

WEEKLY COMMENT: FRIDAY 17 JUNE 2022

1. The *Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022* (“the March 2022 Tax Act”), which received the Royal assent on 30 March 2022, contains the new rules relating to interest deductibility for residential properties and the corresponding changes to the bright-line test. Inland Revenue issued *Special Report on Public Act 2022 No 10* (“the March 2022 SR”) on 31 March 2022 on interest limitation and additional bright-line test rules.
2. Last week and the week-before-last, I reviewed the new bright-line test rules, the bright-line acquisition dates, the implications for co-ownership of property and the rollover trust rules. This week I complete my review of the new bright-line test rules by looking at the new main home exclusion rules.

Main home exclusion: application

3. The new main home exclusion rules apply only to land acquired on or after 27 March 2021. The old main home rules apply to land acquired on or after 29 March 2018 but before 27 March 2021, to which the 5-year bright-line test in s CZ 39 applies.
4. Section 49(7) of the March 2022 Tax Act provides that the main home exemption in s CB 16A:
 - (a) Applies to a person’s disposal of residential land, if the person acquires an estate or interest in the land on or after 27 March 2021;
 - (b) Does not apply if the person makes an offer for the acquisition of the land, on or before 23 March 2021, that is irrevocable before 27 March 2021 and the person acquires an estate or interest in the land on or after 27 March 2021 as a result of that offer;
 - (c) Does not apply to:
 - (i) A person’s disposal of a freehold estate in residential land that the person acquired as the owner of a leasehold estate with a perpetual right of renewal, if the person was granted the leasehold estate before 27 March 2021;
 - (ii) A person’s disposal of an estate or interest in residential land that the person acquired as the result of the completion of a land development or subdivision, if before 27 March 2021 the person entered into the agreement under which they acquired the estate or interest upon the completion of the land development or subdivision.

New main home exclusion rules

5. Under the old main home rules, a person could qualify for the main home exclusion where their property was rented out for some of the time they owned it, provided the property was used predominantly as the owner's main home for more than 50 percent of the bright-line period.
6. Under the new main home rules, the bright-line test no longer applies on an all or nothing basis, but rather it applies only for the period a property is actually used as the owner's main home. The new main home rules require the gain on sale to be apportioned between main home use and non-main home use to ensure only the gain attributable to the non-main home use is taxed (sometimes referred to as the time apportionment rules). There is also a 12-month buffer within which the property can be used other than as the main home without tax implications. The 12-month buffer period can be used multiple times. Periods when the property is not used as a main home that exceed 12 months are taxed.
7. The 12-month buffer rule has been amended so that where a person is constructing their main home and construction takes more than 12 months the main home exclusion can still apply, and the person is not subject to the bright-line test. This is provided the time they take to construct the home is reasonable. There is no definition of "reasonable" and Example 87 provided by Inland Revenue on page 170 of the March 2022 SR refers to "reasonable in the circumstances". Therefore, this will have to be assessed on a case-by-case basis.
8. In addition, there is a new land apportionment rule that applies when there is a main home on the land, but the land is not predominantly used for the main home – for example, a second residence is added smaller than the existing main home, which becomes the person's main home. Under the land apportionment rule, the exclusion will apply to the main home portion, despite the land not being predominantly used for the main home.
9. Section CB 16A(1) sets out the new "main home exclusion" and states that s CB 6A does not apply to a person who disposes of residential land if, for the residential land (an "exempt main home"), all the days in the relevant bright-line period are "exempted predominant main home days", defined, in s CB 16A(1B), as meaning:
 - (a) A day within the land's bright-line period that the land has been used predominantly for a dwelling that was the main home for 1 or more main home persons;
 - (b) A day in a period that is equal to or shorter than the "exempt main home period limit", if, for the period, the land has not been used predominantly for a dwelling that was the main home for 1 or more main home persons, but:
 - (i) The start of the period adjoins either a day described in paragraph (a) or the start of the land's bright-line period; and
 - (ii) The end of the period adjoins either a day described in paragraph (a) or the end of the land's bright-line period.
10. "Exempt main home period limit" is defined in s CB 16A(1C) as meaning 365 days or, in the case of a period during which the person constructs a dwelling used as a main home for 1 or more main home persons, the length of that period, if it is reasonable.

11. “Main home person” is defined in s CB 16A(1D) as meaning, for a person, 1 or more of the following people:

- (a) The person;
- (b) A beneficiary of a trust, if the person is a trustee of the trust that owns the residential land disposed of, 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 that is being disposed of.

12. Section CB 16A(3) states that the exclusion in s CB 16A(1) does not apply to a person 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;
- (b) The person (including a “group of persons” as defined in s CB 16A(5)) has engaged in a regular pattern of acquiring and disposing of exempt main homes described in s CB 16A(1), and for this purpose, a “group of persons” is defined in s CB 16A(5) as:
 - (i) Meaning 2 or more persons when together all of the persons occupy, or have occupied, an exempt main home described in s CB 16A(1); and
 - (ii) Including a non-natural person if one of the persons referred to in paragraph (a) has significant involvement in, or control of, the activities of the non-natural person (and for the avoidance of doubt, if the other person is able to direct, alone or as part of a group, the activities of the non-natural person, they have significant involvement in, or control of, the activities of the non-natural person).

Quantification of income (land apportionment rule) under section CB 6A

13. A new land apportionment rule for land that is not predominantly used as the main home has also been introduced. This rule applies alongside the new main home rules (including the 12-month buffer) that apply to land acquired on or after 27 March 2021. This land apportionment rule does not apply to the old main home rules.

14. Previously, the main home exclusion applied where the land was used predominantly for the main home – meaning that more than half the land was used for the main home. This meant that a main home could fall outside the main home exclusion and be subject to tax under the bright-line test if less than half the land was used as a main home. For example, if two rental properties were built on the same title as a main home and those rental properties took up more than half the land, the previous main home exclusion would not apply. The whole gain on the sale of the property would be taxed if the land was sold within the applicable bright-line period, rather than just the gain attributable to the rental properties.

15. A land apportionment rule has been introduced for land not predominantly used as a main home to ensure the main home portion of the land is not taxed under the bright-line test.

16. The land apportionment rule will not apply if:

- (a) More than half the land was used for the main home, and the property was the person's main home for all the ownership period (including days in the 12-month buffer period): the main home exclusion applies;
 - (b) More than half the land was used for the main home, but the main home exclusion does not apply because the property was not the person's main home for the whole ownership period, in which case, any gain on sale that relates to periods the land was used as a main home will not be taxed, and only the gain that relates to periods the land was not used as the main home will be taxed.
17. The land apportionment rule applies, so that only the non-main home portion of the land is taxed, if:
- (a) The land was used for both a main home and a non-main home; and
 - (b) Less than half the land was used for the main home (so the usual main home exclusion, which applies where the land is predominantly used for a main home, does not apply).
18. Section CB 6A(8) provides the formula for calculating taxable income under s CB 6A derived from disposing of property. The income from the disposal is reduced by an amount equal to:
- $$(\text{Unadjusted income}) \times (\text{Exempted non-predominant main home days} \times \text{main home percentage} + \text{exempted predominant main home days}) / \text{Total days}$$
19. "Unadjusted income" is the income derived from disposing of property taxable under s CB 6A (i.e. 10-year test land or 5-year test land) before applying the above reduction.
20. "Exempted non-predominant main home days" is the total number of:
- (a) Days within the land's bright-line period that the land has been used for a dwelling that was the main home for 1 or more main home persons;
 - (b) Days in a period that is equal to or shorter than the exempt main home period limit if, for the period, the land has not been used for a dwelling that was the main home for 1 or more main home persons, and:
 - (i) The start of the period adjoins either a day described in paragraph (a) or the start of the land's bright-line period; and
 - (ii) The end of the period adjoins either a day described in paragraph (a) or the end of the land's bright-line period; but
 - (c) Does not include any exempted predominant main home days.
21. "Main home percentage":
- (a) Is defined in s CB 6A(11B) as the percentage area of the land that, during the exempted non-predominant main home days has been used as a main home;
 - (b) Inland Revenue notes in the March 2022 SR that:
 - (i) Whether all the land is to be included in the main home percentage will be a question of fact to be determined by considering whether all the land is used for or in connection with the main home;

- (ii) Land that has been used for a dwelling is not limited to the land on which the dwelling is situated or to the surrounding curtilage (like a yard or garden) and can, depending on the facts, include other areas used in connection with or for the benefit of the dwelling;
 - (iii) The apportionment is based in the percentage area of land – there is no option to pay tax based on the actual valuations of the property at the start and end of the period the property was not the taxpayer’s main home.
22. “Total days is defined in s CB 6A(11D) as the total number of days in the land’s bright-line period.
23. The combination of “exempted non-predominant main home days” and “main home percentage” gives an apportioned day count for the days where less than half the land has been used as a main home (including days of non-main home use under 12 months). For example, where a person has a house and a granny flat on the same title, and they live in the granny flat.
24. Exempted predominant main home days is covered in s CB 16A and provides the days when the land is predominantly used for the main home.
25. Together, the number of days provide the fraction of time when the main home exclusion will apply to the land being sold, and consequently, the amount by which the unadjusted income from the land is reduced.
26. The cost of residential property to which the land apportionment of income rule applies is correspondingly reduced under s DB 23C as follows:
- (a) Section DB 23 permits a deduction for the cost of revenue account property;
 - (b) For the purposes of s DB 23, s DB 23C(1) provides that the cost of residential land for which income is derived under s CB 6A(8) is *reduced by* the excluded adjustment amount calculated using the formula in s DB 23C(2);
 - (c) The formula in s DB 23C(2) for calculating the excluded adjustment amount for the purposes of s DB 23C(1) is:
$$\text{Cost} \times (\text{Exempted non-predominant main home days} \times \text{Main home percentage} + \text{Exempted predominant main home days}) / (\text{Total days})$$
 - (d) “Cost” is the cost of the land and the other items in the formula have the same meanings as in the income apportionment formula in s CB 6A(8).
27. Section CB 6A(11E) provides that the apportionment formula will not apply to a person described in s CB 16A(3), being a person to whom the main home exclusion does not apply because it has been used 2 or more times in the preceding 2 years, or the person or the person’s group has engaged in a regular pattern of acquiring and disposing of exempt main homes.



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