Depreciation – what do I need to know?

Special Excluded Depreciable Property

2011 income year

1 April 1993

?

Estimated useful life

30 July 2009

grandparented structures

COVID-19

excluded depreciable property

What about Fit-out?

Commercial buildings

Businesses can claim depreciation loss as a deductible expense each tax year.

You can claim a deduction for depreciation loss on capital assets. You can do this for those you own, lease (under certain types of leases, as depreciation for tax purposes is only allowed on specified or finance leases), or buy under a hire purchase agreement and use, or intend to use, in your business.

You can claim deductions for depreciation on chattels being used to earn income. But you can only claim the proportion relating to income producing times.

Most farm buildings do not appreciate in value. Farm buildings are more likely to depreciate in value over commercial and residential buildings.

Changes to depreciation rules

From 1 April 2011, tax depreciation on all buildings was at 0%. As part of the Government's economic response to COVID-19, from the 2020-2021 income year onwards, depreciation is allowable for commercial and industrial buildings.

As part of its COVID-19 tax relief measures, the Government raised the low-value asset threshold for depreciation from $500 to $5,000. This allows the immediate expensing of assets purchased on or after 17 March 2020 that cost less than $5,000. This threshold is in force till 16 March 2021. For assets purchased on or after 17 March 2021, this threshold will be permanently increased from $500 to $1,000. For items that fall below the threshold, the depreciation loss is the item's cost. Above the threshold, the items must be depreciated using the diminishing value or straight-line method. Ask us about calculating depreciation.

The rules around depreciation made exceptions for farming businesses through the period following 1 April 2011.

Exception – grandparented structures

Even after the changes from 1 April 2011, some buildings could be treated as 'structures' for tax purposes. While 'buildings' are not depreciable, 'structures' continued to be depreciable. Buildings purchased prior to 30 July 2009 can be treated as structures for tax purposes. These are said to be 'grandparented' – they are treated under the old rules, not the new.

The key example here for farming businesses is barns (including drying barns). The definition of 'barns' provided by Inland Revenue is quite wide.

> 'Barns are typically large structures. They provide dry shelter on farms for things such as livestock, grain, hay, farm vehicles, and equipment. They are constructed out of long-lasting materials, such as wood, corrugated iron, steel, or concrete and have walls and a roof.'

Most farm buildings (outside the farmhouse and whatever residential quarters there are) would come under that definition. If you sell a building and make a loss on the sale, there's no deduction for that. If you sell a structure – like a barn – and make a loss, you are allowed a deduction.

what does this mean?	For a barn which you bought before 30 July 2009, if you sell it and make a loss, that loss is deductible - it's a grandparented structure. Once the barn is sold however it will lose its status as a grandparented structure and will be required to be treated as a building by the new owner.
but what about improvements?	Any improvements made after 30 June 2009 are not included and they must be treated as a separate item. We'll talk about fit-out a bit further on.

Exception – Special Excluded Depreciable Property

Another category of buildings on which depreciation can be calculated is that of Special Excluded Depreciable Property. Basically, this is all structures that aren't listed in the new Schedule 39 of the Income Tax Act 2007.

what does this mean?	There are a number of assets which you would typically expect to find on a farm, and we can continue to depreciate them at the scheduled rates.

So, if you've built a barn sometime after 1 April 1993, it meets the definition of a 'building'. But it also meets the definition of a 'barn'. Barns are provided for separately and we can depreciate those.

Other items listed include cool-stores and freezing chambers, slaughterhouses on farms, fowl houses, plastic hothouses and PVC tunnel houses, glasshouses, covered sheds, and implement yards.

We go back to that distinction between a 'building' and a 'structure'. For example, you could say a covered yard is not a building at all. It's unlikely to have walls. More likely it's just a roof with open sides. It's more likely to be a structure. So you'd apply the default depreciation rate of 4% for structures.

What about fit-out?

While depreciation cannot be calculated on buildings for the periods between 1 April 2011 and 31 March 2020, depreciation could be calculated on fit-out during that period, where the building is commercial and not residential.

'Fit-out' has quite a wide definition under the rules but it's basically plant attached to a commercial building that is non-structural and not used for water-proofing the building.

You can apportion a value for depreciation on fit-out.

For example, maybe you have a woolshed. It's over 50 years old and for whatever reason, you're no longer comfortable depreciating this as a barn. However, sometime in the 90s you did a lot non-structural work on the shed, maybe put in a ventilation system, some secure storage areas, shelving and strip lighting.

It was a considerable cost at the time, but you never claimed depreciation on it as a separate item.

It is possible to do an apportionment for commercial fit-out, provided you can show:

- it's a commercial building (for instance, a woolshed or hay barn would be clearly commercial, not residential)

- the fit-out elements are non-structural and not used for waterproofing the building

Keep in mind

The Inland Revenue website has detailed information on depreciation including its guide IR260. If you would like to talk it through, please contact us and we'd be happy to look at how the rules apply to your situation.