

## Interpretation Statement IS 10/02

### MEANING OF "BUILDING" IN THE DEPRECIATION PROVISIONS

#### Note (not part of the Interpretation Statement):

This Interpretation Statement sets out the meaning of the term "building" in the context of the depreciation provisions.

Previously some items of depreciable property that are considered to be buildings under this Interpretation Statement may not have been treated as buildings for depreciation purposes. The Minister of Revenue announced on 30 July 2009 a proposal to "grand-parent" the existing treatment of these items – [Depreciation: Govt to mitigate 'building' interpretation](#). At the end of this Interpretation Statement there is a table listing these items with accompanying examples.

Also, as a result of this statement some asset classes in the Commissioner's Table of Depreciation Rates will be reviewed including the asset classes for carparks (building and pads); buildings (portable) and site huts. Any changes to these asset classes will involve the issuing of new depreciation determinations. Any new depreciation determinations for economic rates will be issued in draft form for consultation.

All legislative references are to the Income Tax Act 2007 unless otherwise stated. The legislation referred to in this Interpretation Statement is set out in the Appendix.

This Interpretation Statement applies on and after 30 July 2009.

#### Summary

1. This Interpretation Statement sets out the Commissioner's view on the meaning of the term "building" for the purposes of the depreciation provisions contained in the Income Tax Act 2007. The term "building" is not defined in the Income Tax Act 2007. Therefore, the purpose of this Interpretation Statement is to provide a definition, which when applied to an item of depreciable property, will determine whether that item is a building. This is important because the depreciation provisions require taxpayers to know whether an item of depreciable property is a building in order to determine the depreciation treatment of that item.
2. For depreciation purposes, buildings are treated differently from other items of depreciable property. If an item of depreciable property is a building:
  - a different depreciation rate may apply;
  - the 20% loading that applies to certain depreciation rates does not apply; and
  - a deduction for a loss on items no longer used, or a deduction for a loss on disposal, cannot be claimed except in limited circumstances.
3. The term "building" can have various meanings depending on the context in which the term is used. For example, a possible wide meaning of the

term "building" includes structures that are "built", such as fences. A possible narrower meaning might exclude certain types of buildings for particular reasons, such as buildings that provide a specialised setting or have a specialised function or purpose or are integrated with plant. The Commissioner's view is that in the context of the tax depreciation provisions, a building is an item within the ordinary or conventional meaning of the term "building". Case law indicates that a building within the ordinary or conventional meaning of that term generally has the following characteristics:

- A building is a structure of considerable size.
  - A building is permanent in the sense that it is intended to last a considerable time.
  - 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.
  - A building is enclosed by walls and a roof.
  - A building can function independently of any other structure. However, a building is not necessarily a physically separate structure.
4. Given that the design of, and materials used in, buildings are likely to change over time (without altering the basic concept of an ordinary or conventional building), it is not possible to be definitive as to the design or type of materials that are characteristic of such a building. However, the design of a building and the materials used to construct a building need to be of a kind that are intended to last for a considerable period.
  5. 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.
  6. The Commissioner's view is that the term "building" for the purposes of the depreciation provisions is the ordinary or conventional meaning without modification to exclude certain types of buildings. This interpretation is supported by the definition provided for "temporary building" in section YA 1 and the provision that allows a loss on the destruction of a temporary building (section DB 20). This interpretation is also supported by the legislative development of the depreciation provisions in relation to buildings.
  7. At the end of this Interpretation Statement there is analysis on how the Commissioner considers the building characteristics apply to particular items of depreciable property listed in the Commissioner's Table of Depreciation Rates. While the analysis does not cover all items within the Buildings and Structures asset category, it is intended to demonstrate the practical application of the building characteristics identified in this statement. Particular reference is made to items that, as a result of the

view set out in this Interpretation Statement, the Commissioner will now treat as buildings for depreciation purposes.

## **Background**

8. To ascertain the meaning of “building” in the depreciation provisions, it is useful first to understand how the term is used in the depreciation provisions. The term “building” has been in the current depreciation regime since the introduction of the regime in 1993. However, the term was also used in the asset disposal provisions prior to the current regime. To understand the current context in which the term “building” is used, it is useful to consider earlier provisions.

### ***Pre-1993 treatment for buildings – depreciation and disposal***

9. Prior to the current depreciation regime that was introduced by the Income Tax Amendment Act 1993, buildings were in certain circumstances treated differently from other depreciable assets in the Income Tax Act 1976.
10. The rules dealing with the disposal of depreciated assets required consideration of whether an item of property was a building for various provisions. For example, the provision that specifically excluded depreciable buildings from allowable deductions on loss on disposal, was introduced by the Income Tax Amendment Act (No 4) 1988 as section 117(1A) of the Income Tax Act 1976. In addition to this, the depreciation deduction provision required consideration as to whether an item of property was plant, machinery, or equipment, a temporary building, or premises. Of these terms only the term “temporary building” was defined in the Income Tax Act 1976.
11. Temporary buildings were defined to cover certain types of buildings including buildings that were built to house plant or machinery and needed to be demolished to remove that plant or machinery. Temporary buildings were expressly treated differently from other buildings in various provisions.
12. Section 108(1) of the Income Tax Act 1976 was the depreciation allowance provision. At the Commissioner’s discretion, section 108(1) provided for the depreciation of plant, machinery, or equipment, or a temporary building if the depreciation was caused by fair wear and tear or by the item becoming obsolete or useless. Also, at the Commissioner’s discretion section 108(1) provided for the depreciation of assets “not being plant, machinery or equipment, or a temporary building” (i.e. premises) if the depreciation was caused only by fair wear and tear. In this way, section 108(1) required taxpayers to determine whether their assets (including buildings) were plant or premises. Also, section 106(1)(l) of the Income Tax Act 1976 provided that no deduction was allowed for any loss incurred on the demolition, destruction, or disposal of any premises other than a temporary building.
13. Under section 108(1), typically buildings were given cost price (i.e. straight line) depreciation rates by the Commissioner. The Commissioner published these depreciation rates in the IR260 booklet.
14. The interim depreciation regime that was introduced by the Income Tax Amendment Act (No 2) 1992 provided for a 25% loading on existing

depreciation rates for certain assets acquired after 16 December 1991 and on or before 31 March 1994. The loading specifically did not apply to buildings. This provision was originally introduced as section 108A of the Income Tax Act 1976. The interim provision was introduced as a short-term measure before the implementation of the changes that led to the current depreciation regime.

15. Therefore, the earlier provisions prior to the current depreciation regime required consideration of a number of terms: "building", "premises", "temporary building", and "plant, machinery or equipment". These terms had been referred to in the Income Tax Act 1976 since it was enacted and were also referred to in the relevant equivalent sections of the Land and Income Tax Act 1954. In this way the earlier provisions operated within a different scheme to the current regime.

### ***Current depreciation regime***

16. Unlike the previous depreciation rules, the current depreciation provisions specifically require consideration as to whether an item of depreciable property is a building rather than whether it is premises, plant, machinery or equipment, or a temporary building. (However, it is still necessary to consider whether a building is a temporary building for particular provisions outside the depreciation provisions.)
17. A deduction is allowed for the depreciation loss on an item owned by a person that is "depreciable property" and that is used or available for use by the person to the extent that the loss was incurred in deriving assessable income: sections DA 1 and EE 1(2). "Depreciable property" is property that might reasonably be expected to decline in value while it is used or available for use in deriving assessable income or in carrying on a business for that purpose: section EE 6(1). Section EE 7(a) provides that although land cannot be "depreciable property", buildings, fixtures, and the land improvements listed in schedule 13 can be if they satisfy section EE 6(1).

### ***Method of depreciation***

18. Generally, three alternative methods are permitted for calculating the amount of a depreciation loss: the straight-line method, the diminishing value method and the pool method: sections EE 9(1) and EE 12 to EE 24. As buildings are not "poolable property", the pool method cannot be used for buildings: sections EE 12(2) and EE 66(2). An item's economic useful life ("EUL") is a component of both the straight-line method and the diminishing value method. An item's EUL is the period over which the item might reasonably be expected to be useful in deriving assessable income or useful in a business for the purpose of deriving assessable income taking into account passage of time, likely wear and tear, exhaustion and obsolescence and assuming the item is subject to normal and reasonable maintenance: section EE 63.

### ***Setting rates***

19. Section EE 9(2) directs that the economic rate is dealt with in section EE 26, the annual rate is dealt with in sections EE 31, EE 33, and EE 34, and special and provisional rates are dealt with in sections EE 35 and EE 36.

20. Section EE 26 sets out the relevant provisions for determining economic rates and sets out the ordering of how the various provisions apply. As will be shown, determining whether an item is a building or not is critical to working out what rate-setting provision applies.
21. Section EE 26(1)(a) provides that rates are set under section EE 27 for items that are **not buildings**, fixed life intangible property, excluded depreciable property, or property for which an economic rate is set under section EE 29 or EE 30, and are acquired on or after 1 April 2005. (Section EE 29 is applicable only for certain aircraft and motor vehicles.) Therefore, section EE 26(1)(a) directs that if the item is a building then section EE 27 is not applicable.
22. Section EE 26(1)(b) provides that rates are set under section EE 28 for items that are **buildings acquired on or after 19 May 2005 and do not have a rate set under section EZ 23**. (As well as setting rates for buildings acquired before 19 May 2005, section EZ 23 also sets rates for buildings acquired on or after 19 May 2005 as relationship property or from a company in the same wholly-owned group of companies, from a person who applied to the item an economic rate set under section EZ 23 or a corresponding section.) Therefore, if the item is a building acquired on or after 19 May 2005 then section EE 26(1)(b) directs that section EE 28 is the rate setting provision for that item (unless it is relationship property described above).
23. Section EE 26(1)(c) provides that rates are set under section EE 29 for certain aircraft and motor vehicles.
24. Section EE 26(1)(d) provides that rates are set under section EE 30 for items that have an estimated residual market value greater than 13.5% of cost (ie, a "high residual value") and would otherwise have a rate set under section EE 27 or EE 28. Therefore, section EE 26(1)(d) directs that rates are generally set under section EE 30 for items with high residual value that are **not buildings acquired on or after 1 April 2005, and buildings with high residual value acquired on or after 19 May 2005**.
25. Section EE 26(1)(e) provides that rates are set under section EZ 23 for items that are **not buildings (or fixed life intangible property, or excluded depreciable property) acquired before 1 April 2005, and buildings acquired before 19 May 2005**.
26. Therefore, in deciding what is the relevant provision for determining a rate for a particular item, section EE 26 requires determination of whether the item is a building. If it was acquired on or after 19 May 2005 then the relevant provision is generally section EE 28 if it is a building that does not have an estimated residual market value greater than 13.5% of cost, or section EE 30 if it is a high residual value building. If the building was acquired before 19 May 2005 then the relevant provision is section EZ 23. Section EZ 23 does not apply to buildings that are excluded depreciable property (ie, buildings that were depreciable property before 1 April 1993 and are being depreciated using the pre-1993 rates).

27. The following table summarises what items the above provisions apply to:

<b>Provision</b>	<b>Items that the provision applies to:</b>
section EE 27	Applies to items that are acquired on or after 1 April 2005 and are <b>not</b> : <ul style="list-style-type: none"> <li>• buildings,</li> <li>• fixed life intangible property,</li> <li>• excluded depreciable property,*</li> <li>• items that have an estimated residual market value greater than 13.5% of cost, or</li> <li>• certain aircraft and motor vehicles.</li> </ul>
section EE 28	Applies to buildings acquired on or after 19 May 2005
section EE 29	Applies to certain aircraft and motor vehicles
section EZ 23	Applies to: <ul style="list-style-type: none"> <li>• plant and equipment acquired before 1 April 2005; and</li> <li>• buildings acquired before 19 May 2005 or buildings acquired on or after 19 May 2005 as relationship property or by a company in the same group</li> </ul> that are not excluded depreciable property.
section EE 30	Applies to: <ul style="list-style-type: none"> <li>• plant and equipment acquired on or after 1 April 2005 that have an estimated residual market value greater than 13.5% of cost; and</li> <li>• buildings acquired on or after 19 May 2005 that have an estimated residual market value greater than 13.5% of cost.</li> </ul>

\* Excluded depreciable property is defined in section EE 64 as depreciable property that was being used before 1 April 1993 and is depreciated using the pre-1993 rates.

28. In addition to the above provisions, section EE 31 provides a 20% loading to be applied to depreciation rates on New Zealand new items acquired in the person's 1995/96 or later income year, excluding buildings, used imported cars, and international aircraft. This is similar to the 25% loading that applied to certain assets during the interim depreciation regime mentioned above.

*Loss on disposal and loss on items no longer used*

29. A loss on items no longer used and a loss on disposal cannot be claimed in respect of buildings except in certain limited circumstances: sections EE 39 and EE 48(3).

30. However, section DB 20 allows a deduction for a loss incurred through the destruction of a temporary building. A "temporary building" is defined in section YA 1 as a building that:

- is erected under a permit issued by a local authority or a public authority, and must be demolished or removed if the local authority or the public authority requires its demolition or removal; or
- is erected at a construction site, and is to be demolished or removed on or before the completion of the construction; or
- was erected, and is used, to house specific plant or machinery, and will have to be demolished to remove or replace the plant or machinery.

*Summary of current depreciation regime – treatment of buildings*

31. Therefore under the current regime, it is necessary to determine whether the item of depreciable property is a building for the following reasons:
- a different depreciation rate, as provided for in section EE 26, may apply; and
  - the 20% loading that applies to depreciation rates provided for in section EE 31 does not apply; and
  - a deduction for a loss on items no longer used, or a deduction for a loss on disposal cannot be claimed except in limited circumstances under sections EE 39 and EE 48(3).

**Analysis**

32. Although the depreciation provisions require consideration as to whether an item of depreciable property is a building, there is no definition of the term “building” in the Income Tax Act 2007.
33. Section 5 of the Interpretation Act 1999 states:
- (1) The meaning of an enactment must be ascertained from its text and in the light of its purpose.
  - (2) The matters that may be considered in ascertaining the meaning of an enactment include the indications provided in the enactment.
  - (3) Examples of those indications are preambles, the analysis, a table of contents, headings to Parts and sections, marginal notes, diagrams, graphics, examples and explanatory material, and the organisation and format of the enactment.
34. In *Commerce Commissioner v Fonterra Co-operative Group Ltd* [2007] 3 NZLR 767, the Supreme Court most recently set out the approach to be applied in order to interpret legislation applying the requirements of section 5 of the Interpretation Act 1999.
35. The Supreme Court in *Fonterra* held (at para 22) that:
- It is necessary to bear in mind that s 5 of the Interpretation Act 1999 makes text and purpose the key drivers of statutory interpretation. The meaning of an enactment must be ascertained from its text and in the light of its purpose. Even if the meaning of the text may appear plain in isolation of purpose, that meaning should always be cross checked against purpose in order to observe the dual requirements of s 5. In determining purpose the court must obviously have regard to both the immediate and the general legislative context. Of relevance too may be the social, commercial or other objective of the enactment.

36. The Supreme Court's approach is consistent with the earlier Court of Appeal decision in *CIR v Alcan New Zealand Ltd* [1994] 3 NZLR 439. In this decision McKay J stated (at page 444), in the context of interpreting tax legislation, that the object of statutory interpretation is to "ascertain the true meaning". This "true meaning":

... must be consonant with the words used, having regard to their context in the Act as a whole, and to the purpose of the legislation to the extent that this is discernible.

The approach adopted by the court in *Fonterra* was to consider the text first before examining the relevant purpose.

37. As noted, the term "building" is not defined in the Income Tax Act 2007. In approaching the meaning of the text, the ordinary meaning of the term can be considered before going on to consider the meaning of the term as it is used in the context of the depreciation provisions.

### **Meaning of "building"**

38. The *Concise Oxford English Dictionary* (11<sup>th</sup> ed (revised), Oxford University Press, 2006) defines "building" as:

- 1 a structure with a roof and walls.
- 2 the process or trade of building houses and other structures.

39. The *Shorter Oxford Dictionary* (6<sup>th</sup> ed, Oxford University Press, 2007) 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.
- 2 The action of BUILD *verb*

40. These definitions indicate that a building is a permanent fixed structure providing shelter, such as a house, school, factory, or stable. This interpretation of "building" has been referred to in case law as the conventional meaning of "building": *R v Marks ex Australian Building Construction Employees' and Builders Labourers' Federation* (1981) 147 CLR 471. However, the dictionary definitions also support a wider interpretation of "building"; that is, a building could simply be a permanent fixed structure or thing that is built.

### *Conventional meaning of "building"*

41. Several factors have been regarded as being characteristic of a building within the conventional meaning of the term.
42. *Stevens v Gourley* (1859) 7 CBNS 99 indicates that a building within the conventional meaning is a structure of considerable size that is permanent (in the sense of durability). Byles J (at p 112) summarised that the term "building" "is usually understood [to be] a structure of considerable size, and intended to be permanent, or at least to endure for a considerable time". 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 are characteristic of a building; a building will be constructed using the building materials of the day: *Clarke*



*v Wilkie* (1977) 17 SASR 134. However, given the requirement of permanence, a building would usually be constructed of durable materials intended to last for a significant period.

43. A building is also permanent in the sense that it is generally designed to be located permanently on the site where it stands. However, *Stevens v Gourley* indicates that a structure need not be attached to the ground on which it stands in order 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 considered to be a building. A structure that can easily be moved from place to place will not be a building within the conventional meaning. In *Melfort Danceland v Star City (Rural Municipality)* [1977] 3 WWR 737 the court noted that courts had consistently held that a moveable home is not a building.
44. A building in the conventional sense is enclosed by walls and a roof that is designed to provide shelter: *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. 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".
45. A further characteristic of a building is that it can function independently of any other structure. In *Barat v Minister of National Revenue* [1991] 2, CTC 2,360 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: *Spencer v Soljan* (1984) 10 NZTPA 289.
46. In *Spencer v Soljan* McMullin J commented (at p 292) that:

[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.
47. Also, a structure need not legally be part of the land on which it stands in order to be a building: *R v Swansea City Council ex p Elitestone Ltd* (1993) 66 P & CR 422.

#### *Reasonable person test*

48. 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. In *Re St Peter the Great, Chichester* [1961] 1 WLR 907, Buckle J accepted (at p 912) that there were three tests to determine what constituted a building.
  - (1) Would the ordinary man think this was a building?
  - (2) Has the relevant structure four walls and a roof?
  - (3) Can one say that the structure is built?

49. Applying these tests, Buckle J concluded that an electricity substation was not a building under legislation that prohibited the erection of any buildings on any disused burial ground except for the purpose of enlarging a place of worship. The substation consisted of a low voltage feeder pillar that was a rectangular metal cupboard with doors just over 4 feet high housing cables and fuses, a transformer just over 6 feet high, and high voltage switchgear comprising eight switches in metal boxes. Buckle J found that the substation met none of the above three tests.

50. In *Harris v De Pinna* (1886) LR 33 Ch D 238 a “reasonable person” test was also applied. In *Harris* the issue was whether a structure used for storing and seasoning timber was a building. The structure consisted of upright baulks of timber fixed on stone bases built on brick piers, with cross-beams and diagonal iron braces, divided into floors or stagings with open unglazed ends between the uprights. Chitty J said (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.

51. In *Metals & Alloys Co v Ontario Regional Assessment Commissioner* (1985) 36 RPR 163 a similar approach to *Harris* was taken. The court commented (at para 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.

52. Therefore, in determining whether a structure is a building, it is appropriate to consider the appearance and function of the structure and to ask whether a reasonable person would regard the structure as a building. This approach is more appropriate than relying on the simple test stated in early cases where it was considered that a structure must have walls and a roof in order to be a building. For example, if the approach in the early cases were applied, the parking building in *Barat v Minister of National Revenue* might not be regarded as a building (because the top floor did not have a roof and the building had only half-walls). However, a parking building would be a building within the ordinary or conventional understanding of that term.

### ***Alternative meanings of “building”***

53. The ordinary or conventional meaning of the term “building” includes buildings with the above mentioned characteristics and would be considered buildings by a reasonable person. In some contexts the term “building” could have an alternative meaning. For example, possible alternative meanings could be:

- a wider meaning that includes structures that are ‘built’; or
- a narrower meaning that excludes certain types of specialised buildings.

### *Wider meaning of "building"*

54. Buildings and structures are things of substantial size and have a degree of permanence, but not all structures are necessarily buildings: *Cardiff Ruling Authority v Guest Keen Baldwins Iron & Steel Co Ltd* [1969] 1 All ER 27. However, structures (which would not be buildings under the conventional meaning) such as fences, grain silos, tunnels, driveways, tanks, and bleachers have been held to be buildings in some contexts. A New Zealand case where a wider meaning of "building" was adopted was *Chief Executive of the New Zealand Customs Service v Rakaia Engineering & Contracting Ltd* [2002] 3 NZLR 24. In this case the Court of Appeal considered that grain storage bins were buildings under the customs tariff.
55. Other cases in which the wider interpretation of "building" has been adopted include *Buckleigh v Brown* [1968] NZLR 647 (a fence), *Wood v Cooper* [1894] 1 Ch 376 (a trellis screen), *Schweder v Worthing* [1912] 1 Ch 83 (a tunnel), *Clarke v Wilkie* (1977) 17 SASR 134 (a concrete driveway), and *Imperial Oil Ltd v Sherwood (Rural Municipality)* [1922] 2 WWR 1,156 (tanks and bleachers). The structures that were held to be buildings in these cases have some but not all of the characteristics of buildings within the conventional meaning outlined above.

### *Narrower meaning of "building"*

56. In some situations the term "building" may be intended to exclude buildings that are specialised in the sense of the setting they provide or their function or integration with plant or equipment. That is, the ordinary or conventional meaning of "building" is modified to exclude such buildings. This may arise where interpretatively there is an alternative to defining the item as a "building", such as defining the item as "plant".
57. Case law indicates that a building will be considered plant where the building is more than the setting in which business activities take place and plays an essential role in the business process. The building must perform an essential function in the business process before it takes on the characteristics of plant: *Broken Hill Pty Co Ltd v FC of T* (1968) 41 ALJR 377; *Wangaratta Woollen Mills Ltd v FC of T* 69 ATC 4,095.
58. In addition to this, cases decided under the pre-1993 depreciation provisions such as *Colonial Motor Co Ltd v CIR* (1994) 16 NZTC; *Case G11* (1985) 7 NZTC 1,035; and *Lake Pine MDF Ltd v CIR* (1994) 16 NZTC 16 may also indicate that certain buildings should be treated as plant. However, as mentioned earlier, these cases were considered under a different depreciation regime where the Courts were deciding between whether an item was "premises" or "plant". Therefore, the question before the Court was not whether the item was a building or not.

### *Importance of context*

59. The appropriate interpretation of "building" depends on the context in which the word is used. In *Spencer v Soljan*, McMullin J, who delivered the decision of the Court of Appeal, commented (at pp 291–292), "[w]hat is a building for the purposes of one statute may not be a building for the purposes of another". Similar statements were made in *Foster v Fraser* [1893] 3 Ch 158, *Paddington Corporation v AG* [1906] AC 1, *Cobb & Co Ltd v Commissioner of Taxation* (1959) 101 CLR 333, and *Hilderbrandt v Stephen; Dew Engineering & Development Ltd v R* [1996] 3 CTC 2,904.

60. A wider meaning of “building” has often been adopted in cases involving legislation or restrictive covenants the object of which is to protect the rights of owners of adjacent properties, but this is subject to the wording of the legislation or particular contract in question. Arguably, it might be suggested that a narrower concept of “building” has been adopted in cases involving legislation that required determining whether an item was part of the premises or something else such as plant. Hence, in determining whether either a wider or narrower meaning of “building” should be adopted in a particular context, it is necessary to consider the purpose of the legislation or contract in question.

### ***Purpose of the depreciation provisions***

61. The depreciation provisions provide that buildings are treated differently from other items of depreciable property. To determine what meaning the term “building” is intended to have it is necessary to look at the legislative context. This involves considering the purpose of the depreciation provisions including their development and their connection with the provisions dealing with temporary buildings. In particular, it is appropriate to consider the purpose behind treating buildings differently from other items of depreciable property.
62. The rationale for allowing a deduction for depreciation is that capital assets used in the production of income decrease in value over time and, in line with accounting practice, for tax purposes the cost of such capital assets is set off against income over the life of the assets: *Clifford v IR Commrs* (1966) 10 AITR 229; *Para Handkerchief and Textiles (1964) Ltd v CIR* (1992) 14 NZTC 9,125; *Paterson v CIR* (2005) NZTC 19,096; ‘New legislation - Taxation (Depreciation, Payment Dates Alignment, FBT, and Miscellaneous Provisions) Act 2006’, *Tax Information Bulletin* Vol 18, No 5 (June 2006). The appropriate tax depreciation rate for a capital asset (which is relevant to the calculation of the amount of deduction in respect of depreciation in each year) depends on how long the useful life of the asset is. Therefore, economic depreciation rates are set based on the EUL of items of depreciable property. The Commissioner determines EULs for items of depreciable property through the depreciation rate determinations the Commissioner issues. In this way, buildings that are expected to have a shorter useful life than buildings generally may be provided with a depreciation rate based on a shorter estimated useful life.
63. While at no stage was the term “building” defined for the purposes of the depreciation provisions, there were indications that a building within the ordinary or conventional meaning was the preferred interpretation. These indications are:
- preserving the prohibition on not allowing losses on the sale or disposal of a building;
  - the list of buildings that the 25% interim loading did not apply to;
  - the policy rationale for the changes to the depreciation method for setting depreciation rates for buildings; and
  - the deduction available under section DB 20 for temporary buildings.

64. First, the officials' report on the Taxation (Base Maintenance and Miscellaneous Provisions) Bill 2004 (2 May 2005) discussed submissions on the bill arguing that losses on disposal of buildings should be deductible. The report acknowledged that there was a case to consider for allowing a general deduction for losses from the sale or disposal of buildings. However, the following two important points were stated in the officials' report, and the submissions were declined.
- Although buildings may usually be expected to depreciate over time, rates of depreciation are typically low. The market value of buildings is subject to fluctuations and, as a consequence, the value of buildings can be variable. If gains are not taxed when buildings appreciate, there is an argument for not allowing deductions for losses on sale, in order to prevent over-investment in buildings. Although similar issues can arise for other assets, this is likely to be a particularly important problem for buildings because of their low depreciation rates and the volatility of estimates of the value of buildings.
  - There is also a concern that the value of land improvements (including buildings) is normally calculated as the difference between the overall value of a property and the unimproved value of the land. There are tax integrity issues when values are apportioned (between the land and improvements) for tax reasons, rather than their actual value. This issue has the potential to create a significant tax avoidance problem and is exacerbated by the fact that buildings move in and out of the tax base.
65. Secondly, when the interim 25% loading was introduced in 1992 it did not apply to buildings. Most of the types of items that did not qualify for the 25% loading, as set out in the schedule of pre-1993 depreciation rates published in *Tax Information Bulletin* Vol 4, No 9 (April 1993), were buildings within the conventional meaning of that term or were items that formed part of a building within the conventional meaning. The later enacted 20% loading also did not apply to buildings and there was nothing brought into the legislation to clarify that another meaning applied.
66. Thirdly, the officials' issues paper *Repairs and maintenance to the tax depreciation rates* (Policy Advice Division, Inland Revenue Department, Wellington, 2004), which led to the depreciation changes enacted in 2006, states that:
- the starting point for review of the depreciation rates was that depreciation rates should reflect the actual fall in the market value of assets in order to ensure that, as far as possible, investment decisions are not influenced by tax considerations (at paras 1.12–1.14);
  - for depreciating assets, the depreciation loading increases the present value of depreciation deductions, which reduces the cost of investment and the cost of capital which in turn increases investment (at para 4.11);
  - minor levels of inflation can produce a bias favouring longer-lived relative to shorter-lived assets (at para 5.1);
  - the existing depreciation provisions provide a tax bias in favour of longer-lived assets (at para 4.25); that is, depreciation rates for shorter-lived assets are low in comparison to the rate applicable to longer-lived assets.
67. The policy rationale for distinguishing buildings from other items of depreciable property in these rate-setting provisions is that some evidence

suggests that the rate of economic depreciation for buildings differs to the rate for equipment. The United States distinguishes in its statistics on economic depreciation between equipment and structures (which includes buildings). There is some evidence that for a given useful life, the diminishing value depreciation rate for a building will be less than the rate for an item of equipment with the same estimate of useful life (chapter 4 of the above mentioned officials' issues paper).

68. Another reason for treating buildings differently is that with even moderate rates of inflation, calculating depreciation deductions using historical costs creates a bias between short-lived and long-lived assets. Allowing depreciation loading on shorter lived assets and not on longer lived assets such as buildings was the preferred solution to address this bias. While other classes of asset may also be long-lived and may receive the loading, buildings represent a significant proportion of such assets (chapter 3 of the above-mentioned officials' issues paper).

69. However, the above-mentioned officials' issues paper recognised (at para 5.23) that a "structure" may not be a building and that it may have an economic life more equivalent to plant and equipment. The item on the amendments in *Tax Information Bulletin* Vol 18, No 5 (June 2006) says:

"Building" is not a defined term in the Income Tax Act 2004. **Guidance on whether a structure is considered a building is given in Inland Revenue's depreciation guides.** The Commissioner is undertaking a project to more clearly define a building.

[Emphasis added.]

70. As mentioned, whether the term "building" is considered to mean a building within the conventional meaning of the term or to have some other meaning is dependent on the context in which the term is used. The extrinsic material that has surrounded the depreciation provisions in 1988-1993 and in 2006 shows that buildings within the depreciation provisions are considered to be ones that are generally long-lived and have a characteristic of permanence. Thus, the Commissioner's view is that the interpretation to be given to "building" in the depreciation provisions is one that aligns with the ordinary or conventional meaning of "building" as set out in case law outlined above.

71. Lastly, the existence of a statutory definition for temporary buildings and the deduction available on disposal under section DB 20 for temporary buildings tends to also support an ordinary or conventional meaning of "building" in the depreciation provisions. This follows from the fact that it is only this limited class of building (ones defined as being temporary in nature) that attract a deduction for a loss on disposal. The wider class – all ordinary or conventional buildings – are generally denied any loss under sections EE 39 and EE 48(3). It can be argued that section DB 20 (and its predecessors) would serve no purpose if a narrower interpretation of "building" was adopted. In particular, one category of temporary building are buildings that have been erected, and used, to house specific plant or machinery, and will have to be demolished to remove or replace the plant or machinery. This suggests that these types of building would otherwise fall within the wider class but are permitted special treatment under section DB 20. There would be no reason for section DB 20 if these items (and the other categories of temporary buildings) would in any case be entitled to a loss on disposal under the ordinary loss on disposal rules. This indicates that the three types of buildings covered by the temporary building definition are subject to the treatment that other buildings are

given under the depreciation provisions. However, if a temporary building is destroyed, there may be an opportunity to claim a loss on the destruction of the building under section DB 20, which otherwise would not be available.

#### *Relevance of section EE 30 and section EZ 23*

72. In the current depreciation regime there are two provisions that refer to plant: section EE 30 and section EZ 23. This raises the question as to whether these two sections are relevant to the interpretation of the meaning of "building" in the depreciation provisions. As seen above, section EE 30 relates to the setting of depreciation rates for items that have an estimated residual market value greater than 13.5% of cost that are either plant or equipment acquired on or after 1 April 2005 or buildings acquired on or after 19 May 2005. Section EZ 23 relates to the setting of depreciation rates for any items that are either plant or equipment acquired before 1 April 2005 or buildings acquired before 19 May 2005 (unless these items are "excluded depreciable property"). However, a building that may also be considered plant will have a rate set according to it **being a building** rather than plant. This is because section EE 26 sets out the appropriate rate setting provisions and directs how a rate will be set for a building, regardless of whether it might also be described as plant.
73. Section EE 26 sets out how section EE 30 fits with the other rate setting provisions. For determining the applicable rate setting provision, section EE 26(1)(d) provides that section EE 30 applies for items that have an estimated residual market value greater than 13.5% of cost where section EE 27 or section EE 28 would otherwise have applied. Section EE 27 applies to items (excluding buildings) acquired on or after 1 April 2005. Section EE 28 applies to buildings acquired on or after 19 May 2005. Therefore, section EE 30 does not apply to buildings that have an estimated residual market value greater than 13.5% of cost acquired before 19 May 2005. Instead, section EE 26(1)(e) provides that such buildings have a rate set under section EZ 23. In this way it is not necessary to determine whether an item is a building or plant. The only question is whether an item is a building, or not a building. Section EE 26 then directs which provisions will apply.

#### **Conclusion**

74. For the purposes of the depreciation provisions the Commissioner's view is that the term "building" has an ordinary or conventional meaning. Further, it is the Commissioner's view that the ordinary or conventional meaning of "building" is not modified for the purposes of the depreciation provisions either in terms of being broader to include many built structures, nor to exclude buildings that provide a specialised setting or have a specialised function or purpose or are integrated with plant. In the case of the latter group, for some such buildings (those that are "temporary buildings") section DB 20 provides concessionary treatment by allowing deductions for losses incurred on the destruction of the building. This concessionary treatment would also be available for some buildings that have shorter economic useful lives than buildings in general or are situated at construction sites.

## Examples

75. The following is an analysis of examples of items of depreciable property that are listed in the Commissioner's Table of Depreciation Rates. These items are considered in relation to the characteristics common to buildings identified in this Interpretation Statement.
76. The items listed in Table 1 are considered to be buildings for the purposes of the depreciation provisions and have been treated as buildings in the Commissioner's Table of Depreciation Rates.

**Table 1: Items considered to be buildings**

<i>Buildings and Structures asset category:</i>
Buildings (not specified)
Buildings with prefabricated stressed-skin insulation panels
Buildings with reinforced concrete framing
Buildings with steel or steel and timber framing
Buildings with timber framing
Fowl houses
Grandstands
Hot houses
Pig houses
Shade houses
Tanneries
<i>Agriculture, Horticulture and Aquaculture industry category:</i>
Dairy sheds and yard

77. The items listed in Table 2 are analysed in more detail below in terms of the characteristics common to buildings identified in this Interpretation Statement, in order to clarify whether they should be considered buildings for the purposes of the depreciation provisions.

**Table 2: Items reviewed to determine whether they are buildings**

<b>Asset class</b>	<b>Industry or asset category</b>	<b>Is the loading currently applied in IR265?*</b>	<b>Does the analysis conclude that the items in the asset class are typically buildings?</b>	<b>Should the loading be applied to the typical item?</b>
Carparks (buildings and pads)**	Buildings and Structures asset category	Yes	Yes ** (carpark buildings)	No**
Powder dryer buildings	Dairy Plant industry category	Yes	Yes	No
Chemical works	Buildings and Structures asset category	Yes	Yes	No
Fertiliser works	Buildings and Structures asset category	Yes	Yes	No
Barns	Buildings and Structures asset category	Yes	Yes	No
Barns (drying)	Cigarette Manufacturing industry category	Yes	Yes	No
Buildings (portable)***	Buildings and Structures asset category	No	Yes***	No***
Site huts***	Contractors, Builders and Quarrying	Yes	Yes***	No***

\* Inland Revenue's *General Depreciation Rates* (IR 265)



- \*\* The existing asset class for “carparks (buildings and pads)” will be split into two asset classes: one for carpark buildings and one for carpark pads that are separate from the carpark building as carpark pads are not considered buildings.
- \*\*\* The existing asset classes for “buildings (portable)” and “site huts” are to be reviewed to establish whether new asset classes should be created for those items that are not buildings.
78. Some of the asset classes in Table 2 are very broad and include several different items. In these cases, the typical items of depreciable property within the particular asset class are considered. Other asset classes are more specific, and the specific item that the asset class represents is considered. It is acknowledged that the items within a particular asset class vary. Therefore, whether an item of depreciable property is a building will depend on whether the building characteristics apply to the individual item being considered. However, the typical items within each asset class listed in Table 2 are generally considered buildings for the purposes of the depreciation provisions (except for separate carpark pads and certain portable buildings and site huts). It is noted that section 91AAG of the Tax Administration Act 1994 provides taxpayers with the opportunity to apply for a provisional rate if there is no applicable economic rate that applies for their item of depreciable property.
79. Asset classes for other structures such as silos and bunkers and items that are land improvements under schedule 13 such as bridges and tunnels are not considered to be buildings for the purposes of the depreciation provisions. However, there may be buildings associated with some of the land improvements listed in schedule 13. In these cases those buildings would be treated separately as a building for the purposes of the depreciation provisions.
80. Also, structures such as marquees that can be dismantled, relocated and rebuilt easily are not considered buildings because they do not have the characteristics of an ordinary or conventional building because of their lack of permanence. This concept of lack of permanence is discussed below under the discussion of the asset class “buildings (portable)”.

### ***Carparks (building and pads)***

#### *Description of item*

81. The *Concise Oxford English Dictionary* (11th ed (revised), Oxford University Press, 2006) contains the following definition of “car park”:
- n. Brit. an area or building where cars or other vehicles may be left temporarily
82. This definition indicates that the ordinary meaning of a carpark is an area reserved for parking a vehicle and that area may be situated within a building.
83. The “carparks (buildings and pads)” asset class in the Buildings and Structures asset category in the Commissioner’s Table of Depreciation Rates includes carparking structures for vehicle parking purposes, which may be multi-level structures. These carparking structures are often referred to as “carpark buildings” or “carparking buildings”. Each level contains allotted vehicle parking spaces and is accessed by a ramp.

84. Typically, carparking buildings are built on solid foundations and made from reinforced concrete. Each level consists of columns and beams that provide structural support. Carparking buildings are generally not fully enclosed, with lowered walls or barriers around each side of each level and often no roof over the top level.
85. A carparking pad that is a flattened area of hard surface (for example, a concrete, sealed, or paved surface with markings for vehicle parks) on which vehicles can park, and that is not part of a carparking building described above, is likely to be a hardstanding for tax depreciation purposes. Hardstandings are depreciable land improvements as they are listed in schedule 13.

#### *Application of "building" characteristics*

86. Despite carparking buildings not often being fully enclosed by walls and a roof, the application of the other characteristics of a building (identified in the statement) to carparking buildings suggests that carparking buildings are buildings within the ordinary or conventional meaning of the term.

#### *Appearance and function test*

87. Carparking buildings have the general appearance of conventional buildings despite not being fully enclosed. Also, the function of carparking buildings is to provide parking spaces for vehicles in a multi-level layout that provides shelter for the vehicles (for example from traffic and weather). Therefore, it is considered a reasonable person would regard a carparking building as a building.
88. It is considered that a carparking pad that is not part of a carparking building does not have the appearance of a conventional building.

#### *Case law*

89. In the Canadian case *Barat v Minister of National Revenue* [1991] 2 CTC 2,360, Hamlyn TCJ had to decide whether a parking garage was a building for the purposes of a provision disallowing a deduction from the taxpayer's income of the construction, renovation, or alteration costs relating to buildings. Although *Barat v Minister of National Revenue* refers to a parking garage, the item being considered is the same type of structure as the carparking structures described above. Hamlyn TCJ concluded that the 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.

#### *Conclusion*

90. The application of the characteristics of a building, and the appearance and function test support the conclusion that a carparking building is a building. A review of the case law also supports the conclusion that these structures are buildings. Therefore, it can be said within the "carparks (buildings and structures)" asset class, a carparking building is a building for the purposes of the depreciation provisions, which means the methods for setting economic depreciation rates for buildings apply to carparking buildings, and the 20% loading in section EE 31 does not apply to the economic rate for carparking buildings.

91. A carpark pad that is a flattened area of hard surface on which vehicles can park and is not part of a carparking building, is not a building, and instead is likely to be a hardstanding, which is listed in schedule 13 as a depreciable land improvement. Therefore, the 20% loading in section EE 31 applies to the economic rate for carpark pads as described above within the "carpark (buildings and pads)" asset class.
92. These conclusions mean that the existing asset class for "carparks (buildings and pads)" in the Commissioner's Table of Depreciation Rates should be split into two different asset classes: "carpark buildings" and "carpark pads". A new depreciation determination is required to bring these changes into effect.

### ***Powder dryer buildings***

#### *Description of item*

93. The "powder dryer buildings" asset class is listed in the Commissioner's Table of Depreciation Rates within the "Dairy Plant" industry category. A powder dryer building is a structure that houses a milk powder dryer along with other drying equipment that is used for producing powdered dairy products such as milk and whey powder.
94. Powder dryer buildings are structures of significant size to contain the large drying equipment required for producing milk powder. Powder dryer buildings are generally constructed with concrete wall panels and steel plate roofs and often have specialised air temperature control systems incorporated into the building structure.
95. The Dairy Plant industry category in the Commissioner's Table of Depreciation Rates contains asset classes for the other items of plant and equipment used in the process of producing milk powder. This includes dryers, evaporators, and packing machines.

#### *Application of "building" characteristics*

96. The application of the characteristics of a building (identified in the statement) to powder dryer buildings, suggests that powder dryer buildings are buildings within the ordinary or conventional meaning of the term.

#### *Appearance and function test*

97. Powder dryer buildings have the general appearance of conventional buildings. Also, the function of a powder dryer building is to house the dryer that is used for producing powder and provide an environment which enables the dryer to operate. Therefore, it is considered that a reasonable person would regard powder dryer buildings as buildings.

#### *Conclusion*

98. The application of the characteristics of a building and the appearance and function test support the conclusion that a powder dryer building is a building. Therefore, the methods for setting economic depreciation rates for buildings apply, and the 20% loading in section EE 31 does not apply to the economic rate.

## ***Chemical works***

### *Description of item*

99. In the *Concise Oxford English Dictionary* (11th ed (revised), Oxford University Press, 2006) the following definition is provided for “works” within the definition of “work”:

5 (works) [treated as sing.] chiefly Brit. a place where industrial or manufacturing processes are carried out.

100. This definition indicates that the ordinary meaning of chemical works is a place where chemicals are processed.
101. The “chemical works” asset class is listed in the Commissioner’s Table of Depreciation Rates in the Buildings and Structures asset category. However, the Chemical Plant industry category lists the asset classes that relate to the plant and equipment used to process chemicals. Therefore, it is considered that the “chemical works” asset class does not relate to the chemical-processing plant and equipment, and instead relates only to the structures that house the plant and equipment.
102. Items of property classed as “chemical works” are typically large and house some part of the chemical processing plant or equipment. These structures are constructed out of long-lasting materials, such as wood, concrete, or corrugated iron, and have walls and a roof.

### *Application of “building” characteristics*

103. The application of the characteristics of a building (identified in the statement) to chemical works suggests that chemical works are buildings within the conventional meaning of the term.

### *Appearance and function test*

104. Chemical works have the general appearance of conventional buildings. Also, the purpose of a chemical works is to house the plant and machinery involved in chemical processing. Therefore, it is considered a reasonable person would regard chemical works as buildings.

### *Conclusion*

105. The “chemical works” asset class does not apply to plant and equipment used for chemical processing. The “chemical works” asset class applies to structures that house chemical-processing plant and equipment. These structures are typically large, have walls and a roof, and have the general appearance of a building.
106. The application of the characteristics of a building and the appearance and function test support the conclusion that chemical works are buildings. Therefore, it can be said that chemical works are buildings for the purposes of the depreciation provisions, which means the methods for setting economic depreciation rates for buildings apply, and the 20% loading in section EE 31 does not apply to the economic rate for chemical works as described above within the “chemical works” asset class.

107. Due to the similarity in appearance, construction, and function, the same conclusion applies to the “fertiliser works” and “tanneries” asset classes, which are listed in the Commissioner’s Table of Depreciation Rates in the Buildings and Structures asset category. These asset classes relate to the structures that house processing plant and equipment. The asset classes for plant and equipment that may be housed in a fertiliser works are contained within the Chemical Plant industry category. The asset classes for plant and equipment that may be housed in a tannery structure are contained in the Tanning and Fellmongering industry category.

### **Barns**

#### *Description of item*

108. The “barns” asset class is listed in the Commissioner’s Table of Depreciation Rates in the Buildings and Structures asset category.

109. The *Concise Oxford English Dictionary* (11th ed (revised), Oxford University Press, 2006) contains the following definition of “barn”:

**n. 1** A large farm building used for storage or for housing livestock. **2** N. Amer. A large shed for storing road or railway vehicles.

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

#### *Application of “building” characteristics*

111. The application of the characteristics of a building (identified in the statement) to barns suggests that barns are buildings within the ordinary or conventional meaning of the term.

#### *Appearance and function test*

112. Barns have the general appearance of conventional buildings. Also, the function of a barn is typically to store and protect from the elements livestock, grain, and so on. Therefore, it is considered that a reasonable person would regard a barn as being a building.

#### *Conclusion*

113. The application of the characteristics of a building, and the appearance and function test support the conclusion that barns are buildings. Therefore, it can be said that barns are buildings for the purposes of the depreciation provisions, which means the methods for setting economic depreciation rates for buildings apply, and the 20% loading in section EE 31 does not apply to the economic rate.
114. Due to the similarity in appearance, construction, and function, the same conclusion applies to the “barns (drying)” asset class listed in the Cigarette Manufacturing industry category in the Commissioner’s Table of Depreciation Rates.

## ***Buildings (portable)***

### *Description of item*

115. The “buildings (portable)” asset class is listed in the Commissioner’s Table of Depreciation Rates in the Buildings and Structures asset category. The kind of property that the “buildings (portable)” asset class relates to are structures that provide shelter and that are designed and built to be moveable rather than located in one place. Therefore, such structures are not attached to the ground by permanent foundations and are generally smaller than buildings designed to be located in one location. The extent of mobility varies amongst portable buildings and depends largely on the size of the particular structure.

### *Application of “building” characteristics*

116. Many portable buildings would be of a size comparable to many small permanent buildings. Therefore, the conventional building characteristic of significant size is seen to be met in many cases for portable buildings. In *Stevens v Gourley* (1859) 7 CBNS 99 the shop, which was of “considerable dimensions” but not attached to the earth, was found to be a building.
117. The characteristics dealing with permanence may or may not be met depending on the portability of a particular portable building. Permanence in the sense that a building is designed to be located permanently on the site where it stands is related to its size. For example, the shop in *Stevens v Gourley* was not attached to the ground but was large enough to be considered a building. Therefore, if a portable building cannot be easily moved because of its size and weight (that is, movable only by machinery such as a crane) then the conventional building characteristic of permanence of location is met. Many portable buildings would fit into this category. This is in contrast to the types of things Byles J in *Stevens v Gourley* listed (at page 113) that would not be considered a building because of their portability. These were a bird cage, a wig box, a dog kennel, and a hen coop. Therefore, unlike the shop in *Stevens v Gourley*, which was fixed to the ground by its own weight, a structure that is easily moved from place to place will not be a building within the ordinary or conventional meaning of that term.
118. In *Melfort Danceland* a mobile home was found not to be a building. The mobile home in this case appears to be one that was on wheels. Therefore, a structure that is permanently attached to wheels and is of a size comparable to a caravan or mobile home would lack the characteristic of permanence of location because it is easily moved.
119. Permanence in the sense that a building is intended to last a considerable time was a factor considered alongside the permanence of location factor (i.e. the degree of portability) in *Stevens v Gourley*. Byles J in *Stevens v Gourley* considered that a building is of considerable size, and intended to be permanent or at least to endure for a considerable time. Byles J then lists items that are considered to be buildings, and those that are not because of their ease of portability (eg, a bird cage, a wig box, etc), which indicates that the more portable (or lightweight) an item the less durable it is.
120. The other two characteristics of conventional buildings, being having walls and a roof, and being able to function independently of any other

structure, are likely to be met for most portable buildings. Many portable buildings are separate and individual structures that have the appearance of a small building (i.e. have walls, a roof and a door) and so function to provide shelter.

121. The application of the characteristics of a building (identified in the statement) to portable buildings, suggests that those portable buildings that are sufficiently permanent and of a sufficient size and appearance are buildings within the ordinary or conventional meaning of the term.
122. In *Dew Engineering & Development Ltd v R* [1996] 3 CTC 2,904 “modules” connected to one another by bolts to form a laboratory designed to be portable were held not to be a building for the purposes of an exclusion to allowable tax deductions for research and development expenditure. The laboratory was made up of five modules (each of which was made of steel and contained a floor, roof and walls and were described as being almost identical to the components of walkways at Ottawa International Airport) and could be easily and quickly dismantled and relocated. Amongst the reasons for not treating the laboratory as a building was that it lacked permanence in that it was not fixed to the ground, it was easily disassembled and reconstructed, and it was not intended to remain in a particular location. Also, its energy needs were met by connection to the facilities of the structure to which it was appended. (Although these reasons appear to contradict the above points in relation to determining whether a portable building is a conventional building, the context of promoting research and development seem to have influenced the decision that the laboratory was not a building for the purposes of the particular provision. Therefore, it is considered that the case must be viewed with some caution in terms of its applicability in the depreciation context.)
123. To ascertain whether a portable building is sufficiently permanent and of a sufficient size and appearance to come within the meaning of “building” for the purposes of the depreciation provisions the following should be considered:
  - whether it is of a size comparable to many permanent buildings (i.e. requires heavy duty lifting such as a crane to move it);
  - the durability of the materials it is made from (i.e. not too lightweight);
  - whether it looks like a building (i.e. has walls and a door and possibly windows, but does not look like a container or some other item or structure);
  - whether it is fixed to the ground (i.e. not easily moved, at least fixed by its own weight, intended to remain in a particular location, and does not have wheels);
  - whether it is designed to be dismantled, relocated and rebuilt easily (i.e. individual components that are required to be integrated to make the whole structure and are easily moved may not form a building).

#### *Appearance and function test*

124. Some portable buildings may not actually fall within the ordinary or conventional meaning of “building” because no reasonable person would consider them to be buildings in the conventional sense. For example, some containers may be used to provide shelter for people or goods, but would not be described as buildings. Therefore, such items are not considered buildings for the purposes of the depreciation provisions.
125. However, containers that have been converted into portable buildings may fall within the conventional meaning of “building” depending on the extent of conversion and their size. For example, something that looks like it could have been derived from a large container but has windows and a door would more likely have the appearance of a conventional building.
126. Also, some portable structures that provide shelter would not be considered conventional buildings by a reasonable person because they are too small and easily moved. For example, most dog houses and many garden sheds would be too small to be considered conventional buildings.

### *Conclusion*

127. The “buildings (portable)” asset class relates to structures that are designed and built to be moveable rather than located in one place. Such items will not be fixed permanently in one location.
128. The application of the characteristics of a building, and the appearance and function test support the conclusion that those portable structures that come within the “buildings (portable)” asset class that are sufficiently permanent and of a sufficient size and appearance will be buildings for the purposes of the depreciation provisions. Therefore, the methods for setting depreciation rates for buildings apply to those items, and the 20% loading in section EE 31 does not apply to the depreciation rate.
129. Those portable structures that may come within the “buildings (portable)” asset class but are too small or otherwise do not have the appearance of a conventional building are not considered buildings for the purposes of the depreciation provisions. This conclusion means that the existing asset class for “buildings (portable)” in the Commissioner’s Table of Depreciation Rates needs to be reviewed to clarify the distinction between these various portable buildings. This may involve creating other asset classes for portable structures that are not considered to be conventional buildings. New depreciation determinations will be required to bring these changes into effect.

### **Site huts**

#### *Description of item*

130. The “site huts” asset class is listed in the Commissioner’s Table of Depreciation Rates in the Contractors, Builders and Quarrying industry category. The kinds of items that the “site huts” asset class relates to are structures that provide shelter for site workers. Therefore, such structures are designed and built to be moveable from site to site. As such, the “site huts” asset class contains structures that are similar, and in some cases the same as, those structures within the “buildings (portable)” asset class. Such structures are not attached to the ground by permanent foundations and are generally smaller than buildings designed to be located in one location. The extent of mobility varies amongst site huts but in most



cases site huts will be of a size that cannot be easily moved without machinery such as a crane.

*Application of "building" characteristics*

131. As with many portable buildings, many site huts would be of a size comparable to small permanent buildings. Therefore, the conventional building characteristic of significant size is seen to be met in those cases.
132. Most site huts cannot be easily moved because of their size and weight (that is, movable only by machinery such as a crane). The material used in the construction of a site hut, like other portable buildings, would normally be lightweight for ease of transport but normally sufficiently durable for use over multiple relocations. Therefore, the conventional building characteristics of permanence of location and permanence in the sense of intending to last a considerable time are met.
133. The other two characteristics of conventional buildings having – walls and a roof, and being able to function independently of any other structure – are also likely to be met for most site huts. Most site huts are separate and individual structures that have the appearance of a small building (i.e. walls and a roof with at least a door) and so function to provide shelter.
134. The application of the characteristics of a building (identified in the statement) to site huts, suggests that those site huts that are sufficiently permanent and of a sufficient size and appearance will be buildings within the ordinary or conventional meaning of the term.
135. To ascertain whether a site hut is sufficiently permanent and of a sufficient size and appearance to come within the meaning of "building" for the purposes of the depreciation provisions the same indications as identified above for portable buildings should be considered.

*Appearance and function test*

136. As with some portable buildings, there may be some site huts that do not fall within the conventional meaning of "building" because no reasonable person would consider them to be buildings in that sense. The same example used above for portable buildings, being containers that provide shelter, is also relevant here.
137. Most site huts would not be considered too small to be conventional buildings by a reasonable person.

*Conclusion*

138. The "site huts" asset class relates to structures that are designed and built to be relocated to various sites and so have not been fixed permanently in one location.
139. The application of the characteristics of a building, and the appearance and function test support the conclusion that most site huts are sufficiently permanent and of a sufficient size and appearance to be buildings for the purposes of the depreciation provisions. Therefore, the methods for setting depreciation rates for buildings apply to most site huts, and the 20% loading in section EE 31 does not apply to the depreciation rate. A site hut that is considered a building will come within the definition of

“temporary building” if it was erected at a construction site and will have to be demolished or removed on or before completion of the construction. In such a case section DB 20 allows a deduction for losses incurred through its destruction.

140. Those site huts that may come within the “site huts” asset class that are too small or otherwise do not have the appearance of a conventional building are not considered buildings for the purposes of the depreciation provisions. This conclusion means that the existing asset class for “site huts” in the Commissioner’s Table of Depreciation Rates needs to be reviewed to clarify that this asset class applies to “site huts” that are considered buildings and to determine whether other asset classes should be created for site huts that are not buildings. New depreciation determinations will be required to bring these changes into effect.

## Appendix – Legislation

### *Depreciation provisions*

141. Section EE 6 sets out the definition of depreciable property:

#### **EE 6 What is depreciable property?**

##### *Description*

- (1) **Depreciable property** is property that, in normal circumstances, might reasonably be expected to decline in value while it is used or available for use—
- (a) in deriving assessable income; or
  - (b) in carrying on a business for the purpose of deriving assessable income.

Subsections (2) to (4) expand on this subsection.

##### *Property: tangible*

- (2) An item of tangible property is depreciable property if—
- (a) it is described by subsection (1); and
  - (b) it is not described by section EE 7.

##### *Property: intangible*

- (3) An item of intangible property is depreciable property if—
- (a) it is within the definition of **depreciable intangible property**; and
  - (b) it is described by subsection (1); and
  - (c) it is not described by section EE 7.

##### *Property: geothermal wells*

- (4) For the purposes of this subpart, a person who owns a geothermal well is, for the geothermal energy proving period, treated as acquiring the well as property that declines in value and is to be available for use in carrying on a business for the purpose of deriving assessable income.

142. Section EE 7 sets out what is not depreciable property:

#### **EE 7 What is not depreciable property?**

The following property is not **depreciable property**:

- (a) land, although buildings, fixtures, and the improvements listed in schedule 13 (Depreciable land improvements) are depreciable property if they are described by section EE 6(1);
- (b) trading stock;
- (c) livestock to which subpart EB (Valuation of trading stock (including dealer's livestock)) applies;
- (d) financial arrangements;
- (e) excepted financial arrangements;

- (f) property that will not decline in value, as far as its owner is concerned, because, when they dispose of it, they have a right to be compensated for any decline in its value:
- (g) property that its owner chooses, under section EE 8, to treat as not depreciable:
- (h) property that its owner chooses, under section EE 38, to deal with under that section:
- (i) property for whose cost a person other than the property's owner is allowed a deduction:
- (j) property for whose cost a person is allowed a deduction under a provision of this Act outside this subpart or under a provision of an earlier Act, except for an asset to which section DU 6(4) (Depreciation) applies.

143. Section EE 26 sets out the relevant provisions for setting economic depreciation rates:

**EE 26 Setting of economic depreciation rate**

*Relevant provisions*

- (1) The economic depreciation rate that applies to a kind of item of depreciable property is set under—
  - (a) section EE 27, for items that—
    - (i) are not buildings, fixed life intangible property, excluded depreciable property, or property for which an economic rate set under section EE 29 or EE 30; and
    - (ii) are acquired on or after 1 April 2005:
  - (b) section EE 28, for items that are buildings and—
    - (i) are acquired on or after 19 May 2005; and
    - (ii) do not have an economic depreciation rate set under section EZ 23 (Economic rate for plant or equipment acquired before 1 April 2005 and buildings acquired before 19 May 2005):
  - (c) section EE 29, for certain aircraft and motor vehicles acquired on or after 1 April 2005:
  - (d) section EE 30, for items that—
    - (i) have an estimated residual market value greater than 13.5% of cost:
    - (ii) would, in the absence of section EE 30, have an economic depreciation rate set under section EE 27 or EE 28:
  - (e) section EZ 23 for items that—
    - (i) are not buildings, fixed life intangible property, or excluded depreciable property and are acquired before 1 April 2005:
    - (ii) are buildings acquired before 19 May 2005:
    - (iii) are buildings acquired on or after 19 May 2005, as relationship property or from a company in the same wholly-owned group of companies, from a person who applied to the item an economic depreciation rate set under section EZ 23 or a corresponding provision.

*No rate for fixed life intangible property or excluded depreciable property*

- (2) An economic depreciation rate must not be set for a kind of item of depreciable property that is fixed life intangible property or excluded depreciable property.

*Overriding effect of election under section EE 32*

- (3) Subsection (1)(a), (c), and (d) are overridden by section EE 32.

144. Section EE 28 sets out the method for setting an economic depreciation rate generally for buildings acquired on or after 19 May 2005.

### **EE 28 Economic rate for buildings**

*What this section is about*

- (1) This section is about setting the economic depreciation rate that applies to a kind of item of depreciable property that is a building and for which an economic rate is not set under section EE 30 or EZ 23 (Economic rate for plant or equipment acquired before 1 April 2005 and buildings acquired before 19 May 2005).

*Rate set by Commissioner*

- (2) The Commissioner sets the rate from time to time by –
- (a) following the procedure set out in this section; and
  - (b) issuing a determination under section 91AAF of the Tax Administration Act 1994.

*Procedure for setting economic rate*

- (3) To set the straight-line rate for a kind of item of depreciable property, the Commissioner –
- (a) gets a figure by applying the formula in subsection (4) to items of that kind; and
  - (b) rounds the figure up or down to the nearest rate specified in schedule 11, column 4 (New banded rates of depreciation); and
  - (c) sets the same rate for some or all of the kinds of buildings that are similar to one another, if the Commissioner thinks it is appropriate to do so having regard to –
    - (i) the rate calculated for each kind; and
    - (ii) the reduction in compliance costs that is likely to be achieved.

*Formula*

- (4) The formula is -

$$\frac{1}{\text{estimated useful life.}}$$

*Definition of item in formula*

- (5) In the formula, **estimated useful life** is the estimated useful life of the item expressed in years.

*Contracts existing at 19 May 2005*

- (6) Despite subsection (1), a person who before 19 May 2005 enters into a binding contract for the purchase or construction of a building must apply

to the building the economic rate for the kind of the building determined under section EZ 23.

145. Section EE 30 sets out the method for setting an economic depreciation rate for items that have an estimated residual market value of more than 13.5% of cost:

**EE 30 Economic rate for plant, equipment, or building, with high residual value**

*What this section is about*

- (1) This section is about setting the economic depreciation rate that applies to items of a kind of depreciable property if—
- (a) the kind of depreciable property is not fixed life intangible property, or excluded depreciable property, for which an economic rate cannot be set; and
  - (b) the estimated residual market value for the item is more than 13.5% of cost; and
  - (c) the items are—
    - (i) plant or equipment acquired on or after 1 April 2005;
    - (ii) buildings acquired on or after 19 May 2005.

*Rate set by Commissioner*

- (2) The Commissioner sets the rate from time to time by—
- (a) following the procedure set out in this section; and
  - (b) issuing a determination under section 91AAF of the Tax Administration Act 1994.

*Procedure for setting economic rate*

- (3) To set the diminishing value rate for a kind of item of depreciable property, the Commissioner—
- (a) obtains a figure by applying the formula in subsection (4) to items of that kind; and
  - (b) rounds the figure up or down to the nearest rate specified in schedule 12, column 1 (Old banded rates of depreciation); and
  - (c) sets the same rate for some or all of the kinds of items of depreciable property that are similar to one another, if the Commissioner thinks it is appropriate to do so having regard to—
    - (i) the rate calculated for each kind; and
    - (ii) the reduction in compliance costs that is likely to be achieved.

*Formula*

- (4) The formula is—

$$1 - \left( \left( \frac{\text{residual value}}{\text{cost}} \right)^{\frac{1}{\text{estimated useful life}}} \right)$$

*Definition of items in formula*

- (5) In the formula,—
- (a) residual value is the greater of—
- (i) estimated residual market value, which is defined in section EE 67:
- (ii) 13.5% of cost:
- (b) cost is the cost of items of the kind to which the formula is applied:
- (c) estimated useful life is defined in section EE 63.

146. Section EE 31 sets out when the 20% loading applies:

**EE 31 Annual rate for item acquired in person's 1995-96 or later income year**

*What this section is about*

- (1) This section is about the annual rate that applies to an item of depreciable property that a person acquires, other than under section FL 2(2) (Treatment of emigrating companies and their shareholders), in their 1995–96 income year or a later income year (not including fixed life intangible property or excluded depreciable property, for which rates are set in sections EE 33 and EZ 15 (Annual rate for excluded depreciable property: 1992–93 tax year)).

*Rate*

- (2) The rate is 1 of the following:
- (a) the item's economic rate, special rate, or provisional rate, for an item not described in either paragraph (b) or (c):
- (b) the item's economic rate, special rate, or provisional rate, multiplied by 1.2, for an item that –
- (i) has not been used or held for use in New Zealand as an item of depreciable property before the date on which the person acquires it; and
- (ii) is not a building; and
- (iii) is not a used imported car; and
- (iv) is not an international aircraft:
- (c) a diminishing value rate of 15% or a straight-line rate of 10%, for an international aircraft.

147. Section EE 39 sets out depreciation loss that can be claimed on items no longer used:

**EE 39 Items no longer used**

*When this section applies*

- (1) This section applies when a person in an income year has an item of depreciable property that—
- (a) is no longer used or, because the geothermal energy proving period has ended, becomes unavailable for use under section EE 6(4); and

- (b) is not a building, unless the item meets the requirements of subsection (2); and
- (c) has not been depreciated using the pool method.

*Buildings*

- (2) This section applies to a building that meets the requirements of subsection (1)(a) and (c) if—
  - (a) the building has been irreparably damaged and rendered useless for the purpose of deriving income; and
  - (b) the damage occurs—
    - (i) in the 2005–06 income year or a later income year:
    - (ii) as a result of the extreme climatic conditions that occurred during the month of February 2004 in New Zealand:
    - (iii) as a result of the storm event that occurred during the month of July 2004 in the Bay of Plenty area; and
  - (c) the damage is caused other than as a result of the action or failure to act of the person, an agent of the person, or an associated person.

*Amount of depreciation loss under this section*

- (3) The person has an amount of depreciation loss under this section and under no other provision of this subpart.

*Circumstances*

- (4) The person has an amount of depreciation loss if—
  - (a) they no longer use the item in deriving assessable income or carrying on a business for the purpose of deriving assessable income; and
  - (b) neither they nor a person associated with them intends to use the item in deriving assessable income or carrying on a business for the purpose of deriving assessable income; and
  - (c) the costs of disposing of the item would be more than any consideration they could derive from disposing of it.

*Amount*

- (5) The amount of depreciation loss is the item's adjusted tax value at the start of the income year.

*Adjusted tax value at end of year*

- (6) The item's adjusted tax value at the end of the income year is zero.

148. Section EE 48 sets out the depreciation treatment of items disposed of:

**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 for the income year in which the disposal or the event occurs:



- (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 total of the amounts of depreciation loss for which the person has been allowed deductions for the item including, for an item to which section CZ 11 (Recovery of deductions for software acquired before 1 April 1993) applies, any deduction allowed for its acquisition.

*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, for the income year in which the disposal or the event occurs, that is the amount by which the consideration is less than the item's adjusted tax value on that date.

*When this section does not apply*

- (3) Subsection (2) does not apply if the item is a building unless—
  - (a) the building has been irreparably damaged and rendered useless for the purpose of deriving income; and
  - (b) the damage occurs—
    - (i) in the 2005–06 income year or a later income year:
    - (ii) as a result of the extreme climatic conditions that occurred during the month of February 2004 in New Zealand:
    - (iii) as a result of the storm event that occurred during the month of July 2004 in the Bay of Plenty area; and
  - (c) the damage is caused other than as a result of the action or failure to act of the person, an agent of the person, or an associated person.

149. Section EZ 23 sets out the method for setting an economic depreciation rate for items that are plant or equipment acquired before 1 April 2005 and buildings acquired before 19 May 2005:

**EZ 23 Economic rate for plant or equipment acquired before 1 April 2005 and buildings acquired before 19 May 2005**

*What this section is about*

- (1) This section is about setting the economic depreciation rate that applies to items of a kind of depreciable property if –
  - (a) the kind of depreciable property is not fixed life intangible property, or excluded depreciable property, for which an economic rate cannot be set; and
  - (b) the items are –
    - (i) plant or equipment acquired before 1 April 2005:
    - (ii) buildings acquired before 19 May 2005:
    - (iii) buildings acquired on or after 19 May 2005, as relationship property or from a company in the same wholly-owned group of companies, from a person who applied to the item an economic depreciation rate set under this section or a corresponding provision.

*Rate set by Commissioner*

- (2) The Commissioner sets the rate from time to time by –
- (a) following the procedure set out in this section; and
  - (b) issuing a determination under section 91AAF of the Tax Administration Act 1994.

*Procedure for setting economic rate*

- (3) To set the diminishing value rate for a kind of item of depreciable property, the Commissioner –
- (a) gets a figure by applying the formula in subsection (4) to items of that kind; and
  - (b) rounds the figure up or down to the nearest rate specified in schedule 12, column 1 (Old banded rates of depreciation); and
  - (c) sets the same rate for some or all of the kinds of items of depreciable property that are similar to one another, if the Commissioner thinks it is appropriate to do so having regard to –
    - (i) the rate calculated for each kind; and
    - (ii) the reduction in compliance costs that is likely to be achieved.

*Formula*

- (4) The formula is -

$$1 - \left[ \left( \frac{\text{residual value}}{\text{cost}} \right)^{\frac{1}{\text{estimated useful life}}} \right]$$

*Definition of items in formula*

- (5) In the formula, -
- (a) residual value is the greater of –
    - (i) estimated residual market value, which is defined in section EE 67 (Other definitions):
    - (ii) 13.5% of cost:
  - (b) cost is the cost of items of the kind to which the formula is applied:
  - (c) estimated useful life is defined in section EE 63 (Meaning of estimated useful life).

150. Section EE 63 sets out the definition of “estimated useful life”:

**EE 63 Meaning of estimated useful life**

*Meaning for item of depreciable property, except for copyright in sound recording*

- (1) **Estimated useful life**, for an item of depreciable property, other than a copyright in a sound recording, means the period over which the item might reasonably be expected to be useful in deriving assessable income or carrying on a business for the purpose of deriving assessable income, taking into account—

- (a) the passage of time, likely wear and tear, exhaustion, and obsolescence; and
- (b) an assumption of normal and reasonable maintenance.

*Meaning for copyright in sound recording*

- (2) **Estimated useful life**, for a copyright in a sound recording, means the period from the time at which the copyright might reasonably be expected to be first useful in deriving assessable income until the end of the income year in which it might reasonably be expected that 90% of all the income that will be derived from it has been derived.

### ***Temporary buildings provisions***

151. Section DB 20 allows a deduction for loss incurred through the destruction of a temporary building:

#### **DB 20 Destruction of temporary building**

*Deduction*

- (1) A person is allowed a deduction for a loss that they incur through the destruction of a temporary building.

*Link with subpart DA*

- (2) This section supplements the general permission and overrides the capital limitation. The other general limitations still apply.

152. Section YA 1 sets out the definition of “temporary building”:

**temporary building** means –

- (a) a building that –
  - (i) is erected under a permit issued by a local authority or a public authority; and
  - (ii) must be demolished or removed if the local authority or the public authority requires its demolition or removal; or
- (b) a building that –
  - (i) is erected at a construction site; and
  - (ii) is to be demolished or removed on or before the completion of the construction; or
- (c) a building that –
  - (i) was erected, and is used, to house specific plant or machinery; and
  - (ii) will have to be demolished to remove or replace the plant or machinery