



QUESTION WE'VE BEEN ASKED

QB 18/16

Income tax – bright-line test – main home exclusion
– sale of subdivided section

This Question We've Been Asked (QWBA) explains when a section subdivided from a residential property sold within the bright-line period will be excluded from the bright-line test. It will be of interest to sellers seeking to rely on the main home exclusion.

Key provisions

Income Tax Act 2007, ss CB 6A and CB 16A

Question

When is the sale of a section subdivided from a residential property sold within the bright-line period excluded from the bright-line test?

Answer

The sale is excluded when the main home exclusion applies.

The main home exclusion will apply when:

- more than 50% of the area of the land in the subdivided section has been used for a dwelling that **was the seller's main home**; and
- the seller has used the land in the subdivided section in that manner for more than 50% of the time since the seller acquired the undivided land.

Key terms

Bright-line period: The bright-line period is 2 years or 5 years, depending on the rules in place when the seller acquired the land.

Bright-line test: The bright-line test applies to tax sales of residential land occurring within the bright-line period.

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

Subdividing involves the legal division of land into multiple sections and the creation of new legal titles for each section.

Explanation

The bright-line test

1. The bright-line test taxes residential land sold within the bright-line period.
2. This bright-line test applies to residential land that a person first acquired an interest in on or after 1 October 2015. The period of the bright-line test increased from 2 years to 5 years for residential land that a person first acquired an interest in, on or after 29 March 2018 (see s 6(2) of the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018). Therefore, this QWBA refers to

the “bright-line period” (which will be 2 years or 5 years, depending on when the seller first acquired an interest in the land).

Scope of this QWBA

3. This QWBA is about whether the main home exclusion to the bright-line test can apply in a situation where:
 - **there is undivided land which contains a dwelling (which is the seller’s main home);**
 - the land is subdivided into new sections, one which contains the dwelling and another (or others) which does not contain a dwelling; and
 - the subdivided section (or one of the sections) without a dwelling is sold.
4. Under the main home exclusion, if residential land has been used predominantly for a **dwelling that is the seller’s main home** and used in this manner for most of the time the seller has owned the land, then the sale of that land within the bright-line period is excluded from being taxed under the bright-line test.
5. In this QWBA, it is assumed that none of the other land rules in ss CB 6 to CB 12 of the Income Tax Act 2007 apply to the sale of the subdivided section, eg s CB 6, which applies to the sale of land acquired for the purpose of re-sale. The bright-line test needs to be considered only where the sale is not taxed under any of the other land rules in ss CB 6 to CB 12.
6. Additionally, for simplicity this QWBA assumes that the person disposing of the land is not the trustee of a trust. However, the analysis and conclusions in this QWBA are equally applicable if:
 - The person disposing of the land is the trustee of a trust, and
 - The dwelling was the main home for a beneficiary of the trust; and either
 - o A principal settlor of the trust does not have a main home; or
 - o The dwelling was the main home of a principal settlor.

How does the bright-line test apply to a sale of the subdivided section?

7. Before considering the main home exclusion further, it is useful to consider how the bright-line test applies to the sale of a subdivided section. Section CB 6A(1) sets out the basic bright-line test for sales of residential land within the bright-line period, and s CB 6A(2) sets out a special rule that applies to sales of residential land that the seller has subdivided.
8. Essentially, under s CB 6A(2), when a person sells a section of land that they have subdivided, the bright-line period that applies is the bright-line period that would have applied to the undivided land. Therefore, the bright-line period for the subdivided section does not begin when that subdivided section is registered; rather it begins when the transfer of the undivided land to the seller was registered. The fact that separate computer registers (previously certificates of title) are created for the subdivided sections is irrelevant to the bright-line period.
9. The **bright-line test applies to “residential land”**, which is a broadly defined term. The broad definition means that a subdivided section of land can still be residential land even where there is no dwelling on the land. For land to be residential land, it is sufficient that it is land for which the owner has an arrangement that relates to erecting a dwelling, or that the land is bare land that may be used for erecting a dwelling under the operative district plan.

10. The definition of residential land also excludes land that is:
 - “farmland”, or
 - used predominantly as business premises.
11. If a subdivided section of land is not residential land, the sale of the section will not be subject to the bright-line test.

Can the main home exclusion apply to a sale of a subdivided section of land?

12. The main home exclusion can apply to the sale of a subdivided section of land. This is despite the subdivided section of land being recorded in a different computer register (certificate of title) from the undivided land and despite the land having no dwelling on it. This is because the land in the subdivided section may still have been used predominantly, for most of the time the person owns the land, for a dwelling that was the **seller’s main home, as required by s CB 16A(1)**. The onus is on the seller to prove the main home exclusion applies and, therefore, that the bright-line test does not apply.
13. The following discusses the requirements of the main home exclusion generally before discussing how these requirements can be satisfied by a subdivided section of land.

The main home exclusion

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

CB 16A Main home exclusion for disposal within 5 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 time the person owns the land, 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.

[Emphasis added]

15. For the main home exclusion to apply, the land in question must have been used predominantly, for most of the time the seller owned it, for a dwelling that was the **seller’s main home**. This test has a number of elements, which are discussed below.
16. The land in the subdivided section must have been used predominantly for a dwelling **that was the seller’s main home** for more than 50% of **the seller’s period of ownership**. **“Main home” is defined in s YA 1:**
 - 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
17. **There are three points to note from the “main home” definition:**
 - A person can only have one “main home” under this definition.
 - To be the “main home” of a person, a dwelling must be mainly used as a residence by the person (ie, a home).

- If the person has more than one home, the main home is the home with which the person has the greatest connection.
18. The Commissioner's guidance on the "permanent place of abode" test can assist in determining which property the seller has the greatest connection with. That guidance is in "IS 16/03: Tax residence" *Tax Information Bulletin* Vol 28, No 10 (October 2016): 2.
19. 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 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.** It is the actual use of the land, rather than any intended use, that is relevant.
20. 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 for a dwelling include whether the land is:
- set aside exclusively for private residential purposes;
 - being 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.
21. The area of land in question must have been used for a dwelling by the seller.
22. For the main home exclusion to apply, the land in the subdivided section needs to have been used predominantly **for a dwelling that was the seller's main home**. This is a physical area test. The test involves a comparison of the physical area of land used by **the seller for the dwelling and the total area**. "Predominantly" in this context means more than 50%.
23. **From time to time, particularly where the split between the seller's private residential use of the land in the subdivided section and their use of the land in the subdivided section for other purposes is close, the nature and the importance of the different uses could be taken into account to determine the seller's predominant use.** The Commissioner considers this is the best interpretation of the exclusion because it is consistent with the scheme of the land rules and the purpose of the provision. It also **takes into account case law on the interpretation of words like "predominantly" in the context of the land rules.**
24. The words **"for most of the time the person owns the land"** 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" means more than 50%.**

The main home exclusion can apply to a subdivided section of land

25. The main home exclusion can apply to a subdivided section of land. There is no need for there to be a dwelling on the subdivided section. Land in a subdivided section without a dwelling can satisfy the requirement of being used predominantly, for most of the time the seller owned **it, for a dwelling that was the seller's main home**.
26. Section CB 23B clarifies that the land taxing provisions and the exclusions apply to an amount derived from the disposal of land where that land is part of the land to which the relevant section applies, the whole of the land to which the relevant section applies

or disposed of together with other land to which the relevant section applies. The Commissioner considers that s CB 23B does not affect the conclusion that the main home exclusion can apply to a subdivided section of land and that there is no need for there to be a dwelling on the subdivided section.

27. The Commissioner considers the seller of a subdivided section of land owns the land in the subdivided section from the date they acquired the undivided land. The fact that new computer registers (certificates of title) are created on subdivision does not mean that the seller did not already own the land in the subdivided section. The seller had an interest in the land in the subdivided section while it was part of the estate of the undivided land.
28. The land in the subdivided section could satisfy the requirements of the main home exclusion based solely on the use of the land in the subdivided section prior to the subdivision. The use of the land in the subdivided section after subdivision could also be relevant if, before being sold, the land continues to be used for a dwelling on one of the other sections resulting from the subdivision.

Example 1 – sale of subdivided section of land with no new dwelling

Simon acquires a property as his main home and, due to a change of circumstances, decides to subdivide it after 2 months. New computer registers (certificates of title) are created for the subdivided section with the dwelling and the subdivided section at the **rear of the property that was used as the backyard for Simon's** home (the backyard section). While attempting to sell the backyard section, Simon continues to enjoy the land in the section as his backyard. Simon eventually manages to sell the section 12 months later.

The sale of the backyard section is within the bright-line period that would have applied for the undivided property. Simon can use the main home exclusion for the sale because the land in the backyard section was predominantly used in connection with a **dwelling that was Simon's main home for most of (in fact, all of)** the time he owned the land.

29. Some activities undertaken on land in a subdivided section, before or after subdivision, may mean that the land is not being used for a dwelling **that was the seller's main** home. The period of ownership while that activity was being undertaken will need to be taken into account when calculating whether the seller has used the land in the subdivided section for a dwelling that was their main home for most of the time it was owned.

Example 2 – sale of subdivided section of land with new dwelling

Same facts as in Example 1 except that immediately after subdividing the backyard section Simon clears the area and begins constructing a new dwelling with surrounding curtilage (a small garden and a garage).

The main home exclusion will not apply to the sale of the backyard section of land because the land in the section was not used predominantly for a dwelling that was **Simon's main home** for most of the time he owned the land. Simon owned the land for a period of 14 months, but only used the land in the subdivided section for his main home for 2 months.

Example 3 – Delay in using the land as the main home

Hugo purchases empty land with the intention of building his dream home on it. It takes 18 months to obtain finalised architectural plans, the relevant building consents and engage a builder. Construction and final sign off take a further 18 months to complete. While the house is under construction Hugo lives with family in a nearby suburb. Hugo finally moves into the house 3 years after purchasing the land.

The cost of construction was more than Hugo had anticipated and he decides to subdivide and sell off a portion of his backyard to help pay his mortgage.

It takes a further year after moving into the house for Hugo to subdivide and sell the portion of his backyard. At all times during this period the subdivided portion of the backyard remained part of the backyard and Hugo continued to use it.

Even though the subdivided portion of Hugo's backyard was used predominantly for his dwelling (as the backyard), the sale of the subdivided portion of the backyard is not excluded from the bright-line test by the main home exclusion. Hugo has owned the land for 4 years, but only lived in the house for 1 of the 4 years (25% of the time he owned the land). Hugo has not used the subdivided portion of the backyard for a dwelling that was his main home for more than 50% of the time that he has owned the land.

How many times can a seller use the main home exclusion?

30. Under s CB 16A(2) the main home exclusion will not be available where a seller disposes of residential land and:
 - the seller has already used the main home exclusion two or more times within the 2 years immediately preceding the bright-line date (eg, in the case of a sale of land, within 2 years of the date the sale agreement is entered into); or
 - the seller has engaged in a regular pattern of acquiring and disposing of residential land.
31. Each section of land that results from a subdivision is a separate piece of residential land. If the main home exclusion is applied to the sale of multiple sections of land resulting from a subdivision (which could include the section with the dwelling), the application of the exclusion to each section will count as a separate use of the exclusion for the purposes of s CB 16A(2)(a).
32. This means, for example, if an area of residential land was subdivided into three sections of land and all three sections were sold and the main home exclusion was relied on for the sale of the first two sections, the main home exclusion could not be relied on for the sale of the third section (or for any other sales made by the seller in the following 2 years).
33. Additionally, the acquisition of undivided land and subsequent sales of subdivided sections will be taken into account when determining whether the seller has engaged in a regular pattern of acquiring and disposing of residential land.

34. These exceptions to the main home exclusion are considered further in "QB 16/07: Income tax – land sale rules – main home and residential exclusions – regular pattern of acquiring and disposing, or building and disposing" *Tax Information Bulletin* Vol 28, No 9 (October 2016): 4.

References

Subject references

Bright-line test
Main home exclusion
Subdivisions

Legislative references

Income Tax Act 2007, ss CB 6A, CB 6–CB 12, CB 16A, CB 23B, YA 1 ("own", "main home", "residential land")
Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018, s 6(2)

Other references

"IS 16/03: Tax residence" *Tax Information Bulletin* Vol 28, No 10 (October 2016): 2.
"QB 16/07: Income tax – land sale rules – main home and residential exclusions – regular pattern of acquiring and disposing, or building and disposing" *Tax Information Bulletin* Vol 28, No 9 (October 2016): 4.