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Rural too is affected by the 'bright-line test'

New rules, known as the "bright-line test", were introduced in October 2015 to allow Inland Revenue to easily tax property investors that frequently buy and sell residential property for a profit. These new rules apply to residential property that is purchased after 1 October 2015 and sold within two years of purchase. The way that the legislation is drafted may result in some taxpayers being unexpectedly caught. This is due to the wide definition of residential land; for our rural clients there are some situations where this taxing rule might apply.

Residential land is defined as any land that has a residential dwelling on it, or is zoned to allow one to be built. This wide definition means a significant number of rural properties will be affected. Thankfully, an exclusion is in place for land that is, or is capable of, being worked as part of a farming or agricultural business of the land owner. For example, a 5ha plot of land suitable for use for floriculture is excluded from the definition of residential as it is being worked as a farming or agricultural business.

Not all large areas of rural land will automatically be treated as farmland. To determine whether land is capable of being worked requires looking at the capability of the land at the time of sale. Land that requires significant investment or modification to be used as a farming business would therefore not qualify. Inland Revenue provided an example of a 50 hectare plot of land that is covered in gorse. The land is not farmland as it is not currently capable of being used for farming purposes.

Clearly lifestyle properties would also not be able to apply this exemption. Instead the principle residence exemption would need to be applied. This exemption, known as the main home exemption, exempts from the rule any property that is used as the principle residence of the owner. It is important to note that this exemption can only be used twice in a two year period.

The definition of a principle residence however is not straight forward to apply. Caution should be taken when purchasing property that will not be lived in for more than 50% of the time. An example of this would be second homes such as the family bach. As these types of properties are unlikely to be used as the principle residence of the owners the main home exemption won't be able to be applied. Therefore, if these types of properties are purchased and sold within two years it is likely any gain made will be taxable.

Care is also needed for residential property that is owned in a trust. The main home exemption should be able to be applied to most simple trust situations. But where the principal settlor of the trust is not living in the property then the exemption cannot be applied. An example of this could be where a trust settled by the parents purchases a unit for their daughter to live in while at university. As the parents, the settlors of the trust, are not living in the property they are unable to apply the main home exemption for any gain made if purchased and sold within two years.

As you can see the application of the rules can affect more than just property speculators.

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