

## FACT SHEET | PUKA MEKA

# Leaky buildings and income tax – deductibility of repairs and maintenance expenditure – general principles

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IS 26/01 FS 2

This fact sheet accompanies IS 26/01: *Income tax – deductibility of repairs and maintenance expenditure – general principles*. IS 26/01 explains when you can claim an income tax deduction for repairs and maintenance costs for physical property and features 27 examples (including two relating to leaky buildings). This fact sheet gives a brief summary of the key points from IS 26/01 that specifically relate to leaky buildings. Another fact sheet (IS 26/01 FS 1) summarises all the key points from IS 26/01.

All legislation references are to the Income Tax Act 2007.

## Key provisions | Whakaratonga tāpua

Section DA 1 (general permission) allows deductions for expenditure incurred in deriving assessable income.

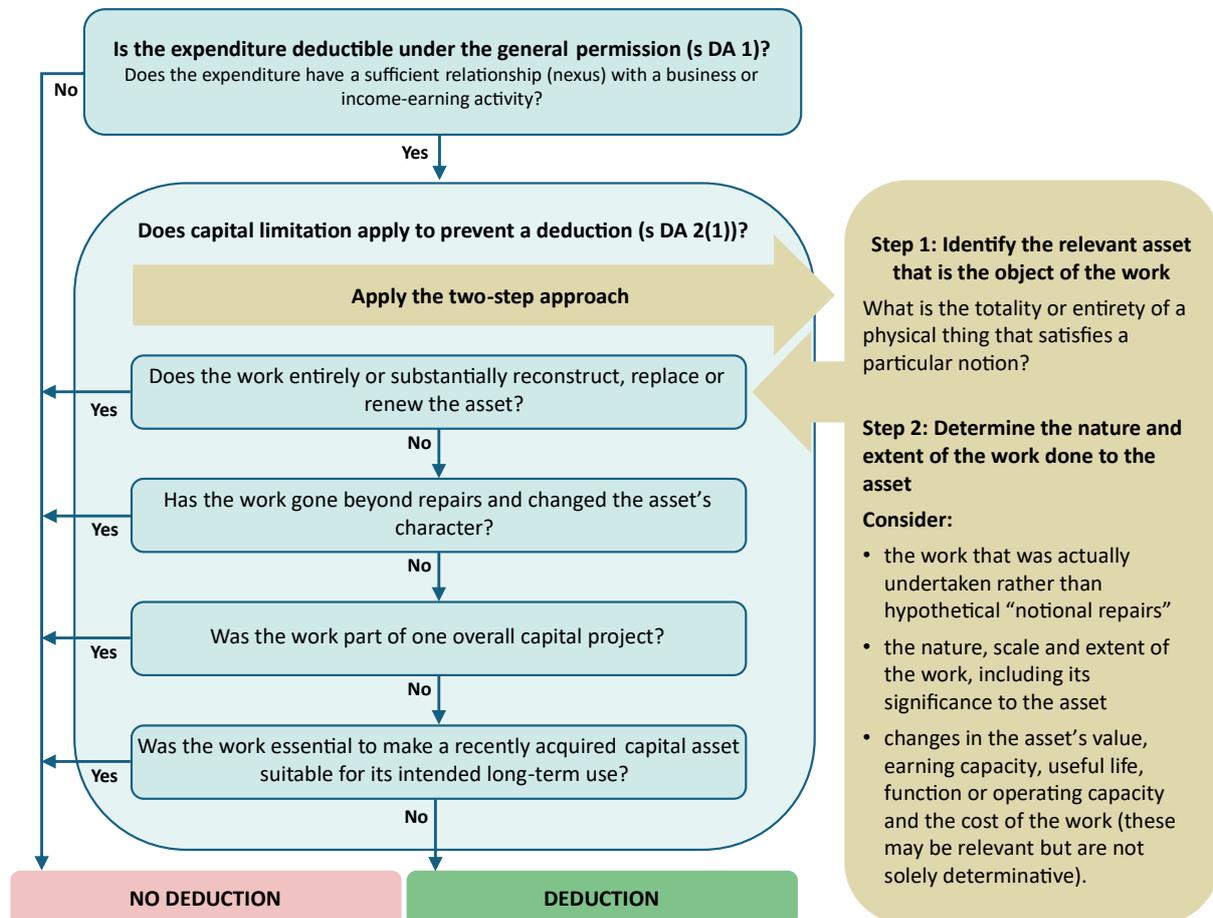
Section DA 2(1) (capital limitation) denies deductions for capital expenditure.

## Introduction | Whakataki

1. IS 26/01 *Income tax – deductibility of repairs and maintenance expenditure – general principles* is about tax deductions for the cost of work carried out on physical property used in a business or income-earning activity. This work might be called repairs, maintenance, alterations or improvements.
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2. A deduction is allowed if the expense:
  - meets the requirements of the general permission (section DA 1(1)); and
  - is not prevented by the general limitations (section DA 2).
3. The general permission requires that you incur the expense to:
  - help earn income (either assessable or excluded income under the Act); or
  - be part of running a business aimed at earning that income.
4. The guidance in IS 26/01 assumes you already meet these requirements. It focuses on the capital limitation in section DA 2(1) that prevents deductions for capital expenses.
5. From 22 May 2025, a 20% Investment Boost deduction may be available for capital repairs and maintenance expenditure that is an improvement to an item of depreciable property, such as a commercial building. For more information see [New assets - Investment Boost](#). Investment Boost is not available for residential rental buildings.
6. The following flowchart will help guide your analysis.

Figure 1 | Hoahoa 1: Summary of analytical approach



## Does the capital limitation deny a deduction?

- To decide whether an expense is capital (not immediately deductible) or revenue (deductible), courts look at the full set of circumstances including what the expense is meant to achieve from a practical business point of view. Every case is unique and the courts emphasise that you must look carefully at the specific facts before applying past court decisions to different circumstances.
- However, generally, the courts take a two-step approach to repairs and maintenance expenditure:
  - Identify the relevant asset that is being repaired or worked on.
  - Consider the nature and extent of the work done to that asset.
- For the purposes of this fact sheet, it is assumed the relevant asset identified under the first of these steps is the building that is being repaired or worked on. This leaves the

second step, which is to consider the nature and extent of the work done to the building.

## Step 2 – consider the extent and nature of work done

10. Whether repairs and maintenance expenses can be deducted depends on what work was actually done. You cannot claim a deduction for a hypothetical or notional repair cost that might have been incurred if the work been done differently.
11. When looking at the extent and nature of the work done, consider:
  - Did the extent of the work involve the reconstruction, replacement or renewal of the building, either entirely or substantially? If yes, the expense is capital expenditure.
  - If not, did the nature of the work go beyond fixing normal wear and tear (ie, repairs) and change the building's character? If yes, the expense is also capital expenditure.
12. To decide whether the work done on the building is capital in nature, consider the nature, and extent of the work. This includes how significant the work is to the asset. Changes to a building's value, earning capacity, useful life, function or operating capacity—whether intended or not—cannot by themselves make the work capital. The cost of the work may also be relevant.
13. If the work is part of one overall capital project, the cost of that work takes on the overall project's capital nature. But, if the work is standalone and not part of a larger plan, it is assessed on its own. Costs incurred at the same time can be treated separately, depending on whether they are part of a larger project or not.
14. If the expense is for work carried out on a recently acquired building that is essential to make it suitable for your intended long-term use, the cost is part of the building's acquisition cost and cannot be deducted. But, if the building is used to earn income before the work is completed, any extra repairs caused by this use may be deductible. For more information, see: QB 25/17 *Income tax: Can I claim a deduction for expenses I incur on repairing a recently acquired capital asset?*<sup>1</sup>

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<sup>1</sup> *Tax Information Bulletin* Vol 37, No 7 (August 2025): 61 [www.taxtechnical.ird.govt.nz/questions-we-ve-been-asked/2025/qb-25-17](http://www.taxtechnical.ird.govt.nz/questions-we-ve-been-asked/2025/qb-25-17).

## Inherent defects and leaky buildings

15. Inherent defects are faults in a building's design, construction or manufacture that can be a cause of work being carried out. This may be because the defect requires routine maintenance and repair work to be brought forward or because it results in additional required work, or both.
16. If a building is damaged by one of these defects, the cause of the work and the removal of the defect are relevant but are not deciding factors by themselves. For leaky buildings, the problem usually requires removing the defect, which often involves major work on important parts of the building.
17. The courts have considered a "repair" involves the restoration of a thing to a condition it formerly had without changing its character. In the case of leaky buildings, this raises the question of what the building's relevant former condition is. In the Commissioner's view, this is likely to be the "as constructed" condition of the building, including the inherent defects in that construction. Therefore, work to remediate damage caused by the inherent defects that goes beyond restoring this original condition may not involve repairs if the building is improved or enhanced by removing the inherent defects. In that case, the nature of the work undertaken is more likely to be considered an improvement, the costs of which involve capital expenditure.
18. With leaky buildings an improvement is highly likely to occur. The removal of the inherent defect is likely to be a legal requirement imposed on work done to remediate damage in a leaky building, so it meets current building standards. It is also likely the work required involves replacing original materials used in constructing significant and integral parts of the building with superior materials.
19. Even if the extent of the work does not result in the reconstruction, replacement or renewal of the whole or substantially the whole of the building, the nature of the work is likely to change its character. Especially, given the effect of making a building weathertight is usually a significant change in its original condition and its functionality.<sup>2</sup>
20. The income tax treatment of expenditure incurred to remediate weathertightness issues with these types of properties has been considered by the High Court in *Lawrence* and by the Taxation and Charities Review Authority in *Case 4/2025*.<sup>3</sup> In both cases, the expenditure was found to be capital in nature.

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<sup>2</sup> See also *The Leaky Building Crisis – Understanding the Issues* (Thomson Reuters, Wellington, 2011), Chapter 12 Tax Law Issues at 12.2.2(2)(b) per Craig Elliffe.

<sup>3</sup> *Lawrence v CIR* [2024] NZHC 905 and *Case 4/2025* [2025] NZTCRA 4.

## Conclusion

21. To decide whether repairs and maintenance expenses are deductible, it is necessary to look at the full set of circumstances, including what the expenditure is calculated to effect from a practical business point of view.
22. In summary, the Commissioner's view is that it is not the cause of the work (ie, an inherent defect) or the fact of its removal that, of itself, means the building's character is changed. Although this factor is relevant, it is not determinative of whether the work is capital in nature. In the case of leaky buildings, however, the nature and extent of the work typically required to remediate weathertightness issues arising from inherent defects will usually necessitate removing those defects. In doing so, the work is likely to affect significant and integral parts of the building such that substantial remedial work is unavoidable. This work is likely to go beyond a repair and change the character of the building (compared with its original defective character). This means it is more likely than not that expenditure on remediating a leaky building will involve capital expenditure, unless the nature and extent of the work is limited (see IS 26/01 Examples 26 and 27).

## About this document | Mō tēnei tuhinga

Some of the Tax Counsel Office's longer or more complex items are accompanied by a fact sheet that summarises and explains an item's main points. While it summarises the Commissioner's considered views, a fact sheet should be read alongside the full item to completely understand the guidance. Fact sheets are not binding on the Commissioner. See further [Status of Commissioner's advice](#) (Commissioner's statement, Inland Revenue, December 2012).