December 2010

Fact sheet – Post-budget changes to tax depreciation rules

Budget 2010 removed depreciation deductions for most buildings from the start of the 2011–12 income year. At the same time the Government announced a review of the tax treatment of commercial building fit-outs to ensure that depreciation allowances apply to commercial and industrial building fit-outs.

- Following this review, the bill introduces new rules to ensure that the fit-out of commercial and industrial buildings will continue to be depreciable.
- Budget 2010 also removed depreciation loading for assets purchased after 20 May 2010. The bill makes technical changes to these rules to ensure that depreciation loading still applies to assets where investment decisions were made before 20 May 2010 but not completed until sometime after.

Commercial fit-outs depreciable

- The law will be clarified so that commercial and industrial fit-out remains depreciable property.
- The law relating to residential fit-outs will remain unchanged. Residential fit-out is generally non-depreciable as set out in the Commissioner of Inland Revenue's Interpretation Statement IS10/01.
- Items of fit-out that are shared between commercial and residential purposes – for example, lifts, electrical cabling, fire protection, sewerage and water reticulation in a mixed-purpose building will be depreciable if the dominant purpose of the building is commercial. Fit-out used only for commercial purposes will be depreciable property.
- The new rules recognise that there are commercial buildings that provide residential-type accommodation by excluding a number of these types of buildings from the meaning of "dwelling". This will ensure that fit-outs associated with these buildings will continue to be depreciable. The types of buildings that will be specifically excluded from the meaning of "dwelling" are:
  - hospitals;
  - hotels, motels, inns, hostels, or boarding houses;
  - certain serviced apartments;

- convalescent homes, nursing homes, or hospices;
- rest homes or retirement villages, from hospital care through to residential care facilities; and
- camping grounds.

- A new rule will allow commercial building owners, who did not itemise building fit-out separately from the building at the time of acquisition, to amortise up to 15% of the building's adjusted tax book value at 2% straight-line per year until the building is disposed of.

Depreciation loading

Depreciation loading was removed on a prospective basis as part of Budget 2010. Loading continues to apply in respect of assets purchased or constructed before 20 May 2010 or when there was a commitment to purchase or construct an asset on or before 20 May 2010. While the existing legislation that gave effect to this grandparenting worked in most situations, its result was unclear in others.

- Under the new rules an asset will be eligible for depreciation loading if:
  - it is acquired on or before 20 May 2010; or
  - there was a decision to purchase or construct it and its owner either:
    - entered into a binding contract for its purchase or construction on or before 20 May 2010; or
    - incurred expenditure in relation to it on or before 20 May 2010.

- The first part of this rule will cover assets that were clearly purchased on or before 20 May 2010. The second part will cover situations when there was a clear commitment to purchase an asset, but when the purchasing process was incomplete or, for an asset under construction, when the asset was not yet built.

- Evidence of a decision to purchase or construct an asset can be provided through documents that conclusively show such a decision had been made. Alternatively, a decision can be evidenced through a statutory declaration sent to the Commissioner of Inland Revenue that states that a decision had been made.