in the land on or after 27 March 2021 (s CB 6A).
12. If the residential land is disposed of within the applicable bright-line period, the amount received is treated as income.

When was an estate or interest in the land first acquired

13. Section CB 15B provides a general rule for when land is acquired. However, s CB 15B does not apply for the purposes of s CB 6A or s CZ 39.
14. Therefore, general principles as to when land is acquired apply to determine when a person first acquires an estate or interest in land. TCO referred to QB 17/02² which discusses when land is acquired in terms of the application provision for the old 2-year bright-line test. It states that in a typical land purchase, the purchaser will first acquire

¹ IS 22/03: *Income tax – Application of the land sale rules to co-ownership changes and changes of trustees* (14 June 2022).

² QB 17/02: *Income tax – Date of acquisition of land, and start date for 2-year bright-line test* (30 March 2017).

an interest in land when a binding contract to purchase the land is formed (even if some conditions still need to be met).

15. TCO concluded that the Applicant acquired an interest in all three pieces of land well before any of the bright-line application dates and on the face of it none of the bright-line tests would apply.
16. However, TCO also considered the question as to whether the Applicant's share in the land increasing progressively over the years means one of the bright-line tests could apply to a portion of any of the land.
17. The bright-line tests in ss CB 6A and CZ 39 state: "an amount that a person derives from disposing of residential land is income of the person ...". It was therefore necessary to identify the residential land that is being disposed of and ascertain when the person disposing of the land first acquired an estate or interest in that land.
18. Were the Applicant to potentially be selling part-shares of any of the land (for example, selling a one third share to someone, then subsequently selling another third, etc) it would be necessary to identify when the particular share being sold at any time was acquired. TCO's view was a "first in first out" approach would likely be the most appropriate way to identify an acquisition date for any given share being sold. But when land is sold in its entirety, the application of the bright-line tests depends on when the person first acquired an interest in the land being sold (for example, the estate). A subsequent increase in the share of the estate a person holds was not relevant.
19. As the Applicant will be selling the properties in their entirety, TCO was of the view that none of the sales will be subject to tax under either of the bright-line tests, because the Applicant first acquired an interest in each estate before any of the bright-line test application dates.

Issue 2 | Take tuarua: Change affecting land

20. This issue concerned whether s CB 14 potentially applies to the future disposal of the land by the Applicant.
21. Under s CB 14, an amount a person derives from disposing of land will be income if:
 - it is not income under any of ss CB 6A to CB 12 or s CZ 39;
 - the person disposed of the land within 10 years of acquiring it;
 - the amount derived is more than the cost of the land;

- at least 20% of the excess (the extent to which the amount derived exceeds the cost of the land) arises from one or more of the listed factors relating to the land; and
 - in the case of some of the listed factors, the factor occurred after the person acquired the land.
22. The relevant factor in relation to the three sections the Applicant will be selling is a change to the rules of an operative district plan under the Resource Management Act 1991.
23. TCO decided it could not consider the 20% threshold until after the sales are made and, in any event, whether the 20% threshold is met will be a factual matter that TCO may not be able to rule on (s 91E(4)(a) of the Tax Administration Act 1994).
24. However, TCO considered they may be able to rule out s CB 14 applying to some or all of the land on the basis of the sales falling outside the 10-year period.

When land is acquired for the purposes of s CB 14

25. Section CB 14 refers to a person disposing of land “within 10 years of acquiring it”.
26. The general rules in s CB 15B as to when a person acquires land for the purposes of subpart CB apply to s CB 14. It is the date that *begins a period* in which the person had an interest in the estate that will generally be the date of acquisition of the estate as a whole. As such, a person’s share in an estate increasing over time would not generally mean there would be different acquisition dates for different shares in the estate (assuming the estate was disposed of in its entirety).
27. However, the general rule in s CB 15B(1) as to when land is acquired is overridden for some transactions by subparts FB and FC. These subparts provide for the timing of acquisition where there is transfer of property on a distribution by an executor in accordance with a will.
28. For the Applicant’s half share of each of section one and section two, subparts FB and FC do not apply and TCO determined that the acquisition date for that share of the land was the date that an estate in the land was first acquired and this was outside the 10-year disposition period.
29. However, subparts FB and FC do apply to the one-half share of each of section one and section two the Applicant acquired via the executor of the Applicant’s spouse’s estate, in accordance with the spouse’s will. As such, the general rule in s CB 15B(1) is overridden in terms of ascertaining the Applicant’s date of acquisition of these half shares.

30. The transfer of the spouse's estate to the executor falls within s FC 1(1)(a), and the distribution from the executor of the estate to the Applicant falls within s FC 1(1)(b). As such, subpart FC applies to both of those transfers of the one half share the Applicant's spouse held in each of section one and section two before their death.
31. As the share the Applicant's spouse held was not tax-base property (defined (relevantly) as revenue account property), s FC 3 will apply, because:
 - the circumstances of the transfers to the executor and from the executor to the Applicant are as described in s FC 1(1)(a) and (b), respectively,
 - the Applicant was the deceased's surviving spouse.
32. Where FC 3 applies, the transfers to the executor and from the executor of the Applicant's spouse's estate to the Applicant are treated as transfers of property under a settlement of relationship property under subpart FB.
33. Section FB 3 applies for the purposes of various provisions including s CB 14. As such, by virtue of subsection (3), the executor is treated as having acquired the land the Applicant's spouse held before their death on the date it was acquired by the Applicant's spouse. The Applicant is then treated as having acquired the land on the date it was acquired by the executor, being the date it was acquired by the Applicant's spouse. In other words, by virtue of ss FB 3 and FC 3, the Applicant is treated as having acquired the half shares in each of section one and section two that they acquired via the executor on the date the Applicant's spouse first acquired an estate in the land.
34. The acquisition date for the half share in each of section one and section two that the Applicant's spouse held at the time of their death is ascertained under the general rule in s CB 15B (for the purposes of subpart CB other than bright-line).
35. Section CB 15B applies to the half shares in section one and section two that the Applicant's spouse held at the time of their death in the same way it applies to the Applicant's half shares. TCO determined that the acquisition date for the land was the date that an estate in the land was first acquired and this was outside the 10-year disposition period.
36. As such, the disposals of section one and section two will not be subject to s CB 14. This subject to the condition that neither of the sections were tax-base property.
37. Section three was held by the Applicant and their spouse as joint tenants. The Applicant became the sole owner of this section upon the spouse's death, by operation of survivorship. As such, subparts FB and FC are not relevant, so the general rule in s CB 15B is not overridden.

- 38. TCO determined that, under s CB 15B, the acquisition date for section three was the date that an estate in the land was first acquired and this was outside the 10-year disposition period.
- 39. As such, the disposal of section three will also not be subject to s CB 14.

Issue 3 | Take tuatoru: Deduction if s CB 14 applies

- 40. Section DB 28 applies when a person derives income under s CB 14 that is not income under any other provision. It provides that the person is allowed a deduction of 10% of the profit on the disposal for every year the land was owned (up to a maximum of \$1,000).
- 41. As s DB 28 is relevant only if s CB 14 applies and TCO concluded s CB 14 will not apply to the disposal of any of the land, it was not necessary to consider or rule on s DB 28.