Inland Revenue
Te Tari Taake

CSUM 25/07: NZTCRA finds remediation work on unit was capital in nature

Decision date: 22 April 2025

CASE

P v Commissioner of Inland Revenue [2025] NZTCRA 04

LEGISLATIVE REFERENCES

Income Tax Act 2007, ss DA1(1), DA2(1)

Tax Administration Act 1994, s138P

LEGAL TERMS

Deductible expenditure; capital limitation; weathertightness; repairs and maintenance; change in character; one project.

Summary

The Taxation and Charities Review Authority (**TCRA**) confirmed the Commissioner's assessments for the income tax years ending 31 March 2015 and 2017 disallowing deductions claimed for remedial work undertaken on the disputant's unit. The remedial work to fix weathertightness issues changed the character of the asset and was capital in nature.

Impact

The outcome of this case turns on its facts with the TCRA finding the remediation work was substantial and changed the character of the asset.

Facts

The disputant owned a unit (the **Unit**), one of 13 residential units in a multi-level building.

In 2011 water leaks appeared in the Unit causing damage, which was greatly accelerated by defective building techniques including the direct monolithic cladding that was not installed correctly and poor construction detailing of the plaster clad deck and deck exterior wall junctions. There were also issues with a defective fire-rated barrier with the adjoining unit.

The remedial work on the Unit included removal of the direct-fix monolithic cladding and replacing it with a monolithic plaster finished fibre cement sheet cladding system on a cavity on a rigid air barrier, replacement of water damaged timber framing and treatment of undamaged timber framing, removal of tiles and the membrane underneath on the decks and replaced with trafficable membrane instead of re-tiling, removal of the planter box and replaced with a glazed balustrade. The existing doors and windows were also removed while work was completed and re-flashed and reinstalled.

The disputant claimed the costs of the remediation work as deductible expenditure in his 2015 and his 2017 income tax returns based on the expenditure being for repairs to the unit.

The Commissioner says the work was of a capital nature as it substantially improved the Unit from being a defective, leak prone unit to a watertight, safe and secure unit.

Issues

The main issue to be determined was whether the expenditure incurred was for work that changed the character of the Unit and therefore capital in nature and not deductible.

Decision

In addressing the primary issue of whether the work is a repair or a non-deductible capital expense, the relevant asset on which the work was performed must be identified. The parties agreed that the asset in question was the Unit, not the whole building. The TCRA agreed that was the appropriate approach.

The TCRA concluded that the remediation work on the Unit was substantial and went beyond the scope of repairs in the following ways:

- The work was significant in terms of cost;
- The work changed important parts of the structure. The replacement of the cladding was significant not only in being a critical component of the building, but also the replacement was a great improvement;
- The work included restoration of part of the structural framing;
- The decking area involved substantial replacement of materials incorporated into the unit there were poorly designed. And constructed so as not to achieve acceptable weathertightness; and

- The result of the work is a fully functional unit, that will have the longevity, function and legal status it should have had from the time of its construction; however, as constructed it was seriously defective.

The work on the external wall cladding, framing, deck surface, deck balustrade and planter were all a single project. The project required major work on the Unit and replacement of inferior and unacceptable systems with effective ones. These were necessarily addressed simultaneously for reasons of cost, efficiency and ensuring all components were effective in achieving full weathertightness.

This work went beyond repairing wear and tear and improved and altered the character of the asset. The Unit was remediated with the result that all the defects were addressed and the Unit put into a sound watertight condition. The Unit was greatly superior to its state when constructed.

The disputed expenditure was non-deductible capital expenditure because that work was an integral part of a substantial capital project and the work itself extended beyond the scope of repair, altering the character of the unit.