

# Information Sheet

## Bright-line Test



A Supplementary Order Paper<sup>1</sup> (**SOP**) passed by the Government in March 2018 will extend the Bright-line test from 2 years to 5 years. This Information Sheet will set out the implications of this extension and what you should know about the Bright-line test generally.

Remember that, as a Licensee, you should be aware of the potential effects of the Bright-line test but ensure that you do not put yourself in the position of giving legal, tax or accounting advice to clients and/or prospective purchasers. It is not the role of the Licensee to advise clients and prospective purchasers on whether the Bright-line Test or any other tax will apply to a transaction.

We recommend our members to:

- **Provide information** on the below changes; and
- **Encourage** vendors and purchasers to obtain legal advice **before** signing an agreement for sale and purchase, as required by Rule 9.7<sup>2</sup> of the Client Care Rules; and
- **Record your advice** to the parties in writing so that there is a paper trail confirming your discussions with them.

### What is the Bright-line test?

The Bright-line test was first introduced in 2015 through the Taxation (Bright-Line Test for Residential Land) Act 2015. In short, the Act requires income tax to be paid on gains from the sale of any property that is classed as “residential land” that is bought and sold within certain timeframes, unless an exemption applies.

From **29 March 2018**, the timeframe of 2 years in the original Bright-line test will be extended to 5 years.

For standard purchases of residential properties, with no complicating factors such as association with property developers or dealers, the following generally applies:

- For sale and purchase agreements entered before 1 October 2015: Bright-line test does not apply;
- For sale and purchase agreements entered after 1 October 2015 but before 29 March 2018: 2-year Bright-line test applies;
- For sale and purchase agreements entered on or after 29 March 2018: 5-year Bright-line test applies.

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<sup>1</sup> Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Bill

<sup>2</sup> Rule 9.7: Before a prospective client, client, or customer signs an agency agreement, a sale and purchase agreement, or other contractual document, a licensee must—

- (a) recommend that the person seek legal advice; and
- (b) ensure that the person is aware that he or she can, and may need to, seek technical or other advice and information; and
- (c) allow that person a reasonable opportunity to obtain the advice referred to in paragraphs (a) and (b).

## Exemptions from the Bright-line Test

Income tax will not need to be paid on gains where the sale is of:

- a) The vendor's (or seller's) main home; or
- b) A property that has been inherited; or
- c) A property that is being transferred under a relationship property agreement.

### When does the 2-year/5-year for the Bright-line period start and end?

For standard purchases of residential properties, the Bright-line period starts from the date of registration of title (settlement date) and ends on the date the person enters into an agreement to sell the property.

There are some situations when residential property is bought or sold, which do not follow the standard rules above. For example, different rules govern "off the plan" sales. Please refer to the **attached** appendix for the IRD's guidance note on these exceptions to the standard rules.

We set out some examples below to demonstrate how the Bright-line test applies in a practical context.

#### Example 1

Investor A signed an agreement to purchase a residential property on 2 February 2018. Settlement occurred on 8 April 2018. The property was **not** used as a main home. Investor A signed an agreement to sell the property on 6 October 2021.

The agreement was signed before 29 March 2018, so the 2-year Bright-line test applies.

The Bright-line period for Investor A started on 8 April 2018 (settlement date) and ended on 6 October 2021. As it ended after 2 years, the sale would not be subject to taxation under the Bright-line rules.

#### Example 2

Investor B signed an agreement to purchase a residential property on 19 May 2018. Settlement occurred on 20 August 2018. The property was **not** used as a main home. Investor B signed an agreement to sell the property on 9 July 2023.

The agreement was signed after 29 March 2018, so the 5-year Bright-line test applies.

The Bright-line period for Investor B started on 20 August 2018 (settlement date) and ended on 9 July 2023. As it ended just before 5 years, Investor B would need to pay tax on any gains from the sale of the property under the Bright-line rules.

### **Example 3**

Investor C signed an “off the plans” agreement on 5 April 2018 to purchase a residential property. Settlement occurred on 17 May 2020. The property was **not** used as a main home. Investor C signed an agreement to sell the property on 15 August 2022.

The agreement was signed after 29 March 2018, so the 5-year Bright-line test applies.

As this was an “off the plan” sale, the Bright-line period for Investor C started on 5 April 2018 (date of the agreement to purchase the property) and ended on 15 August 2022. As it ended before 5 years, the sale would be subject to taxation under the Bright-line rules.

*See Appendix A for time periods applicable to off-the-plan sales.*

## **Collection of Tax Information from Vendors and Purchasers**

The introduction of the original 2-year Bright-line Test followed changes introduced from 1 October 2015 in relation to the collection of tax information.

All transfers of land after 1 October 2015 must be accompanied by tax statements before an agreement can be settled.

Most vendors and purchasers will need to provide full IRD numbers for the tax statement. In some cases, Taxpayer Identification Numbers (TINs) for those receiving overseas income may also be needed.

There is an exemption for providing an IRD number where it is a New Zealand resident’s main home, but this will not apply for offshore persons or trusts. Parties will need to seek advice from a lawyer or accountant who will help them with exemptions or where they have more than one home.

Parties may need to seek accounting advice before applying for an IRD number for a trust or other entity. The time between the satisfaction of the conditions in an agreement and the settlement date should allow for the time that may be required for obtaining an IRD number.

Overseas buyers (and sellers) who do not have IRD numbers will also have to apply for IRD numbers. This will require the overseas buyer to open a bank account in New Zealand. The IRD has helpful information about this process on its website.

### **“Red Flags” for Real Estate Agents to be aware of:**

#### **a) Where the settlement date is 14 days or less from the satisfaction of conditions:**

Licensees should be vigilant where the parties are seeking to allow a very limited amount of time between satisfaction of the conditions and settlement. If a party to an agreement cannot complete the tax statements prior to the settlement date, they may suffer serious loss including incurring penalty interest for not being able to settle. In circumstances where the Licensee is aware there is a contemporaneous sale and purchase (such as in an on-sale situation), this could be a particularly significant issue.

**b) Where two or more people are shown on the title:**

Clients should always be asked if the property is owned, wholly or in part, by a trust or estate.

**c) Where the client has one or more properties and asks if the Main Home Exemption will apply:**

The Licensee must always ensure the client seek advice from a lawyer/conveyancer on this question.

**d) Where the client(s) have sold a house recently with the consequence that they may not be able to obtain the Main Home Exemption:**

The Licensee must always ensure the client seek advice from a lawyer/conveyancer on this question.

**e) Where the client has purchased a property and is sub-dividing a portion of it for sale:**

The client should be alerted to the possibility that the Main Home exemption may not apply to the sale of the new sections and encouraged to seek professional advice from a lawyer.

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# Appendix A

We set out below how the start and end date of the Bright-line period is calculated for common types of land transactions. This information is sourced from the [IRD website](#) and is for general information purposes only. It is not legal or tax advice.

Type of acquisition (the way the property is bought)	Start date of Bright-line period
Standard purchase of land	Registration (settlement date)
Sales when there is no registration of title	Latest date property acquired (according to technical tax rules) – the person should get specialist advice if this situation applies to them.
Sales "off the plan"	Date of entry into the agreement to purchase
If a person acquired land and subsequently subdivided it.	The original date of registration for the undivided land
Converting a lease with a perpetual right of renewal into freehold title	Date the lease with a perpetual right of renewal is acquired

Type of disposal (the way the property is sold)	End date of Bright-line period
Standard purchase of land	Date of entry into agreement for sale
Gift	Date of gift (generally registration of title)
Compulsory acquisition	Date of compulsory acquisition
Mortgagee sale	Date land disposed of by mortgagee
Other disposals where no contract to sell	Date of disposal according to technical tax rules – the person should get specialist advice if this situation applies to them.