Accountants and tax experts warn investors forced to sell early will be 'collateral' damage in new two year 'bright line' test aimed at speculators; Parents buying homes for kids via trusts will get caught too

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BDO Partner Alan Scott (left) and CAANZ Tax leader Peter Vial appear before the Finance and Expenditure Select Committee on Sept 23. Photo by Lynn Grieveson for Hive News.

By Lynn Grieveson

Property investors who suffer a change in circumstances forcing them to sell a property will be the “collateral damage” of the proposed bright line test, said tax lawyers and accountants at a parliamentary select committee hearing on Wednesday.

The bright line test, which comes into effect on 1 October, is designed to crack down on property speculation by automatically taxing the profit made on residential property (other than the main home) that is sold within two years of purchase.

Submitters from Chartered Accountants - Australia and New Zealand (CAANZ), EY, KPMG, Chapman Tripp and the Law Society were unanimous in telling the Finance and Expenditure Committee that the test would see rental property investors who sold due to illness, job loss or relationship breakdown hit with tax charges, while true traders and speculators would change their behaviour to avoid being taxed on their capital gains.

“This bright line test is a bad idea and shouldn't be enacted as in our view it will be ineffective in meeting the stated policy objective,” said Stephen Tomlinson of the Law Society Taxation Committee.

He described the proposed legislation as “incoherent, and just makes the current rules which are already fraught with difficulty even more difficult to apply.”

Tomlinson said the Taxation (Land Information and Offshore Persons Information) Bill passed earlier this month, which amended the Land Transfer Act to require buyers and sellers to provide IRD numbers, would be more effective than the bright line test at deterring property speculators by providing Inland Revenue “with effectively an audit list to basically go and check these property transactions, go and ask questions where they think questions should be asked and enforce the current taxation regime.”

The submitters were also unanimous in criticising the bright line test as inconsistent with already existing land taxation regulations.

BDO Tax Partner Alan Scott warned that people living in a property bought through a trust using money provided by parents might not be able to use the main home exemption to escape being taxed, even though they are a beneficiary of the trust.

Unlike under existing legislation, the parents, as “principal settlor,” would be the only ones able to claim the main home exemption.

'Change the start time'

The submitters also all called for a change in the time that the bright line clock started ticking, to bring it into line with current regulations setting the date of acquisition of a property as the day the contract becomes unconditional, rather than when the title is registered.

They said this would effectively make the bright line period longer than two years in nearly all cases.

“Using the date that title is registered also has an aspect of unfairness about it, because it effectively defers the start of the bright line period and that's contrary to the principle that was put in the regulatory impact statement to minimise the number of sales that are made taxable without an intention of sale,” said Peter Vial of Chartered Accountants Australia and New Zealand.

“We think that deferring the start of the bright line period by that acquisition date definition will mean that more properites are caught where there is no intention of disposal, more sales are caught, so there will be more collatoral damage.”

Ringfencing also criticised

The proposed bright line law also differs from existing land taxation law by ring-fencing losses made by property investors, which Tomlinson called “quite an abhorrent aspect” of the rules.

“The stated purpose of these rules is just to buttress the [intention] test. There is no such ring-fencing of losses under the existing test so we query why there should be a ring-fencing of losses under this proposed bright line test. It does create an economic distortion and we consider that is unnecessary and it is a bit of a design flaw of the Tax Act. We don't have those type of restrictions in relation to other types of losses. I thought we had got rid of that in the late 1980s ... and we find this now creeping back into the Tax Act,“ Tomlinson said.

The bright line test would also capture as “collatoral damage” people who sold within two years because they were forced into a mortgagee sale or were subject to a compulsory acquisition.

After hearing submissions calling for exemptions for such vendors, Jamie-Lee Ross asked why shouldn’t people forced into a mortgagee sale pay tax on any capital gain.

EY Executive Director David Snell said that depended on what the government’s true aim in bringing in the bright line test was.

“If you are bringing in this rule because you feel the current intention test needs some support it shouldn't be taxable because that is not what you are trying to design. If you are trying to tax as wide a range of gains as possible, then yes, it should be taxed. However, that latter point was not how the policy was explained on introduction,” Snell said.

He agreed with previous submissions arguing that, rather than introducing the bright line legislation, the government should instead amend the existing tax legislation to include an assumption that property sold within two years was being traded and therefore subject to tax – but allowing vendors the right to argue against the assumption.

'Cut it to one year'

Also presenting a submission was Andrew King of the Property Investors’ Federation. He called for the bright line test to be cut so it applied only to properties sold within one year.

“Rental property is a long term thing. Most of our members will not be affected unless something that happens out of their control such as a terminal illness or losing their job,” King said.

“A trader or speculator makes their money through trading and speculating,” he said.

“They buy and sell fast because holding the property incurs costs and reduces their potential gain. If the bright line test was one year it would catch 95% of the traders and speculators but it wouldn't have the affect on rental property investors who intended to hold for the long term but were forced by circumstances to sell.”

King also called for a hardship clause to exempt property investors forced to sell because of illness or job loss.