

EXPOSURE DRAFT - FOR COMMENT AND DISCUSSION ONLY

Deadline for comment: **05 November 2021**

Please quote reference: **ED0233**

Email feedback to Public.Consultation@ird.govt.nz

QUESTIONS WE'VE BEEN ASKED

Elections not to depreciate commercial buildings

Issued: XX XXXX 2021

Publication number QB XX/XX

This question we've been asked clarifies the ramifications to taxpayers of making an election not to depreciate their commercial building prior to 1 April 2011.

Key provisions

Income Tax Act 2007 – s EE 8

Question

The depreciation rates for buildings with a useful life of 50 years was reduced to 0% from the 1 April 2011; the 2012 tax year. With effect from the 2021 income year the rates of depreciation for commercial buildings were reinstated to their pre-2012 levels.

What are the ramifications for taxpayers that elected, prior to the 2012 income year, to treat their commercial building as not being depreciable property and not claim the relevant depreciation loss?

Answer

Where a taxpayer made an election to treat their commercial building as not being depreciable property, that election is irrevocable, and the taxpayer is bound by that election until the building is disposed of. To be effective, the election must have been made "in writing".

A taxpayer that did not make an election and depreciated their commercial building must continue to depreciate the building at the rate set by the Commissioner.

A taxpayer that did not make an election but has never claimed a deduction for depreciation in respect of their commercial building may make a retrospective election not to depreciate that building. The retrospective election will apply from the date the building was acquired.

Key terms

"Commercial building" means (for the purpose of this publication) a building that is not a "residential building".

"Election" means notice given to the Commissioner in a taxpayer's return of income.¹

"Residential building" means a dwelling and includes a building intended to ordinarily provide accommodation for periods of less than 28 days at a time, if the building, together with other buildings on the same land, has less than 4 units for separate accommodation.²

¹ s EE 8(4) of the Income Tax Act 2007.

² s YA 1 of the Income Tax Act 2007.

Explanation

Background

The depreciation regime

1. Taxpayers are allowed a deduction for depreciation for items of depreciable property³ which are used in a business to gain assessable income.⁴
2. It is mandatory for a taxpayer to claim a deduction for depreciation where one is allowed. The deduction is calculated by using the most appropriate rate of depreciation for that asset as set out in the Commissioner's table of depreciation rates⁵ and applying it to the cost of the asset.⁶
3. When the asset is disposed of, the taxpayer is deemed to have claimed the applicable depreciation deduction, even in circumstances where they have chosen not to claim the deduction. For the purposes of calculating the depreciation recovery income or loss on sale, taxpayers are deemed to have claimed the allowable depreciation deduction and the quantum of income or loss on disposal is calculated accordingly.
4. There may be valid commercial reasons why a taxpayer may not wish to claim a deduction for depreciation. With this in mind, in 1997 Parliament introduced s EE 8 of the Income Tax Act 2007⁷ to allow taxpayers to elect that certain of their assets were to be treated as not being depreciable property. The effect of making such an election was that a taxpayer cannot claim a deduction for the amount of depreciation in respect of the elected asset that they otherwise would have been entitled to.
5. An election to treat an asset as not being an item of depreciable property can be made in the year that the asset was acquired, or the year in which the use of that asset in the taxpayer's business changed. A change in use can occur when, for instance, a private

³ *Depreciable property* is defined by s EE 6 of the Income Tax Act 2007.

⁴ ss DA 1, DA 4 and EE 1(2) of the Income Tax Act 2007.

⁵ These are set out in the department's booklet *IR265* available at ird.govt.nz

⁶ s EE 16(3) of the Income Tax Act 2007.

⁷ Previously s EG 16A of the Income Tax Act 1994.

asset is introduced into a business and becomes eligible for a claim for depreciation. Once made, an election is irrevocable.

6. Making an election does not allow a taxpayer to “pick and choose” which years they claim a deduction for a depreciation loss on these assets. An election can only be made:
 - prospectively at the time that the asset is acquired, or its use changes, or
 - retrospectively, but only if the taxpayer has not made a claim for a depreciation loss in any year since they acquired the asset.
7. Once a taxpayer has claimed a deduction for an amount of depreciation in respect of their asset or made an election to treat that asset as not being depreciable property, the taxpayer is bound to follow that treatment until the asset is disposed of. The taxpayer therefore chooses “once and for all” whether to claim a deduction for a depreciation loss in respect of that asset.
8. An election to treat an asset as not being depreciable property can only be made by a taxpayer giving “notice” to the Commissioner of the taxpayer’s intention in the taxpayer’s return of income. The Commissioner must be “notified”.
9. Given the election requirements stated at [6], a taxpayer needs to provide the Commissioner with the following information:
 - Where a prospective election is being made, the notice needs to advise the Commissioner of the asset(s) that the election is in respect of and that asset’s acquisition date (or the date that its use in the business changed and how it changed).
 - Where a retrospective election is being made, the notice will need to advise the Commissioner of the asset that the election is in respect of, the asset’s acquisition date, as well as a statement that the taxpayer has not made a claim for depreciation in respect of that asset since the date of its acquisition. A retrospective election can be made in any income year after the year the asset was acquired, including the year that the asset is disposed of and the years subsequent to its disposal.
10. Although the election is required to be made in the taxpayer’s return, the election also needs to provide notice to the Commissioner of the election. Given this, and the fact that a taxpayer’s return of income does not provide the Commissioner with any of the required information, it is the Commissioner’s view that a taxpayer is only able to make an election in writing by correspondence (either separately or attached to the return), by email or by webmail.

11. Simply choosing not to depreciate an asset in a taxpayer's tax accounts does not notify or provide notice to the Commissioner that the taxpayer wishes to elect to treat that asset as not being an item of depreciable property. This is because tax accounts are not supplied to the Commissioner with a taxpayer's return of income. In addition, per [2], without making an election, not claiming an amount of depreciation where one is allowed is not a choice available to taxpayers and (per [3]) may have consequences when the taxpayer disposes of the asset.
12. Despite the legislative wording, the Commissioner does not expect taxpayers to literally attempt to provide notice "in" their return of income. It is sufficient that written notice is either attached to the return or provided separately to the Commissioner at, or approximate to, the time that the return is provided.

The depreciation of commercial buildings

13. Prior to the 2012 income year buildings with an estimated useful life of 50 years were able to be depreciated for tax purposes at a rate of 2% per annum. Commercial buildings fell within this category. However, the budget of 20 May 2010 introduced a number of changes to the depreciation regime, including replacing the straight-line depreciation rate of 2%⁸ applicable to buildings with one of 0%.
14. This change was included in the Taxation (Budget Measures) Act 2010⁹ and was effective from the beginning of a taxpayer's 2011–12 income year. It is important to note that the ability to claim depreciation was not removed. What changed was the rate at which the amount of any depreciation was calculated.
15. Commercial buildings remained depreciable at the rate of 0% until the beginning of the 2020–21 income year.¹⁰ The Covid-19 Response (Taxation and Social Assistance Urgent Measures) Act 2020 reinstated the previous depreciation rates of 2% or 1.5%.¹¹

⁸ Or 1.5% using the diminishing value method.

⁹ See *Tax Information Bulletin* Vol 22, No 7 (August 2010) for further information.

¹⁰ Further information regarding the application date for this change is contained in [QB 21/05: The application date for the depreciation of commercial buildings](#).

¹¹ See *Tax Information Bulletin* Vol 32, No 5 (June 2020) for further information.

The effect of making (or not making) an election to treat a commercial building as not being depreciable property

16. Prior to the depreciation rate for commercial buildings being reduced to 0%, while many taxpayers claimed a deduction for depreciation on their commercial building, there were a number of taxpayers that made a written election to treat their building as not being depreciable property and subsequently did not claim a deduction for depreciation in respect of that commercial building.
17. There were a number of other taxpayers that, while deciding not to depreciate their commercial building, did not adequately give notice to the Commissioner of their election (by way of notifying the Commissioner in writing, per [5]-[12]). Rather they simply did not claim a deduction for the amount of depreciation loss on their commercial building in their tax accounts in the mistaken belief that this was all that was required by way of an “election”.
18. Now that taxpayers are able to depreciate their commercial buildings at a rate other than 0%, the effect of these previous decisions to depreciate (or not depreciate) their commercial buildings is summarised as follows:

Taxpayers that have previously claimed a deduction for an amount of depreciation loss on their commercial buildings

19. Without first electing to treat an asset as not being depreciable property, claiming a deduction in respect of depreciation is mandatory for all taxpayers (per [2]). Once a taxpayer has made a claim for an amount of depreciation in respect of that commercial building in any income year, there is no ability for the taxpayer to elect to treat that asset as not being depreciable property. As stated previously (at [6]), a retrospective election is only able to be made where a taxpayer has never made a claim for depreciation in respect of that asset.
20. The taxpayer must therefore continue to claim a deduction for the amount of depreciation in respect of their commercial building in each income year. If a taxpayer does not claim a deduction for the amount of depreciation on their commercial building in an income year, they will be deemed to have made a claim (per [2] and [3]).

Taxpayers that have previously made a written election to treat their commercial building as not being an item of depreciable property

21. An election made by a taxpayer is irrevocable. It has effect for the income year in which the election is made, and all future income years until a disposal event occurs. That is:

- the commercial building is disposed of,¹² or
 - the use of the building changes and as a result the taxpayer is denied a deduction for the amount of depreciation loss on the building,¹³ or
 - the nature of the taxpayer's activities change to one of gaining exempt income, or
 - the building suffers irreparable damage or damage that renders the building useless, or
 - the building is subject to acquisition by a person acting under statutory authority.
22. Given the above, until a disposal event occurs a taxpayer that has made a previous election to treat their commercial building as not being an item of depreciable property, cannot claim depreciation in relation to that building. This is so irrespective of the fact that the rate of depreciation may change for the elected asset (in the case of commercial buildings, from 2% or 1.5% to 0%, and then back to 2% or 1.5%)

Taxpayers that have previously not claimed a depreciation loss in relation to their commercial building, but have not made a written election to treat their commercial building as not being an item of depreciable property

23. This circumstance may arise because the taxpayer erroneously believed that an election could be made simply by not claiming a deduction in their tax accounts for the amount of depreciation allowed on their commercial building. It could also occur because the taxpayer was unaware that claiming an amount of depreciation loss is mandatory.
24. The effect in either circumstance is that the taxpayer has failed to claim a mandatory deduction.
25. Given this, the taxpayer has two options. Either:
- the taxpayer commences to claim the relevant depreciation loss in relation to their commercial building, and request that the Commissioner reassess the relevant back year returns to claim the appropriate amount of depreciation in

¹² s EE 8(5) of the Income Tax Act 2007.

¹³ s EE 47 of the Income Tax Act 2007.

those years,¹⁴ (subject to the time-bar rules contained in s RM 2 of the Income Tax Act 2007), or

- as the taxpayer has not claimed a deduction for any amount of depreciation for the commercial building, they can now provide a written election to the Commissioner, electing to retrospectively treat the commercial building as not being an item of depreciable property.¹⁵

Such a retrospective election is effective for all years from the year the commercial building was acquired.¹⁶ This effectively rectifies the errors made in the taxpayer's past returns of income.

As previously stated, a retrospective election can be made in any income year after the year the asset was acquired, including the year that the asset is disposed of and the years subsequent to its disposal.

¹⁴ Such a request can be made in terms of s 113 of the Tax Administration Act 1994. See also standard practice statement [SPS 20/03: Requests to amend assessments](#).

¹⁵ s EE 8(3) of the Income Tax Act 2007.

¹⁶ s EE 8(5) and (6) of the Income Tax Act 2007.

References

Legislative References

Income Tax Act 1994 – s 16A

Tax Administration Act 1994 – s 113

Income Tax Act 2007 – s DA 1, s DA 4, s EE 1(2), ss EE 8(3), (4), (5) and (6), s EE 16(3), s EE 47, s RM 2 and s YA 1

Other References

“Changes to Building depreciation” *Tax Information Bulletin* Vol 22, No 7 (August 2010): 12
<https://www.taxtechnical.ird.govt.nz/tib/volume-22---2010/tib-vol22-no7>

“Depreciation deductions for non-residential buildings” *Tax Information Bulletin* Vol 32, No 5 (June 2020): 2 <https://www.taxtechnical.ird.govt.nz/tib/volume-32---2020/tib-vol32-no5>

About this document

Questions we've been asked (QWBAs) are issued by the Tax Counsel Office. QWBAs answer specific tax questions we have been asked that may be of general interest to taxpayers. While they set out the Commissioner's considered views, QWBAs are not binding on the Commissioner. However, taxpayers can generally rely on them in determining their tax affairs. See further [Status of Commissioner's advice](#) (December 2012). It is important to note that a general similarity between a taxpayer's circumstances and an example in a QWBA will not necessarily lead to the same tax result. Each case must be considered on its own facts.