

INTERPRETATION STATEMENT

Claiming depreciation on buildings

Issued: 20 July 2022

IS 22/04

This Interpretation Statement provides guidance to building owners on when they can claim depreciation on buildings. It considers the meaning of “building” for depreciation purposes and the distinction between residential and non-residential buildings.

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

REPLACES

IS 10/02: Meaning of “building” in the depreciation provisions

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Summary

1. This Interpretation Statement provides guidance to building owners on when they can claim depreciation on buildings. Until the 2010/2011 income year building owners could claim depreciation on buildings that they used, or had available for use, in deriving income or in carrying on a business for that purpose. This changed from the 2011/2012 income year when the depreciation rate for long-life buildings was reduced to 0%. In 2020, the depreciation rate for long-life non-residential buildings was increased.¹ The rate for residential buildings remained at 0%. For this reason, it is important to understand the difference between a residential and a non-residential building. While both “residential building” and “non-residential building” are defined terms, the Act contains no definition of “building”.
2. The Commissioner issued a statement in 2010, [IS 10/02](#) “Meaning of “building” in the depreciation provisions”.² This concluded that the meaning to be given to a “building” was its ordinary or conventional meaning. That ordinary meaning is distinguished from a “wider” meaning which would include all built structures. It is also different from a “narrower” meaning which would exclude items that provide a specialised setting or a specialised function or were integrated with plant. The Commissioner considers that this ordinary meaning is still the appropriate meaning to be given to “building” for depreciation purposes.
3. In *Mercury*³, the High Court endorsed the Commissioner’s “working definition of building” but acknowledged there might be rare cases where a building should be treated as other than a building for depreciation purposes⁴. Such cases will be rare as the definitions of “plant” and “commercial fit-out” exclude items that are structural elements of a building.
4. A non-residential building is defined to exclude a residential building. A residential building is based on the concept of a dwelling. However, it also includes smaller scale operations where a building may provide short-stay accommodation, if the building together with other buildings on the same land, has less than 4 units for separate accommodation. In contrast, buildings that supply accommodation on a commercial scale, such as hotels and motels, fall within the definition of a non-residential building. Therefore, a “non-residential building” will encompass commercial and industrial

¹ The increased rate is 2.0% for owners using the diminishing value method and 1.5% for those owners using the straight-line method.

² *Tax Information Bulletin*, Vol 22, No 5 (June 2010): 24.

³ *Mercury NZ Limited v CIR* (2019) 29 NZTC 24,014.

⁴ Discussed from [73].

buildings and certain buildings that may provide residential accommodation on a commercial scale.

5. However, where a building is used for both residential and non-residential purposes, it will only have a depreciation rate of greater than 0% if it is predominantly or mainly used for non-residential purposes: it is effectively an all-or-nothing test.
6. This statement sets out how to claim depreciation and the impact of the legislative amendments that took effect from the 2011/2012 and 2020/2021 income years.

Introduction

7. This Interpretation Statement updates and replaces [IS 10/02](#) "Meaning of 'building' in the depreciation provisions"⁵. At the time IS 10/02 was issued, buildings were depreciable property with a range of rates of depreciation applying. This changed from the 2011/2012 income year when the depreciation rate for long-life buildings (those with an estimated useful life of 50 years or more) was reduced to 0%.
8. The depreciation rate for non-residential buildings was increased in 2020 in the COVID-19 Response (Taxation and Social Assistance Urgent Measures) Act 2020. The amendments apply from the 2020/2021 income year and retained the 0% depreciation rate for residential buildings.
9. Since the publication of IS 10/02, legislation has changed, depreciation determinations have been issued for certain classes of buildings or structures, and the High Court decided *Mercury*⁶. These developments affect how the depreciation rules now apply to buildings and other structures.
10. This statement steps through the depreciation rules that apply to buildings and explains how to distinguish between a residential building and a non-residential building. Before dealing with the specific categories of buildings, it looks at what is meant by the term "building" and how to distinguish between a building and other items of depreciable property attached to the building.
11. Importantly, this statement examines each of the following:
 - How the depreciation regime works including the meaning of depreciable property and depreciation loss.

⁵ *Tax Information Bulletin*, Vol 22, No 5 (June 2010): 24.

⁶ *Mercury NZ Limited v CIR* (2019) 29 NZTC 24,014.

- The meaning of “non-residential building” including the meanings of building, residential building, and commercial building.
 - How to distinguish between a building and items attached to the building.
 - How to find the right depreciation rate for the item of depreciable property.
 - How the rules apply to a disposal of the building or a change of use.
12. This statement also looks at how the 2020 changes apply in certain special cases:
- How to determine the opening value for the 2020/2021 income year for buildings that were depreciable property in the 2010/2011 income year.
 - What happens to the pool⁷ of commercial fit-out for which deductions have been taken under s DB 65.
 - How the rules apply to buildings that were “grandparented structures” and improvements to those structures.

Depreciation regime overview⁸

13. Depreciation deductions are allowed for the loss in value of depreciable property used, or available for use, in deriving income or carrying on a business for that purpose. The starting point for a deduction for such a loss is s DA 1. Section DA 1 allows a deduction for an amount of expenditure or “depreciation loss” when it is incurred in deriving income or carrying on a business for that purpose.
14. Subpart EE of the Act determines the amount of the depreciation loss and the timing of the deduction. It also provides for the amount and the timing of depreciation recovery income that arises on the disposal or change of use of depreciable property (see from [116]).
15. Section EE 1(2) provides that a depreciation loss arises for a person, in an income year, for an item of property if all the following apply:
- The person owns the item (ss EE 2 – EE 5).
 - The item is depreciable property (ss EE 6 – EE 8).

⁷ See the discussion from [129] relating to the “pool” of embedded commercial fit-out created under s DB 65.

⁸ A quick reference schedule of the key provisions relevant to claiming depreciation on buildings and fit-out of those buildings is included at the end of the statement.

- The item is used, or is available for use⁹, by the person in the income year (s EE 1(2)(c)).

16. The amount of depreciation is calculated under ss EE 9 – EE 11.

Meaning of “own”

17. Sections EE 2 - EE 5 set out what is meant by ownership of the item of depreciable property. These provisions cover situations where property is jointly owned, where property is subject to reservation of title arrangements, and lessee’s improvements.

Meaning of depreciable property

18. A building and items attached to a building can be depreciable property if they meet the requirements of s EE 6(1). Section EE 6(1) defines depreciable property as property that, in normal circumstances, will decline in value while it is used, or available for use, in deriving income or carrying on a business for that purpose. It cannot be property that is described in s EE 7.

19. Section EE 7 describes what is not depreciable property. It specifically excludes land, but does not exclude buildings, fixtures and certain land improvements if they meet the requirements of s EE 6(1). The depreciable land improvements set out in schedule 13 include bridges, chimneys, dams, retaining walls and wharves. Therefore, buildings and certain built structures may be depreciable property.

20. When a person has depreciable property that is used or available for use in the income year, they are allowed a deduction for the depreciation loss. While a person may choose not to take a deduction, they will be treated as having taken the deduction unless they elect to treat the item of property as not depreciable. Being treated as claiming the deduction means the depreciable value of the property will be adjusted (reduced) by the amount of the allowable deduction. This is the property’s adjusted tax value.¹⁰ This is important because if the person later disposes of the property, or if a change of use occurs, the person may have depreciation recovery income. In calculating the amount of that depreciation recovery income, the person is treated as having claimed depreciation (see further details on depreciation recovery income from [116]).

⁹ The Commissioner discusses the meaning of “available to use” in Interpretation Statement [IS 22/01: Income Tax – deductibility of costs incurred due to COVID-19](#), April 2022.

¹⁰ “Adjusted tax value” and calculating depreciation deductions is discussed from [87].

Election to make property not depreciable

21. A building owner may have commercial reasons for choosing to make a building not depreciable. For example, the building owner may be intending to dispose of the property or to change its use within a short time. The building owner can choose that the property is not depreciable by making an election under s EE 8. The Commissioner recently published [QB 21/11](#) "Elections not to depreciate commercial buildings". It explains the rules around:
- when a building owner needs to make such an election
 - how they must make an election
 - whether they can amend an election
 - whether they can make a retrospective election.
22. Importantly, [QB 21/11](#) concludes that while a person can make a retrospective election any time after they acquire the property, they cannot make it after they have claimed a deduction for depreciation loss.

Non-residential buildings

23. A building may be depreciable property, as it will decline in value while it is used or available for use in deriving income or carrying on a business for that purpose. However, the mechanism that Parliament used in 2010 for disallowing depreciation on buildings was to reduce the depreciation rate on long-life buildings to 0%.
24. In March 2020, the COVID-19 Response (Taxation and Social Assistance Urgent Measures) Act 2020 reintroduced depreciation deductions for certain long-life buildings by increasing the depreciation rate for non-residential buildings. The definition of building was repealed and new definitions of "residential building" and "non-residential building" were introduced with effect from the 2020/2021 income year.
25. Non-residential building is defined in s YA 1.

non-residential building means a building that is not a residential building.

26. Therefore, a non-residential building is a "building" that is not a "residential building".

Meaning of “building”

27. The definition of “building” in s YA 1, which applied before the 2020/2021 income year, was as follows.

building, in subparts EE and EZ, does not include –

- (a) a grandparented structure:
- (b) commercial fit-out

28. This definition did not state what a building was but instead stated what was not a building for the purposes of the depreciation provisions.

Ordinary meaning

29. The *Concise Oxford English Dictionary*¹¹ defines “building” as:

1. a structure with a roof and walls.

...

30. The *Shorter Oxford English Dictionary*¹² defines “building” as:

1. A thing which is built, a structure, an edifice, a permanent, fixed thing built for occupation, as a house, school, factory, stable, church, etc.

...

31. These definitions indicate that a building, within its ordinary meaning, is a permanent fixed structure providing shelter, such as a house, school, factory but the definitions also support a wider interpretation of “building”; that is, a permanent fixed structure or thing that is built. The appropriate meaning to be given to the word depends on its context. Mason J, in *R v Marks ex Australian Building Construction Employees’ and Builders Labourers’ Federation*, at 485¹³ noted that the meaning of the word depended on its context:

The meaning of the word “building” depends very much on the context in which it is found. In some circumstances it means a building providing accommodation for people; in others it will include a structure accommodating something whether it be animals, materials, plant or machinery; at other times it signifies a mere structure or edifice e.g. a bridge, a tank or a tower.

...

¹¹ (12th ed), Oxford University Press, 2011.

¹² (6th ed, Oxford University Press, 2007).

¹³ *R v Marks ex Australian Building Construction Employees’ and Builders Labourers’ Federation*, (1981) 147 CLR 471.

Characteristics of a building

32. Many cases have considered the meaning of “building”. The following characteristics are common to a building within the ordinary or conventional meaning of the word:
- A building is a structure of considerable size that is intended to be permanent, or at least to endure for a considerable time¹⁴. Because of changes over time in the types of materials that are used to construct buildings, it is not possible to be definitive about the design or the type of materials that characterise a building; a building will be constructed using the building materials of the day¹⁵: However, given the requirement of permanence, a building would usually be constructed of durable materials intended to last for a significant period.
 - A building is also permanent in the sense that it is generally designed to be located permanently on the site where it stands. However, a structure need not be attached to the ground on which it stands to be a building. In *Stevens v Gourley* a shop that was fixed to the ground by its own weight and was not easily removed to another site was a building. A structure that can easily be moved from place to place will not be a building within the conventional meaning¹⁶.
 - A building in the conventional sense is enclosed by walls and a roof that is designed to provide shelter¹⁷: In *Moir v Williams* Lord Esher MR commented (at p 270) “*what is ordinarily called a building ... is an enclosure of brick or stonework covered in by a roof*”. In *Hilderbrandt v Stephen*, Jacobs J discussed the meaning of “building” and stated (at p 742) with reference to *Moir v Williams* “*in its ordinary meaning, it at least involves the concept of a structure with a roof and a support for that roof*”.
 - A building can function independently of any other structure. In *Barat v Minister of National Revenue*¹⁸ the Court held that a parking garage was a building given the size and permanence of it and the fact it was self-contained and functioned independently of any other structure. However, a building need not be a physically separate structure. In *Spencer v Soljan*, McMullin J noted, at p 292:¹⁹

¹⁴ *Stevens v Gourley* (1859) 7 CBNS 99.

¹⁵ *Clarke v Wilkie* (1977) 17 SASR 134.

¹⁶ *Melfort Danceland v Star City (Rural Municipality)* [1977] 3 WWR 737.

¹⁷ *Moir v Williams* [1892] 1 QB 264; *Hilderbrandt v Stephen* [1964] NSW 740; *Australian Building Construction Employees' & Builders Labourers' Federation v Dillingham Australia Ltd* (1982) 58 FLR 170.

¹⁸ *Barat v Minister of National Revenue* [1991] 2, CTC 2,360.

¹⁹ *Spencer v Soljan* (1984) 10 NZTPA 289.

[s]ome semi-detached structures such as terraced houses comprising individual dwellings may each be buildings for the purpose of [section 91 of the Town and Country Planning Act 1977] despite their contiguity with and physical attachment to one another.

- A structure need not legally be part of the land on which it stands to be a building: *R v Swansea City Council ex p Elitestone Ltd.*²⁰
33. The courts have also accepted that in deciding whether a structure is a building within the conventional meaning, it is appropriate to ask whether a reasonable person would regard the structure as a building based on its appearance and function. In *Harris v De Pinna*²¹ a “reasonable person” test was applied. Chitty J stated at p 249:
- The proposition I am about to put again is not a decisive one, but I will put it. Would an ordinary man, with a reasonable knowledge of the English language, passing this structure speak of it as a building? I agree that, it is only putting it in a somewhat different form. The question in substance is one of fact and viewing it as a whole and having regard particularly to the model, and by no means disregarding the photographs which I have seen, I have come to the conclusion that this is a structure, but not a building within sect. 3 of the Prescription Act.
34. In *Metals & Alloys Co v Ontario Regional Assessment Commissioner*²² Arnup J.A. stated at [50]:
- “Building”, however, is an ordinary English word, and in this statute should be given the meaning an ordinary person would attribute to it. What we have in this case looks like a building. It is almost identical to its neighbouring structure, which is admittedly a building. It is built like a building. It is used like a building. ... The only reasonable conclusion, in my view, is that it is a building.
35. The Commissioner’s view is that for the depreciation provisions, the term “building” has its ordinary or conventional meaning. Building should not have a narrower meaning to exclude certain buildings, such as those that provide a specialised setting or are integrated with plant, or a wider meaning to include all built structures. This was the view reached in IS 10/02 and formed the basis of the Commissioner’s submissions in *Mercury v CIR*²³.
36. In *Mercury* the issue was whether the “turbine halls” at two geothermal powerstations fell within the definition of “building” or whether they were to be treated as part of the gantry cranes situated within the halls and depreciated as plant. This was important because, if the turbine halls were found to be buildings, the relevant depreciation rate at that time would have been 0%. In contrast, if the items were found to be part of the

²⁰ *R v Swansea City Council ex p Elitestone Ltd* (1993) 66 P & CR 422.

²¹ *Harris v De Pinna* (1886) LR 33 Ch D 238.

²² *Metals & Alloys Co v Ontario Regional Assessment Commissioner* (1985) 36 RPR 163.

²³ *Mercury NZ Limited v CIR* (2019) 29 NZTC 24,014.

gantry cranes, the rate would have been 9.6%. The turbine halls had the outward appearance of buildings. The Court found that the turbine halls were buildings.

37. The Commissioner had submitted that the meaning to be given to “building” was its ordinary or conventional meaning. The Court agreed, and stated that the Commissioner’s description of a building in IS 10/02 was “a good working definition of building”:

[51] In 2009, before the enactment of the 2010 Budget Act, the Commissioner issued an interpretation statement on the meaning of “building”. The Commissioner examined the meaning through the legislation, case law and dictionary sources, and came to the following common description of “building”:

- (a) A building is a structure of considerable size.
- (b) A building is permanent in the sense that it is designed to be located permanently on the site where it stands. A building is fixed to the land on which it stands. However, a building need not be legally part of the land on which it stands.
- (c) A building is enclosed by walls and a roof.
- (d) A building can function independently of any other structure. However, a building is not necessarily a physically separate structure.
- (e) The appearance and function of the structure are relevant in determining whether a structure is a building for depreciation purposes (that is, whether the structure looks like the conventional idea of a building and is designed for the uses to which conventional buildings are ordinarily put). It is appropriate to ask whether a reasonable person would regard the structure as a building.

[52] Without examining in detail the cases and other sources the Commissioner used to come to this definition, I consider it is a good working definition of building. Not all of these indicia need be present in each case. For example, a carpark building often does not have a roof.

38. Therefore, for depreciation purposes the meaning to be given to “building” is its ordinary or conventional meaning. This means a “non-residential building” is a “building”, under the ordinary meaning of the word but it is not a “residential building”.

Meaning of residential building

39. The definition of residential building in s YA 1 is based on the concept of a dwelling but is extended to include certain buildings used for short-stay accommodation.

residential building—

- (a) means a dwelling; and
- (b) 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

Residential building – para (a) – dwelling

40. Section YA 1 defines “dwelling” as follows:

dwelling—

- (a) means any place configured as a residence or abode, whether or not it is used as a place of residence or abode, including any appurtenances belonging to or enjoyed with the place:
- (ab) despite paragraph (a), **for the purposes of subpart EE and the definitions of commercial building, commercial fit-out, and residential building**, means any place used predominantly as a place of residence or abode, including any appurtenances belonging to or enjoyed with the place:
- (b) **does not include any of the following**, in whole or part:
 - (i) a hospital:
 - (ii) a hotel, motel, inn, hostel, or boardinghouse:
 - (iii) a serviced apartment for which paid services in addition to the supply of accommodation are provided to a resident, and in relation to which a resident does not have quiet enjoyment, as that term is used in section 38 of the Residential Tenancies Act 1986:
 - (iv) a convalescent home, nursing home, or hospice:
 - (v) a rest home or retirement village, **except** to the extent that, in relation to a relevant place, it is, or can reasonably be foreseen to be, occupied as a person’s principal place of residence for independent living:
 - (vi) a camping ground:
- (c) despite paragraph (b)(iii) and (v), for the purposes of section CB 16A (Main home exclusion for disposal within 5 years) and the definition of residential land—

- (i) includes a serviced apartment described in paragraph (b)(iii):
- (ii) does not include, in whole or part, a rest home or retirement village

[emphasis added]

41. A "dwelling" is a place of accommodation or residence of an individual. A dwelling includes "any appurtenances belonging to or enjoyed with the place". This means that a garage or sleepout or other minor building on the land that belongs to the dwelling or is enjoyed as part of the dwelling will form part of the dwelling.
42. A dwelling does not include most buildings that provide residential accommodation on a commercial scale, or that provide short- or long-term care of the person. Specifically, the definition of dwelling excludes hotels, motels and boardinghouses, and places that provide care such as hospitals, rest homes, hospices and retirement villages. However, a residential place in a retirement village in which the person lives independently is a dwelling.
43. For depreciation purposes, the relevant definition of dwelling is para (ab). This is also the relevant definition for the meaning of residential building, commercial building and commercial fit-out. For these purposes, a dwelling is any place **used** predominantly as a place of residence or abode. This definition focuses on the **use** of the building. This differs from the definition in para (a) that would include a place configured as a dwelling but not used for that purpose.
44. In addition, for the depreciation rules and the meaning of residential building, it is the "predominant" use of the building that will determine whether it is a dwelling and therefore a residential building.
45. The *OED Online*²⁴ defines the words "predominantly" and "predominant" as:

Predominantly:

In a predominant manner; to a predominant degree; (in later use) esp. primarily, largely, chiefly, for the most part.

Predominant:

1 (b) Constituting the main, most abundant, or strongest element; prevailing, preponderating.

²⁴ "Predominantly: Oxford University Press, December 2021, www.oed.com/view/Entry/149891. Accessed 11 January 2022; "predominant": Oxford University Press, December 2021, www.oed.com/view/Entry/149890. Accessed 11 January 2022.

Characterising a building – an all-or-nothing test

46. The definitions of “residential building” and “non-residential building” do not use words of apportionment such as “to the extent”. Instead, the legislation focuses on the building’s predominant or main use. Therefore, if a building is predominantly or mainly used as a place of residence, it will be a residential building and subject to a depreciation rate of 0%. In contrast, a building that is predominantly or mainly used for non-residential purposes will be depreciable at the appropriate non-residential building rate.
47. While a building may be used for both residential and non-residential purposes it will only have a depreciation rate of greater than 0% if it is predominantly or mainly used for non-residential purposes. Because the test is based on the building’s predominant use, it is effectively an all-or-nothing test. In most cases it will be clear what the predominant or main use of a building is. If it is not clear, then the building owner will need to consider the circumstances of the building to determine its predominant or main use.
48. One method for determining a building’s main use may be based on comparing the floor area used for residential purposes with the area used for non-residential purposes. If a floor area test is used, then areas of common use, such as lobbies, hallways and entranceways used by both residential and non-residential occupants, would also need to be factored into the apportionment. See *Example 6 – Mixed-use commercial building*.

Retirement village – independent living arrangements

49. Buildings within rest homes and retirement villages will generally be non-residential buildings. This is because they are excluded from the definition of “dwelling”. However, places within a rest home or retirement village occupied under independent living arrangements are not excluded from the definition of dwelling and therefore may be a residential building. Independent living is defined in s YA 1 as:

independent living means occupancy of a place under an arrangement that—

- (a) does not have a level of compulsory care:
- (b) has a level of compulsory care that is merely incidental to the occupancy

50. Retirement villages will generally comprise a collection of buildings. As the classification of a building as residential or non-residential building is dependent on the building’s predominant use, each building within a rest home or retirement village will need to be considered individually. For example:

- a building that is **wholly used** to provide residential accommodation under independent living arrangements (such as a villa or apartment) will be a residential building and the depreciation rate will be 0%.
- a building that is **predominantly used** to provide hospital care, or assisted care (with compulsory care requirements or where those requirements are not merely incidental to the occupancy) will be a non-residential building.
- a **mixed-use building** might have some independent living apartments within a building that also provides hospital care, or assisted care. In this case, whether the building is a residential building or a non-residential building will depend on its predominant use.²⁵

No requirement that a dwelling is a primary residence

51. The definition of dwelling is not limited to buildings that are used as a person's primary residence or home. In addition, there are no requirements for any degree of permanency of occupation, or full-time use. This means that a dwelling will include a holiday home that a person lets out for residential purposes from time-to-time. Therefore, a dwelling can include a building that is used to provide short stay accommodation.

Residential building – para (b) – short stay accommodation

52. The second part of the definition of residential building defines the boundary between residential and non-residential buildings that provide short stay accommodation. Specifically, a building will be a residential building *"if the building, together with other buildings on the same land, has less than 4 units for separate accommodation"*. The inclusion of "less than 4 units" excludes larger commercial operations. But it makes it clear that the term "residential building" includes buildings that are used exclusively for short-term accommodation, such as Airbnb properties, if there are less than 4 units on the same land.

Distinguishing between buildings and items attached to a building

53. After establishing whether the building is a non-residential building, the next step is to understand whether items attached to a building are separate items of depreciable

²⁵ For further discussion on the meaning of independent living arrangements see "Clarifying that certain building fit-out is depreciable property" *Tax Information Bulletin* Vol 23, No 1 (Feb 2011) [68].

property or whether they are treated as part of the building. This is because an owner of depreciable property needs to establish the correct rate of depreciation that applies to the “item of property”.

Identifying the item of property

54. The Commissioner’s general position on identifying an item of property is based on a three-step test that was set out in [IS 10/01](#) “Residential rental properties – Depreciation of items of depreciable property”.²⁶ The test is a guide to identifying whether an item is a separate asset or part of a larger asset. Although IS 10/01 dealt with depreciation of residential rental properties, the Commissioner’s view is that the principles generally apply to commercial properties.
55. Later statements have consistently applied the three-step test. It was summarised in [QB 20/01](#) “Can owners of existing residential rental properties claim deductions for costs incurred to meet Healthy Homes standards?”²⁷ Again this statement focusses on residential rental properties and income tax deductions, but it provides general guidance on the approach to be taken for identifying the relevant asset:
- Step 1: Determine whether the item is in some way attached or connected to the building. If so, go to step 2. If not, the item will be a separate asset.
 - Step 2: Determine whether the item is an integral part of the residential rental property such that a residential rental property would be considered incomplete or unable to function without the item. If so, the item will be part of the residential rental building. If not, go to step 3.
 - Step 3: Determine whether the item is built-in or attached or connected to the building in such a way that it is part of the “fabric” of the building. If so, the item will be part of the residential rental building. If not, the item will be a separate asset.
56. For non-residential buildings, the legislation distinguishes between a building and other items of depreciable property. In 2010, after the depreciation rate for longer-life buildings was reduced to 0%, legislation was introduced to ensure that building fit-out in a commercial or non-residential building should continue to be separately depreciable. This meant that it could continue to be depreciated at a rate of more than 0%.

²⁶ *Tax Information Bulletin*, Vol 22 No 4 (May 2010), 16.

²⁷ *Tax Information Bulletin*, Vol 32 No 7 (August 2020), 126.

Defining commercial building – commercial fit-out – plant

57. The 2010 changes introduced new definitions of “commercial fit-out”, “commercial building” and “plant”, and amended the definition of building to exclude commercial fit-out. These definitions distinguish between a building and other items of depreciable property that may be able to be separately depreciated.

58. The definition of commercial building in s YA 1 is as follows:

commercial building means a building that is not, in part or in whole, a dwelling, unless use as a dwelling is a secondary and minor use.

59. Whether a building is a “commercial building” is relevant to whether the fit-out of that building is separately depreciable. If a building provides some residential accommodation but this is a secondary and minor use of the building, then the building will still be a commercial building.

60. The relevant definitions of commercial fit-out and plant are contained in s YA 1 as follows:

commercial fit-out means an item to the extent to which it is—

- (a) plant attached to a commercial building, but not used inside a dwelling within the commercial building;
- (b) attached to, and non-structural in relation to, a building, if the item is not used for weatherproofing the building and—
 - (i) is not used in relation to, and is not part of, a dwelling within the building; or
 - (ii) is used in relation to, but is not part of, a dwelling within the building, and the building is a commercial building.

...

plant does not include an item that is structural in relation to a building

61. Commercial fit-out refers to items which are attached to certain buildings. Importantly, commercial fit-out does not include any item which is structural to a building or used for weatherproofing a building. The definition also draws a distinction between the type of building that the item is attached to and how and where the item is used within the building. There are four important distinctions:

- Plant (non-structural) attached to a commercial building is commercial fit-out and depreciable, but **not plant used inside a dwelling** within that building (para (a) of the definition).
- Other items which are attached to **any** building (and non-structural and not used for weatherproofing) are commercial fit-out and depreciable if they are:
 - **not part of** a dwelling within a building, and
 - **not used in relation to** a dwelling within the building.

These are items that are part of and used in wholly commercial areas of a building (para (b)(i) of the definition). For example, a predominantly residential apartment building with commercial retail or a hospitality business on the ground floor could have depreciable fit-out within those commercial areas.

- Items that are attached to a commercial building (and non-structural and not used for weatherproofing) and are **used in relation to a dwelling but are not part of the dwelling** are also commercial fit-out and depreciable. These are items situated in a commercial building (a building which is predominantly non-residential as any residential use is minor or secondary). This would include fit-out in shared or common spaces outside of the residential/dwelling areas.
- Attached items within the dwelling are not commercial fit-out. Whether attached items within the dwelling are depreciable will depend on whether the items are separate items of depreciable property²⁸.

62. *Example 6 – Mixed-use commercial building* explains how the commercial fit-out rules apply in a building that provides some residential accommodation as a secondary and minor use.

Building structure

63. These definitions help to define what will be treated as part of a non-residential building for depreciation purposes. Anything that is a structural part of the building, including an item of plant that is structural to the building, will be considered part of the building. This is because the definition of “plant” excludes an item that is structural in relation to a building. In addition, anything that is non-structural but attached to a building and used for weatherproofing, is excluded from being treated as “fit-out” and therefore treated as part of the building.

²⁸ “Interpretation Statement: IS 10/01: Residential rental properties – depreciation of items of depreciable property”, *Tax Information Bulletin* Vol 22, No 4 (May 2010).

64. The word “structural” has a range of meanings. The *Concise Oxford English Dictionary*²⁹ defines “structural” as meaning:

Structural: relating to or forming part of a structure

65. The *Shorter Oxford English Dictionary*³⁰ includes the following definition:

Structural:

1 (b) Of or pertaining to the structure of a building etc. as distinguished from its decoration or fittings.

66. The *OED Online*³¹ also includes the following definition:

Structural, (noun):

A component or material having a structural or load-bearing role, esp. in a building.

67. From the above definitions, an item that is structural to a building is an item with a structural or load-bearing role, forming a necessary part of the structure of the building. However, it could also be an item that “relates to” the structure, or a “necessary part of the structure ... as distinct from its decoration or fittings”. For depreciation purposes, an item that is attached to a building but non-structural and used for weatherproofing is part of the building, and not a separately depreciable item of commercial fit-out. Therefore, an item that relates to the weathertightness of a building, although it may not be structural from an engineering perspective, will be regarded as part of the building structure.

68. When these definitions were being proposed, officials described the structure of a building as including:³²

- the foundations;
- the building frame;
- floors;
- external walls;
- cladding;
- windows and doors;
- stairs;

²⁹ 12th ed, Oxford University Press, 2011.

³⁰ 6th ed, Oxford University Press, 2007.

³¹ www.oed.com/view/Entry/389383. Accessed 17 December 2021.

³² Officials' Issues Paper *Post-Budget Depreciation Issues*, Inland Revenue, August 2010: 5.

- the roof;
- load-bearing structures such as pillars and load-bearing internal walls.

69. Therefore, a non-residential building will include the component elements of a building that are structural or used for weatherproofing the building. See [133] for a discussion about embedded “commercial fit-out” and deductions taken under s DB 65.

Distinguishing a building from plant

70. The distinction between an item of plant and a building was central to the High Court case of *Mercury*. The case considered whether the “turbine halls” at two geothermal powerstations fell within the definition of “building” or whether they were to be treated as part of the gantry cranes, situated within the halls. The structural support to the gantry cranes formed part of the structure of the building. The turbine halls had the ordinary appearance of a building and functioned in the way a building functions. The High Court noted that the legislation was clear that what might otherwise be “fit-out” or “plant” will be treated as part of the building if it is structural to the building:

[48] ... There is nothing in the legislation that gives any signal that a building for purposes of the depreciation provisions is anything other than a building in the ordinary sense of the word. It is also clear that what might otherwise be “fit-out” or “plant”, if it is “structural” in relation to an (industrial) building, is part of the building and is not treated as plant or fit-out for depreciation purposes. On the other hand, plant merely attached to an industrial building is not included or treated as a building for tax purposes and can be separately treated as plant.

71. Questions can arise if the building does more than provide the ordinary characteristics and functions of a building and provides a specialised setting for a particular process or is integrated into an industrial process. An issue is whether that structure is still a building for depreciation purposes.

72. The Commissioner’s view is that if a building provides a specialised setting, it will still be a building for depreciation purposes. In *Mercury*, one of the considerations was whether a structure that had the appearance of a building, but that provided *more* than a specialised setting for an industrial process, could be treated as something other than a building. In particular, the question was whether a structure that is materially integrated with the “operating” plant and equipment within it, or with the industrial process carried on within the structure, should be treated as plant.

73. The definition of plant excludes an item that is structural to a building. Therefore, it is the Commissioner’s view that if the item has the appearance and characteristics of a building and functions like a building, then such an item will not be plant. However, a building structure that is integrated into an industrial process may be a building for which a different rate of depreciation is appropriate. This is because the process may

affect the building's estimated useful life, and this forms part of the formula for calculating the relevant depreciation rate. The legislation provides for this by allowing an owner to apply for a special rate of depreciation for the item, or a provisional rate for a new item for which the Commissioner has not set a general economic rate. Alternatively, they could ask that the Commissioner consider setting a general economic rate for this new item of depreciable property. Special rates and provisional rates are discussed from [111].

74. Examples of determinations the Commissioner has issued for particular asset classes are:
- Determination PROV 24 for mushroom factory buildings and plant³³;
 - Determination PROV 26 for hydroelectric powerhouses³⁴.

Rare cases – industrial structures

75. In *Mercury*, the Court was referred to Determination PROV 26 in which the Commissioner states a "hydroelectric powerhouse is integral to the function of a hydroelectric power scheme's purpose of generating hydroelectricity". The Court noted that the language of PROV 26 was similar to the arguments raised in *Mercury*, about a structure being integrated with a function or industrial process. The court acknowledged that there might be "rare situations" where a building is "part of the apparatus" of the business and might not be treated as a building for depreciation purposes:

[76] However, I consider that in those rare situations where a building is part of the apparatus for carrying on a business, it might be considered for purposes of the depreciation provisions of the Act to not be a building. Interestingly, that language is similar to the language the Commissioner used in PROV 26 when she said a hydro turbine hall is "integral to the function of the production of hydropower".

76. On the particular facts, the geothermal turbine halls did not fall into this rare situation. The Court considered the turbine halls were buildings in the ordinary sense of the word. In addition, while the turbine halls provided support for machinery, they were not an integral part of the production process to such a degree that they should be considered to be plant.

³³ "Determination PROV 24: Provisional depreciation rate for mushroom factory buildings and plant", *Tax Information Bulletin* Vol 24, No 9 (1 October 2012): 7.

³⁴ "Determination PROV 26: Depreciation rate for hydroelectric powerhouses", *Tax Information Bulletin* Vol 27, No 4 (May 2015): 11.

[81] ...The turbine hall providing “support” for machinery is quite different to its being **an integral part of the production process to such a degree that it can be treated as plant**. [Emphasis added]

77. The Court commented that a “hydro powerhouse” might be one of those structures that fell into this rare situation. Features the Court noted in support of this view included that they are usually situated in rivers, are attached to a dam and have water flowing through them or part of them:

[90] I would add that it strikes me there are likely some material differences between hydro and geothermal powerhouses, including that most hydro powerhouses are situated in rivers and have water flowing through them, or part of them. They are attached to the dam itself. This would tend to suggest that the hydro powerhouse would fall into the limited category of structures that are integrally involved in the production process, similar to the cool store and dry dock examples.

78. For an item to fall within the category of the “rare case” referred to in *Mercury*, it will need to be considered on its own facts. That will require considering the structure against the characteristics typical of a building, as well as the function of the structure. If it is found to be a building, then that will, in most cases, be the appropriate classification for depreciation purposes. The function or use of the building or structure will be a relevant factor to determine the appropriate depreciation rate.

Summary – building

79. In summary, a building for depreciation purposes has its ordinary or conventional meaning as set out in [37] above. The building will comprise all the structural components that are necessary to fulfil the meaning of a building and will generally include the items listed at [68]. The building will also include items attached to it that are non-structural but are used for weatherproofing the building. A building’s structure may provide structural support for an item of plant. However, having this function does not mean that the building is something other than a building. It will still be a building for depreciation purposes.
80. To have a depreciation rate of greater than 0%, a building must be a non-residential building.

Summary – non-residential building

81. In summary, a non-residential building is a building that is not a residential building. Therefore, a building will be **either** a non-residential building **or** a residential building which is determined based on the building’s predominant use. A building owner cannot apportion a mixed-use building for depreciation purposes. Because the test is based on the building’s predominant use, it is effectively an all-or-nothing test.

Depreciation of the building at a rate greater than 0% is only available to non-residential buildings. This is shown in Figure 1.

Figure 1: Distinction between residential and non-residential buildings

Building	
<ul style="list-style-type: none"> • Building has its ordinary meaning. It includes anything that is structural to the building or used for weatherproofing the building • Whether a building is residential or non-residential is an all-or-nothing test 	
Residential building	Non-residential building
<ul style="list-style-type: none"> • Means any place used mainly as a place of residence • Includes any garages or sheds included with the building • Includes places used as residences for independent living in retirement villages and rest homes • Includes short-stay accommodation where less than 4 separate units 	<ul style="list-style-type: none"> • Includes buildings used predominantly for commercial and industrial purposes but not residential buildings • Includes hotels, motels, inns, boardinghouses, serviced apartments and camping grounds • Includes retirement villages and rest homes (except places used as residences for independent living) • Includes short-stay accommodation where 4 or more separate units

82. The non-residential building will include any plant or commercial fit-out that forms a structural part of that building or any item attached to the building and used for weatherproofing the building.
83. A building owner can depreciate commercial fit-out if it is in a wholly non-residential building. Commercial fit-out is also depreciable in a mixed-use building in the following circumstances:
 - In a **predominantly non-residential building**, the fit-out must not be used in a dwelling within the building but it can be used in relation to the dwelling, such as fit-out of the common areas of the building.
 - In a **predominantly residential building**, the fit-out must be in a wholly non-residential area of the building. Items of shared fit-out such as in the common areas of the predominantly residential building are not included in the definition of commercial fit-out.
84. Figure 2 shows the tax treatment for non-residential buildings, residential buildings and commercial fit-out.

Figure 2: Can depreciation be claimed?

Item	Can depreciation be claimed?		
	Building	Commercial fit-out	Shared fit-out
Wholly non-residential building	Yes	Yes	N/A
Predominantly non-residential building	Yes	Yes	Yes
Predominantly residential building	Yes (but at 0%)	Yes	No
Wholly residential building	Yes (but at 0%)	N/A	N/A

85. This statement will now explain how to calculate depreciation deductions for non-residential buildings.

Claiming depreciation on non-residential buildings

Depreciation method

86. Owners of non-residential buildings can claim depreciation deductions on buildings that they use or have available for use for deriving income or in carrying on a business for that purpose. The depreciation methods available for building owners to choose from are either the straight-line (SL) or diminishing value (DV) methods (s EE 12).

Amount of depreciation loss

87. Under s EE 14, the amount of depreciation loss available as a deduction is **the lesser of** the amount calculated under ss EE 15 or EE 16:
- Under s EE 15, the amount is the item's adjusted tax value (ATV) before the deduction of an amount of depreciation loss for the income year.
 - Under s EE 16, the amount of depreciation loss available as a deduction is based on a standard calculation:

$$\text{Annual rate} \times \text{value or cost} \times \text{months}/12$$

88. This means the amount of the deduction for depreciation loss can never be greater than the ATV of the item at the beginning of the income year.

89. The “annual rate” is the annual rate that, in the income year, applies to the item of depreciable property under the depreciation method that the person uses. This rate is expressed as a decimal (s EE 16(3)). The “annual rate” is defined in s EE 61 as meaning the annual depreciation rate applying to an item of depreciable property that a person owns. Depreciation rates are discussed from [102].
90. The “value or cost” is:
- For a person using the DV method, the item’s ATV at the end of the income year before the deduction of an amount of depreciation loss for the item for the income year (s EE 16(4)(a)). Finding the item’s starting ATV is discussed below from [92]. For further discussion on the opening tax book value for the 2020/21 income year, see from [131].
 - For a person using the SL method, the item’s cost to the person **excluding** expenditure for which the person is allowed a deduction under a provision of the Act outside subpart EE (s EE 16(4)(b)(ii)). For further discussion on the meaning of “cost” see from [99].
91. The “months /12” refers to the number of months in the year that the item is used or available for use. Whether a building is “available for use” is a factual question. A building owner will need to consider this each year when calculating the amount of depreciation to be claimed. A building may be considered available for use if it was not being used because it was being repaired, if it was used, or available for use, immediately before the repairs commenced. For further discussion on the meaning of “available for use” see [IS 22/01](#).

Starting ATV

92. To calculate the amount of depreciation loss relating to any item of depreciable property, the owner must first establish the starting value of the item, which will be the item’s opening ATV. This will apply when an owner first acquires an item for use in deriving assessable income or carrying on a business for that purpose. It will also apply when an owner changes the use of an item, such as, from private to business use or where a residential building is converted to commercial use.
93. Section EE 55 provides that the ATV for an item of depreciable property is the amount calculated using the formula provided in s EE 56. That formula is as follows:

Base value – total deductions

Base value

94. The base value of the item is set in ss EE 57 – EE 59 and s EZ 22(1). In the context of buildings and building fit-out it is noted:
- Section EE 58 does not apply to buildings.
 - Section EE 59 applies to petroleum-related depreciable property.
 - Section EZ 22(1) sets the base value for items owned continuously since the 1992-93 income year (the base value is the tax book value for the 1992-93 income year).
 - Section EE 57 sets the base value in all other cases.
95. Therefore, for buildings, the base value will be set under s EE 57 as the cost of the item. The meaning of “cost” is discussed from [99].
96. For other items of depreciable property (such as fit-out), the base value will be calculated under ss EE 57 or EE 58. This depends on whether the owner acquired it for use in deriving assessable income and whether the owner has previously been allowed a deduction for depreciation loss for the item:
- If the owner did not acquire it to use or have available for use in deriving assessable income (or in carrying on a business for that purpose) and has not been allowed a depreciation deduction, the base value is the market value of the item when the person starts to use it or when it becomes available for use (s EE 58(2)). This will generally apply to an item when there is a change of use from private use to business use, and it could apply to the fit-out of a residential building that is changing its use to non-residential.
 - If the owner acquired it to use in deriving assessable income or would have been allowed a deduction for depreciation loss, then the base value for the item will be set under s EE 57. This will be the cost of the item, subject to the adjustments to cost discussed from [99].

Total deductions

97. The “total deductions” are calculated under s EE 60. This includes the amounts of depreciation loss that a person claimed (or was allowed) for the item in the period beginning on the date the item was acquired and ending on the last day of the previous income year. This is subject to some adjustments. For example, if a building owner receives compensation or insurance for an event damaging the building, and the amount received exceeds the expenditure that the building owner incurs because of the event, the excess amount would be deducted from the building’s ATV.

98. Therefore, if a building owner changes a building's use from residential to non-residential, the starting ATV for an item of depreciable fit-out will be:
- the market value of the item at the time that it becomes available for use (s EE 58(2)) if a deduction for depreciation loss had never been allowed for the item since it was acquired by the owner.
 - the item's cost (as the base value) less any deductions that were allowed for the item, if a deduction for depreciation loss would have been allowed for the item at any time since it was acquired by the owner.

Meaning of cost

99. "Cost" is not defined in the Act but is accepted generally as *"that which must be given to acquire something"*.³⁵ "Cost" for depreciation purposes is limited to the initial cost of the item, together with set-up and installation costs. However, s EE 16(4)(b)(ii) excludes from "cost" any *"expenditure for which the person is allowed a deduction under a provision of this Act outside this subpart"*. For a full discussion on the meaning of "cost", see [IS 18/06](#) Income tax – treatment of costs of resource consents.³⁶
100. In addition, the "cost" of the item is reduced by subtracting the amount of any goods and services tax (GST) input tax included in the cost of the item, on the supply to the person (s EE 54).
101. Special rules apply to transfers between associated persons. The general rule is that when a person (person A) acquires an item of property from an associated person, the "cost" of that property for depreciation purposes is limited to the lesser of the cost of that property to person A and the cost to the associated person (s EE 40(7)). Some exceptions apply. For example, it does not apply if person A acquires the property on a settlement of relationship property. It may not apply if the Commissioner decides that it is appropriate to use the cost of the item to person A (s EE 40(8)(a)). The circumstances in which this might be allowed are set out in Standard Practice Statement [SPS 07/05](#)³⁷.

³⁵ *Tasman Forestry Limited v CIR* (1999) 19 NZTC 15,147 (CA).

³⁶ *Tax Information Bulletin* Vol 30 No 11 (December 2018): 10, 15.

³⁷ SPS 07/05: Transfer of depreciable property between associated persons - section EE 33* of the Income Tax Act 2004 (September 07), *Tax Information Bulletin*, Vol. 19, No. 9 (October 2007). *Section EE 33 of the Income Tax Act 2004 is now s EE 40 of the Income Tax Act 2007.

Depreciation rates

102. The next step is to find the correct annual depreciation rate for the item of property. This is important because there are different rates of depreciation that can apply to an item of property depending on when it was acquired or when it first became available for use in deriving income or carrying on a business for that purpose.
- The Commissioner has a [depreciation rate finder and calculator](#) for finding the correct rate for buildings and other items of depreciable property. This calculator can be used for buildings acquired after 19 May 2005, or other items of depreciable property acquired after 1 April 2005. Alternatively, these rates are published in [IR 265](#). The IR 265 also has a useful step-by-step guide to finding the correct rate for the item of depreciable property.
 - If the building was acquired prior to 19 May 2005 or if the other item was acquired prior to 1 April 2005, the relevant depreciation rate can be found in the tables of historic rates published in [IR 267](#) *Historic depreciation rates – for assets acquired before 1 April 2005*. This publication sets out the relevant depreciation rates as follows:
 - Part 1 – Depreciation rates before 1993
 - Part 2 – 1993 to 2005 asset rates: Industry categories
 - Part 3 – 1993 to 2005 rates: Asset categories.
103. For further guidance on how to select the correct rate of depreciation or on changing the rate of depreciation that applies to the item of property see [QB 15/03: "Income Tax- changing to a different depreciation rate for an item of depreciable property"](#).

Annual rates of depreciation

104. To calculate depreciation for an income year a person must use the appropriate "annual rate" that applies to the item. As noted above, "annual rate" is defined in s EE 61 as being "... *the annual depreciation rate applying to an item of depreciable property that a person owns*". Section EE 61 then points to the relevant provisions that set the rate:
- For buildings and other property acquired in the 1995/1996 income year or later (and that is **not** an international aircraft, fixed life intangible property, a patent or design registration), the rate is set under s EE 31.
 - For property acquired after 1 April 1993 and before the end of the 1994/1995 income year, the rate is set by s EZ 13.

- For “excluded depreciable property”³⁸, the rate is set by s EZ 15.

105. Section EE 31 provides that the annual rate that applies to an item of property is the item’s economic, special or provisional rate, subject to some exceptions.

Economic rates

106. Generally, the depreciation rate for an item of property acquired for use in deriving income, or that becomes available for such use, will be the item’s economic rate. Economic rates were introduced from 1 April 1993 and applied to items of depreciable property acquired from that date. The formulas for setting economic rates were revised in 2005 and applied from the 2005/06 income year. The current table of rates includes the economic rates set by the Commissioner for different classes of assets based on the estimated useful life of that class of asset, and based on its use in particular industries.

107. Section EE 26 points to the relevant provisions which set the formula for particular assets. For example, the formula for setting an economic rate for buildings is found in s EE 28. The economic rate for buildings is set under s EE 28(4) as:

$$1 \div \text{estimated useful life}$$

Exceptions to the general economic rate – residential buildings

108. Annual rates for an item of property are sometimes specifically set. Specific rates are set in s EE 31 for residential buildings. For residential buildings, the rate is set at 0%, **whenever the building was acquired** (s EE 31(2)(d), s EE 31(3)(c), s EE 61(3B) and s EE 61(7B)).

Exceptions to the general economic rate – non-residential buildings

109. For non-residential buildings, the annual depreciation rate that applies will depend on the date that the building was acquired by the building owner, the type of building and the way in which the building is used. As buildings are very often acquired with land, see the discussion on when land is acquired in [QB 17/02: “Income tax - date of acquisition of land, and start date for 2-year bright-line test”](#).

110. The “Buildings (non-residential buildings)” rate of 2% (DV) and 1.5% (SL), which applies from the 2020/2021 and subsequent income years is a rate set by the COVID-19

³⁸ Excluded depreciable property is defined in s EE 64 and includes property that a person used or had available for use (other than as trading stock) before 1 April 1993.

Response (Taxation and Social Assistance Urgent Measures) Act 2020 (s 39). These are specific rates set for a generic class of non-residential buildings. These rates apply to buildings with an estimated useful life (EUL) of 50 years or more. The rates are default rates, which means they apply unless more specific rates have been set for the type of building, or a special or provisional rate applies to the building. The current table of rates includes specific rates that have been set for buildings that the Commissioner has determined have a different EUL. For example:

- A more specific rate is set for a chemical works building, which has an EUL of 33.3 years. The rate for the chemical works building will depend on whether the chemical works building was acquired on or before 30 July 2009, or after that date.
- Similarly, a more specific rate is set for buildings with prefabricated stressed-skin insulation panels. Buildings constructed using these materials may be found in some coolstores, meat and fish processing facilities. As buildings may sometimes be partially constructed using these materials, the Commissioner has provided guidance on the buildings that fall within this class in [QB 17/01](#): "Depreciation treatment for 'Buildings with prefabricated stressed-skin insulation panels'"³⁹.
- A building with steel or steel and timber framing (default class) acquired after 19 May 2005, had a rate that applied to the 2010/2011 income year of 3% (DV) or 2% (SL). From the 2011/2012 and subsequent income years, the rate for a building of that construction is set at 0%. However, for the 2020/2021 and subsequent years the owner of the building will have to apply the default rate for a non-residential building of 2% (DV) or 1.5% (SL) because there is no specific rate set for buildings with steel or steel and timber framing for the 2020/2021 and subsequent years.

Special rates or provisional rates

111. A special rate can be set for an item of depreciable property but not for a residential building or for "excluded depreciable property"⁴⁰ (s EE 35). The need for a special rate could arise if an economic rate is available for the item but the way in which the item is used in deriving income means that the EUL of the item differs from the one set by the Commissioner under the general economic rate for the item. A person can apply for a

³⁹ QB 17/01: "Depreciation treatment for 'Buildings with prefabricated stressed-skin insulation panels'", *Tax Information Bulletin*, Vol 29, No 4 (May 2017).

⁴⁰ See n 38.

special rate by following the process outlined under s 91AAG of the Tax Administration Act 1994 ([IR 260B](#)).

112. A provisional rate can also be applied for under s 91AAG of the Tax Administration Act 1994, except if it is for an item of “excluded depreciable property” ([IR 260A](#)). A person can apply for a provisional rate if a new asset class is required. For example, the Commissioner has issued provisional determinations for buildings that have been constructed using special types of materials or have processes carried out within them that affect the building’s useful life (for example, [Determination PROV24⁴¹](#) and [Determination PROV22⁴²](#)). In these cases, no appropriate asset class existed.

Improvements to buildings

113. A building owner who makes an improvement to a building⁴³ can choose to treat the improvement as part of the building or as a separate item of depreciable property. However, in the year in which the improvement is made it is treated as a separate item of depreciable property (s EE 37(2)). This is for the purpose of claiming the part year depreciation loss for the improvement. For further information on improvements, see [IS 10/01](#) paragraphs [167] to [177].
114. In the following year, the building owner can either continue to treat the improvement as a separate item of depreciable property or choose to treat it as part of the building (s EE 37(3)(a)). In either case the appropriate rate of depreciation for the improvement will be the building rate.
115. If the building owner chooses to treat the improvements as part of the building, the building owner must add the improvements’ ATV at the start of the income year to the building’s ATV at the start of the income year (s EE 37(5)). If using the straight-line method, the building owner must also add the improvements’ cost to the building’s cost:

⁴¹ Determination PROV24: Mushroom factory buildings and plant; issued 1 October 2012, *Tax Information Bulletin*, Vol 24, No 9 (October 2012): 7.

⁴² Determination PROV22: Provisional depreciation rate for Dairy Plant Dry Store Buildings; issued 27 February 2012, *Tax Information Bulletin* Vol 24, No 3 (April 2012): 8.

⁴³ For example, a common improvement to a building in New Zealand is seismic strengthening. If treated as a separate asset, the costs related to the strengthening will be depreciable at the relevant building rate.

Improvement treated as part of item

- (5) For the purposes of subsection (3)(a), a person may choose to treat the improvement as part of the item of depreciable property that was improved. They must do 1 of the following for the first income year, after the income year in which they made the improvement, in which they use the improvement or have it available for use:
- (a) if they use the diminishing value method for the item, add the improvement's adjusted tax value at the start of the income year to the item's adjusted tax value at the start of the income year:
 - (b) if they use the straight-line method for the item,—
 - (i) add the improvement's adjusted tax value at the start of the income year to the item's adjusted tax value at the start of the income year; and
 - (ii) add the improvement's cost to the item's cost.

Disposal or change of use

116. When a building owner has a building or item of commercial fit-out that is treated as depreciable property and the owner either disposes of the property or certain events occur, they may have depreciation recovery income, or additional depreciation loss.
117. At the time the disposal or other event occurs, depreciation recovery income will arise if the consideration for the item of depreciable property exceeds the ATV of the item. However, the amount of depreciation recovery income cannot be more than the total amount of deductions for depreciation loss that a person had available for the item of property.
118. "Consideration" for this purpose is subject to some adjustments. For example:
- If the amount of consideration is less than market value, the amount that the person derives is treated as being the item's market value (s EE 45(3)). Section EE 45(3) is subject to some qualifications. For example, it does not apply to a transfer under a relationship agreement⁴⁴.
 - The consideration may be subject to the purchase price allocation rules. Purchase price allocation rules were introduced with effect from 1 July 2021 to reinforce and extend existing provisions requiring parties to a sale of business assets with different tax treatments to adopt the same allocation of the total

⁴⁴ A "relationship agreement" is defined in s YA 1, and includes an agreement made under Part 6 of the Property (Relationships) Act 1976 and an order made by a court under s 25 of that Act.

purchase price to the various classes of assets for tax purposes⁴⁵. However, they do not apply when the total consideration for the purchased property is less than \$1 million, or less than \$7.5 million if the only purchased property is residential land and accompanying chattels.

119. The events that trigger depreciation recovery income arising are set out in s EE 47. They include:

- A change of use of an item that means a person is not allowed a deduction for depreciation loss for that item for the next income year. This includes a change of use of commercial fit-out and a change in the status of a building related to an item of commercial fit-out (s EE 47(2)).
- Damage to a building or the neighbourhood of the building that causes the building to be useless for deriving income, and the building is demolished or abandoned for future demolition (s EE 47(4)).
- When a person acting under statutory authority acquires a property (s EE 47(7)).
- When a lessee who owns fixtures and improvements to the land disposes of their interest under a lease under ss EE 4 or EE 5 (s EE 47(8)).

Depreciation recovery income

120. The amount of the depreciation recovery income is treated as derived in the income year in which it is calculated. It is calculated under s EE 48 as being the lesser of the amount of depreciation loss that a person has been allowed for the item, or the amount by which the consideration exceeds the item's ATV.

EE 48 Effect of disposal or event

Amount of depreciation recovery income

- (1) For the purposes of section EE 44, if the consideration is more than the item's adjusted tax value on the date on which the disposal or the event occurs, the lesser of the following amounts is the amount of depreciation recovery income derived by the person:
 - (a) the amount by which the consideration is more than the item's adjusted tax value on the date on which the disposal or the event occurs; and
 - (b) the amount given by subsections (1B) and (1C).

⁴⁵ The rules (contained in ss GC 20 and GC 21) are explained in *Tax Information Bulletin* Vol 33, No 6 (July 2021): 28.

Amount for subsection (1)(b)

(1B) The amount for the purposes of subsection (1)(b) is given by the following formula:

item depreciation loss + CZ 11 item amount + DB 64 item amount.

Definition of items in formula

(1C) In the formula in subsection (1B),—

- (a) item depreciation loss is the **total of the amounts of depreciation loss for which the person has been allowed deductions for the item**;
- (b) CZ 11 item amount is the amount of any deduction allowed for the acquisition of the item, for the person, if the item is one to which section CZ 11 (Recovery of deductions for software acquired before 1 April 1993) applies;
- (c) DB 64 item amount is the amount of the capital contribution for the item, for the person, if the item is one to which section DB 64 (Capital contributions) applies.

[Emphasis added]

121. Importantly, in calculating the amount of depreciation loss in s EE 48(1)(b), the formula takes account of “the total of the amounts of depreciation loss for which the person has been allowed for the item”. Depreciation loss for this purpose means the amount that a person was entitled to claim, as calculated under subpart EE. This means that it includes an amount that a person could have claimed whether they in fact claimed such deductions.
122. If the amount of depreciation loss claimed by the building owner was in error, for example, where an incorrect depreciation rate had been used, the building owner might be able to make an adjustment to the prior assessments⁴⁶. In [QB 15/03](#): “Income Tax – changing to a different depreciation rate for an item of depreciable property”, the Commissioner discusses when a change to a depreciation rate can be made and when it is required to be made. Whether an amendment can be made to correct past periods will depend on the particular facts and circumstances of the case. In some cases a person can make an adjustment in their next return (see s 113A of the Tax Administration Act 1994), and in other situations the person will need to request that the Commissioner exercise their discretion under s 113 of the Tax Administration Act 1994 (see Standard practice statement [SPS 20/03](#): Requests to amend assessments).

⁴⁶ See QB 15/03: “Income Tax- changing to a different depreciation rate for an item of depreciable property”, *Tax Information Bulletin*, Vol 27, No 4, May 2015:30, ss 113 and 113A of the Tax Administration Act 1994 and SPS 20/3: Requests to amend assessments *Tax Information Bulletin*, Vol 32, No 6, July 2020:11.

123. Example 1 – *Commercial building sold* demonstrates how to calculate depreciation recovery income on the sale of a commercial building.

Example 1 – Commercial building sold

The owners of Buildings A and B have not separately depreciated the commercial fit-out.

	Cost price	Accumulated depreciation loss	Adjusted tax value (ATV)	Sale price
Building A	\$1,000,000	\$200,000	\$800,000	\$1,500,000
Building B	\$1,000,000	\$200,000	\$800,000	\$900,000

Building A

The consideration (sale price) exceeds the ATV by \$700,000.

The amount of the depreciation loss available for the building was \$200,000.

The amount of the depreciation recovery income is \$200,000, as the lesser of the two amounts.

Building B

The consideration exceeds the ATV by \$100,000

The amount of the depreciation loss available to the building was \$200,000.

The amount of the depreciation recovery income is \$100,000, as the lesser of the two amounts.

124. Depreciation recovery income can also arise when there is a change of use of a building or commercial fit-out. In *Example 8 – Partial change of use – commercial fit-out*, a building leased for commercial purposes has a change of use when a floor of the building is let as a residential tenancy.
125. The depreciation recovery income formula also takes account of other specific deductions (under s CZ 11 and s DB 64), neither of which relate to buildings. It does not include deductions taken under s DB 65 (see [130] to [136] for further discussion on s DB 65: the allowance for certain commercial buildings). Therefore, building owners should ensure that the deductions claimed under s DB 65 are adjusted in the calculation to ensure that there is not an over-recovery of depreciation loss. If depreciation recovery income is simply calculated as the difference between the consideration received on disposal and the ATV, the amount of the s DB 65 deductions will need to be added back to prevent an over-recovery of depreciation loss.

126. An example of a depreciation recovery income calculation where s DB 65 deductions had been claimed is included in *Example 4 – Commercial building owned since 2009 – s DB 65 deductions*.

Disposing of residential buildings

127. Although the depreciation rate for a residential building has been set at 0% since the 2011/12 income year, depreciation recovery income could arise on the disposal of a residential building. This will occur if the building is depreciable property of the owner and depreciation loss had been allowed for that building up to and including the 2010/11 income year.

Example 2 – Disposal of a residential rental property

Bob and Shirley own a residential rental property which they bought in August 2008 for \$625,000. A registered valuation at the time of purchase valued the land at \$250,000 and the value of the improvements at \$375,000. Included in the value of the improvements were the following chattels: carpets, curtains and blinds, electric stove, dishwasher and washing machine with a total value of \$9,500. This meant that the value of the building for depreciation purposes was \$365,500 (\$375,000 - \$9,500 = \$365,500).

In the 2009 to 2011 income years, they claimed depreciation on the building as follows:

Value improvements \$365,500	Depreciation (DV 3%)	ATV
Original cost		\$365,500.00
2009 (6 complete months)	\$5,482.50	\$360,017.50
2010	\$10,800.53	\$349,216.97
2011	\$10,476.51	\$338,740.46
2012-2020	0.00	\$338,740.46
Total (accumulated depreciation loss)	\$26,759.54	

In 2021, Bob and Shirley sell the rental property for \$1,250,000.00. Because the consideration is less than \$7.5m and the sale is only of residential land and chattels, Bob and Shirley (and the purchaser) are not required to make a purchase price allocation in accordance with s GC 21. However, Bob and Shirley still need to establish the amount of the sale price that relates to the building, and other items of depreciable property that are included in the sale. If that amount exceeds the amount of the ATV of the relevant items, then there will be depreciation recovery income.

Bob and Shirley obtained a registered valuation for the property before marketing the property. The valuation of the land and buildings combined was \$1,150,000. The land value was \$495,000 and the value of improvements (including chattels of \$20,000) was \$655,000. Based on this valuation, Bob and Shirley worked out that the building accounted for 55.22% of the total valuation. They decided to use the same percentage to establish the portion of the sale price which is attributable to the building:

2021 Registered valuation:

$$\text{Value of improvements } \$635,000 / \$1,125,000 = 55.22\%$$

Apportionment of sale price:

$$\$1,250,000 \times 55.22\% = \$690,250 \text{ (value of improvements)}$$

The amount of depreciation recovery income is the smaller of either:

- the original cost price of the building (\$365,500) less the ATV (\$338,740.46) = \$26,759.54 (being all the depreciation claimed)
- the sale price (\$690,250) less the ATV (\$338,740.46) = \$351,509.54

Therefore, the amount of depreciation recovery income is the smaller amount of **\$26,759.54**.

Additional depreciation loss on certain disposal events

128. In some circumstances under the depreciation rules, additional depreciation loss is available. This occurs if the amount of the consideration received (actual or deemed) is less than the ATV. However, for buildings this only arises where the building is rendered useless and demolished, or abandoned for demolition. In addition, the cause of the damage to the building needs to have been a natural event (such as a flood or earthquake) and beyond the control of the building owner (or their agent or a person associated with them).
129. Additional depreciation loss on disposal is available to the owners of grandparented structures. This is provided for in s EZ 23BD which provides that s EE 48(2) applies if the item is a grandparented structure. Grandparented structures are discussed from [137].

EE 48 Effect of disposal or event

Amount of depreciation loss

- (2) For the purposes of section EE 44, if the consideration is less than the item's adjusted tax value on the date on which the disposal or the event occurs, the person has an amount of depreciation loss that is the amount by which the consideration is less than the item's adjusted tax value on that date.

Income year of depreciation recovery income

- (2B) The person derives the depreciation recovery income in the income year that is the earliest income year in which the consideration can be reasonably estimated.

When subsection (2) does not apply

- (3) Subsection (2) does not apply if the item is a building unless—
- (a) the building has been rendered useless for the purpose of deriving income, and demolished or abandoned for later demolition as a result of damage to the building or of the neighbourhood of the building; and
 - (b) [Repealed]
 - (c) the damage is caused—
 - (i) by a natural event not under the control of the person, an agent of the person, or an associated person; and
 - (ii) other than as a result of the action or failure to act of the person, an agent of the person, or an associated person.

Special cases – opening ATV, s DB 65 and grandparented structures

130. Several special rules provide for the transition from the 2019/20 income year to the 2020/21 income year for building owners who had previously claimed depreciation for their buildings or commercial fit-out. These rules relate to:
- the opening tax book value for buildings owned in the 2010/11 income year
 - deductions that had been taken under s DB 65 for commercial fit-out
 - buildings that had been treated as “grandparented structures”.

Opening tax book value from the 2020/21 income year

131. For building owners who have claimed depreciation deductions for the building before the 2011/12 income year, the opening book value is the ATV of the building as at the end of the 2010/11 income year, **less** any deductions that were taken under s DB 65 in the period up to the 2019/20 income year, **plus** any non-deductible capital expenditure incurred on the building from the end of the 2010/11 income year through until the beginning of the 2020/21 income year. This is shown in Figure 3.

Figure 3: Opening book value for 2020/21 income year

Start	Building ATV at end of 2010/11
Plus	Improvements between 2010/11 and 2020/21
Subtract	Section DB 65 deductions claimed
Equals	Opening book value for 2020/21

132. *Example 3 – Commercial building owned since 2009* shows how this applies to the owner of a commercial building who has been using the building for deriving income since the 2008/09 income year. See [133] for further details about s DB 65.

Example 3 – Commercial building owned since 2009

Jack and Jill Property Ltd bought a unit in a commercial building in the 2008/09 income year to use for their lawnmower sales and service business. They claimed deductions for depreciation loss in the 2009-11 income years. In 2016 they replaced the existing single glazed aluminium-framed windows and side door in the office area with new double glazed PVC units at a cost of \$15,500. The ATV at the end of the 2011 year was \$228,000 and the non-deductible capital expenditure (the improvements) incurred since then was \$15,500. No amount was claimed under s DB 65. Therefore, the opening book value for 2021 is \$243,500.

Embedded commercial fit-out – section DB 65

133. At the time the rules relating to commercial fit-out were introduced some building owners had commercial fit-out that they had not separately depreciated but had instead depreciated at the building rate. As commercial fit-out was intended to be depreciable, a special rule was introduced that allowed certain commercial building owners to make a one-off adjustment to create a “pool asset” that could continue to be depreciated by way of a special allowance under s DB 65. The value of the “starting pool” was calculated under s DB 65(4). This was 15% of the building’s ATV (less the value of any later acquired fit-out for which depreciation deductions had been claimed). The amount of the deduction available to this “pool” under s DB 65(2) was 2%:

DB 65 Allowance for certain commercial buildings*Deduction*

- (2) Except as provided by subsection (6), the person is treated as having a loss for the income year equal to the amount calculated using the formula—

$$\text{starting pool} \times 0.02 \times \text{whole months} \div 12.$$

134. Section DB 65 was repealed in 2020 when depreciation deductions were reintroduced for long-life commercial buildings. To allow depreciation deductions for that fit-out to continue, s EE 56 was amended to permit building owners to adjust the ATV of the building. As noted above, s EE 56 provides that an item's ATV is its "base value" less "total deductions".
135. The base value for a building is provided in s EE 57 and is the cost of the item (subject to some adjustments). The deductions are listed in s EE 60(1). The 2020 amendments added a further deduction in s EE 60(1)(d):

- (d) The total amount of previous deductions under s DB 65 (Allowance for certain commercial buildings).

136. Therefore, the nominal "pool asset", as with the allowance for the embedded commercial fit-out, ceased to exist from the beginning of the 2020-21 income year. The total amount claimed under s DB 65 is adjusted against the ATV of the building at the end of the 2010/11 income year. However, building owners will need to remember that if the building is later disposed of there needs to be a further adjustment for the s DB 65 deductions because they are not included in the depreciation recovery income calculation. This is illustrated in *Example 4 – Commercial building owned since 2009 – s DB 65 deductions*.

Example 4 – Commercial building owned since 2009 – s DB 65 deductions

Junior Wholesalers Ltd bought a warehouse for storing imported car part spares in the 2008/09 income year. At the time Junior acquired the building, the vendor had allocated \$50,000 to partition walls and other assorted fit-out. Junior decided that it was simpler to claim depreciation on the building and the fit-out at the building's depreciation rate. The building's ATV at the end of the 2010/11 income year was \$450,000.

From the 2011/12 income year, under s DB 65(4), Junior was able to create an asset "starting pool" of "commercial fit-out":

$$\begin{aligned} \text{Starting pool} &= \text{Building's ATV} \times 15\% \\ &= \$450,000 \times 0.15 \\ &= \$67,500 \end{aligned}$$

Junior claimed deductions under s DB 65 on the "pool" at 2% (straight-line) for each of the years 2011/12 to 2019/20:

$$\$67,500 \times 0.02 \times 12 \text{ (whole months)} / 12 = \$1,350.00$$

No capital expenditure was incurred on the warehouse during that period. The deductions claimed were as follows:

Commercial fit-out pool s DB 65		
Opening value "pool"		\$67,500.00
2011/12	\$1,350.00	\$66,150.00
2012/13	\$1,350.00	\$64,800.00
2013/14	\$1,350.00	\$63,450.00
2014/15	\$1,350.00	\$62,100.00
2015/16	\$1,350.00	\$60,750.00
2016/17	\$1,350.00	\$59,400.00
2017/18	\$1,350.00	\$58,050.00
2018/19	\$1,350.00	\$56,700.00
2019/20	\$1,350.00	\$55,350.00
Total deductions under s DB 65	<u>\$12,150.00</u>	

For the 2020/21 income year, the opening ATV of the building will be:

Closing ATV 2011 + non-deductible capital expenditure - total deductions s DB 65

$$\$450,000 + \$0 - \$12,150 = \$437,850$$

In April 2023, Junior sells the building to AJ Holdings for \$800,000.

Junior will need to calculate the amount of depreciation recovery income on the sale of the building. The amount will be the lesser of:

- The difference between the ATV of the building and the sale price, and
- The amount of depreciation loss claimed or available to be claimed in respect of the building.

When Junior calculates the amount of any depreciation recovery income it will need to remember that the ATV was reduced at the beginning of the 2021 income year by the amount of deductions taken under s DB 65. As this amount is not clawed back as depreciation recovery income, the amount of \$12,150

should be added to the ATV and then the calculation undertaken. Similarly, the amount of \$12,150 will not be included in the amount of “depreciation loss”.

Grandparented structures

137. This category of non-residential buildings was created in response to the Commissioner’s draft of IS 10/02, which was issued in 2009 for public consultation.
138. IS 10/02 included a number of examples in which the characteristics of a conventional building were applied to several structures. All of these were found to be a “building” using the ordinary meaning of the term. None of these items had been treated as a “building” before the publication of IS 10/02.
139. In July 2009, the Minister of Revenue announced that the Government would introduce legislation to ensure that the tax treatment of these structures would continue for the current owner so long as they remained in the same hands. He also stated that any new expenditure relating to improvements to the building would not be covered by the legislative change.
140. The changes that were introduced in 2010 were to:
- create a category of buildings called “grandparented structures”
 - add a definition of “building” which excluded “grandparented structures”
 - require improvements to a grandparented structure to be treated as a separate item of depreciable property (s EE 37(3B)).
141. A “grandparented structure” was defined in s YA 1 as:

grandparented structure means, for a person, any item on the following list, if the person acquired the item, or entered into a binding contract for the purchase or construction of the item, on or before 30 July 2009:

- (a) barns, including barns (drying):
- (b) carparks (buildings):
- (c) chemical works:
- (d) fertiliser works:
- (e) powder drying buildings:
- (f) site huts

142. The definition of building introduced at that time was:

building, in sub-parts EE and EZ, does not include a grandparented structure

143. The definitions of “grandparented structure” and “building” and s EE 37(3B) were repealed from the beginning of the 2021 income year. However, s EZ 23BD, which was introduced in 2022⁴⁷ and takes effect from the 2020-21 income year, allows owners of grandparented structures to claim deductions for losses on disposal. The provision brings back the definition of “grandparented structure” for this purpose.

EZ 23BD Loss on disposal of grandparented structure

- (1) Despite section EE 48(3), subsection (2) of that section applies if the item is a grandparented structure.
- (2) In this section, grandparented structure means, for a person, any item on the following list, if the person acquired the item, or entered into a binding contract for the purchase or construction of the item, on or before 30 July 2009:
 - (a) barns, including barns (drying):
 - (b) carparks (buildings):
 - (c) chemical works:
 - (d) fertiliser works:
 - (e) powder drying buildings:
 - (f) site huts.

Further examples

144. The following examples demonstrate how the rules will likely apply in different scenarios.

Example 5 – Determining opening value

Daisy Hydroponics Ltd, that has a standard balance date of 31 March, bought a commercial building in July 2020 for \$875,000 (plus GST) for use in carrying on a business of hydroponic horticultural supplies. The land was valued at \$375,000 with improvements (building, building fit-out and chattels) of \$500,000. The

⁴⁷ Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022, s 101.

building value was \$350,000 and this is the opening value for calculating depreciation on the building. The depreciation rate for a non-residential building will be the most appropriate rate for the building. Daisy will be able to choose either 2% DV or 1.5% SL.

Example 6 – Mixed-use commercial building

Portlea Limited has owned a four-storey commercial building since 2015. It has used the building for ground and first floor retail and for office and storage on the top two floors. Portlea has decided to convert the top floor into a penthouse apartment, which it will lease out for residential purposes. It also intends to reconfigure the ground and first floor into more upmarket office space. This will involve moving some non-load bearing partition walls and upgrading the lighting and heating systems. The ground floor lobby has a lift to the upper floors.

Portlea considers that a floor area test is appropriate to determine the predominant use of this building. The lobby area and lift will be available to both the residential and non-residential tenants. From the measurement of the floor area of the building, Portlea calculates that the penthouse apartment, together with a 25% share of the common area, will be 27% of the total floor area. On this basis the building is not a place used predominantly as a place of residence or abode and is therefore not a dwelling or a residential building. The building's main use is as a non-residential building. The penthouse apartment is a "dwelling" within the commercial building.

The whole building will be depreciable at the "Building (non-residential)" rate of 2% DV or 1.5% SL.

The non-structural improvements and fit-out of the offices and of any shared space, such as the lobby, will be depreciable commercial fit-out and plant. This is because commercial fit-out is either plant or non-structural items of depreciable property in a commercial building. A commercial building is one that is not a dwelling, or that includes a secondary and minor use as a dwelling. The penthouse apartment is a "dwelling" within the commercial building but based on the floor area of each, it is a secondary use.

The improvements and fit-out of the apartment will be non-depreciable. This is because the definition of "commercial fit-out" excludes plant used inside a dwelling within a commercial building and non-structural items that are used in or are part of a dwelling within a commercial building.

Example 7 – Mixed-use building with vacant commercial space

Delta Grove Holdings owns a building with four small studio apartments on the upper floor (total 100m²) and a ground floor comprising an empty factory and office space totalling 350m². The ground floor is largely a shell with very little fit-out in place.

The ground floor had been leased to the previous tenant for 5 years until they vacated it 3 months ago. The bathroom facilities need replacing and the whole floor needs refurbishment and fit-out for a new tenant. Delta has not carried out this work as this would be negotiated with any new tenant.

The apartments have been leased and the ground floor is advertised as available for immediate occupation. There has been some interest in the ground floor, but no suitable tenants have been found. Delta is keen to hold out for better lease terms than those offered to date.

Delta wants to know whether the building can be classified as a 'non-residential building'.

A non-residential building is a building that is not a residential building. A residential building is one that is a dwelling, and for the purposes of the residential building definition, a dwelling is a place used *predominantly* as a place of residence or abode. Although the building contains residential dwellings on the upper floor this has been a secondary and minor use of the building. The building's predominant or main use has been for non-residential purposes. That availability for use is continuing while the owner is advertising the ground floor tenancy. The building will therefore be a non-residential building. However, as noted at [91], availability for use is a factual test that needs to be considered each year.

Example 8 – Partial change of use – commercial fit-out

Cityville Limited owns a four-storey commercial building. It decides to give the building a much-needed refurbishment with the intention of letting the building under a single lease as commercial offices. Each floor of the building has a new kitchenette fitted and upgraded toilet and shower facilities. These items have been depreciated separately from the building since acquisition as commercial fit-out. The refurbishment is finished in early 2021 and advertised for lease. A lease is negotiated but the new tenant does not want the top floor.

Cityville advertises the top floor for lease as a “loft” apartment under a residential lease.

The building’s main use is as a commercial building. From the date that Cityville makes the top floor available for a residential lease, the top-floor apartment would be used or available for use as a “dwelling” within the commercial building.

The building will be depreciable at the “Building (non-residential)” rate of 2% DV or 1.5% SL. The improvements and fit-out of the commercial tenancies will be depreciable commercial fit-out and plant.

The change of use of the top floor means that Cityville will need to adjust the depreciation of the commercial fit-out to the extent that it is used in relation to, or part of, a dwelling within the commercial building.

This change of use from “commercial fit-out” to fit-out of a dwelling is an event under s EE 47(2) and the event is treated as occurring on the first day of the next income year. The effect of this event is that depreciation recovery income or additional depreciation loss could arise. Cityville must determine whether the consideration received for the s EE 47(2) event is more than the item’s ATV. For this purpose, Cityville is treated as receiving consideration equal to the item’s market value (s EE 45(5)).

Cityville should maintain a separate schedule of fit-out that is used for the residential tenancy from that date.

The use of the fit-out in the common areas is not changed by the commencement of a residential tenancy. In addition, the event does not trigger a change to the depreciation of the building as the building is still predominantly used for commercial purposes.

Example 9 – Residential house with separate short-term accommodation

Keith buys a property in central Otago. The land has the main house that Keith lives in with his wife. At the rear of the property is a separate building with two bedrooms and an adjoining shared ablutions block with basic cooking facilities. He also has space for a couple of tents.

Keith advertises these forms of accommodation locally on the supermarket notice board and with some local horticultural businesses. He gets backpackers, temporary workers and budget holidaymakers. He lets the bedrooms out separately but those staying must share the cooking and bathroom facilities. How

long he lets the rooms varies, but it is generally less than 2 weeks. Keith prefers to let short term.

The definition of a residential building includes a building used for short-stay accommodation if there are less than 4 units for separate accommodation on the same land. In Keith's case there are two buildings on the same land:

- the building that is rented out, containing two units that can be separately occupied, and
- Keith's own home, which is not part of the rental activity.

This means the building that is rented out is a residential building, and Keith will be unable to claim depreciation deductions for that building.

Example 10 – Farm cottages and separate workers' accommodation block.

Oliver and Mary have a large sheep farm in Southland. They have three cottages on their land. Cottages A and B are permanently occupied by their farmworkers and their families. Cottage C is in the back country of the farm and used from time to time if additional workers are needed. Accommodation in Cottage C is usually for a short term.

Oliver wants to know whether he can claim depreciation deductions for the cottages. All the buildings are used, or available for use, for deriving income or in carrying on a business for that purpose. They are therefore depreciable property.

A depreciation rate of more than 0% is available only if the buildings are non-residential buildings. A building will be a residential building if it is a dwelling. A dwelling is any place "used predominantly as a place of residence or abode".

Cottages A and B are used predominantly as a place of residence for the two workers and their families; therefore, they are residential buildings.

Although Cottage C is used irregularly and for short term periods, it is then used as a residence. Therefore, Cottage C is also a dwelling and a residential building. This means depreciation deductions will not be available for any of the cottages. Items of fit-out of the buildings will not be depreciable.

Depreciation – schedule of key provisions

DA 1	General permission: allows a deduction for depreciation loss if incurred in deriving income or in carrying on a business for that purpose
Subpart EE: quantifies the amount of depreciation loss or depreciation recovery income and identifies when the deduction is allowed, or the income is derived	
EE 1(2)	When depreciation loss arises for depreciable property – sets out the requirement that the item must be used or available for use by the person in the income year
EE 1(3)	When depreciation recovery income arises
EE 2 - EE 5	The meaning of “owns” depreciable property
EE 6	What is depreciable property
EE 7	What is not depreciable property
EE 8	Election that property is not depreciable
EE 9	Identifies the provisions that need to be considered for the elements of the depreciation calculation: <ul style="list-style-type: none"> - methods and calculation (EE 12- EE 24) - rates (EE 26 -EE 36) - improvements (EE 37) - transfers (EE 40 – EE 43) - disposals and similar events (EE 44- 52) - interpretation provisions (EE 54- EE 67)
EE 12	Depreciation methods – straight line, diminishing value and pool methods - a building cannot be poolable property (EE 66(2))
EE 14-16	Calculation of the amount of depreciation - the elements of the formula
EE 28	Setting the economic depreciation rate for buildings
EE 31	Sets the annual rate for a residential building with an EUL of 50 years or more at 0%
EE 35 - EE 36	Special and provisional rates
EE 37	Improvements: how to treat improvements in the year made and following years
EE 40	Transfer of property between associated persons
EE 44	Disposal of depreciable property – and events treated as disposals
EE 45	Consideration on disposal
EE 47	Disposal events – including change of use, irreparable damage to a building, statutory acquisition
EE 48	Effect of the disposal or event – calculating the depreciation recovery income or additional depreciation loss
EE 54	Cost – adjusted for GST
EE 55-60	Adjusted tax value (ATV): formula (EE 56), base value (EE 57 - EE 58), deductions (EE 60)
EE 61	Meaning of annual rate – annual rate for residential buildings set at 0% (EE 61(3B), EE 61(7B))
YA 1	Definitions: commercial building, commercial fit-out, dwelling, independent living, non-residential building, plant, residential building.

References

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Barat v Minister of National Revenue [1991] 2, CTC 2,360

Clarke v Wilkie (1977) 17 SASR 134

Harris v De Pinna (1886) LR 33 Ch D 238

Hilderbrandt v Stephen [1964] NSW 740

Melfort Danceland v Star City (Rural Municipality) [1977] 3 WWR 737

Mercury NZ Limited v Commissioner of Inland Revenue [2019] NZHC 1524, (2019) 29 NZTC, 24,014 (HC)

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About this document

Interpretation Statements are issued by the Tax Counsel Office. They set out the Commissioner's views and guidance on how New Zealand's tax laws apply. They may address specific situations we have been asked to provide guidance on, or they may be about how legislative provisions apply more generally. While they set out the Commissioner's considered views, Interpretation Statements 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 an Interpretation Statement will not necessarily lead to the same tax result. Each case must be considered on its own facts.