

## Square metre rate for the dual use of premises

### Introduction

Operational statements set out the Commissioner's view of the law for the matters discussed and deal with operational issues arising out of the administration of the Revenue Acts.

The Taxation (Business Tax, Exchange of Information, and Remedial Matters) Act 2017 introduced a new section DB 18AA into the Income Tax Act 2007<sup>1</sup>. This Statement explains how the Commissioner of Inland Revenue (the Commissioner) will interpret and apply this new section and provides a number of examples of the legislation's practical application.

Unless otherwise stated, all legislative references in this Statement are to the Income Tax Act 2007.

### Application

This Statement applies from 4 July 2019, the date that the Statement was signed.

The Statement appears in *Tax Information Bulletin* Vol. 31, No 7 (August 2019) and on Inland Revenue's website, [www.ird.govt.nz](http://www.ird.govt.nz)<sup>2</sup>.

### Background

1. Business owners, especially small business owners, often use their private residence for both business and private purposes. This business use may give rise to deductions that can be claimed by the business owner. However, because there are numerous individual expense items that need to be recorded and apportioned between business and personal use, calculating the quantum of any deductible expenditure can create a large compliance obligation compared with the amount of tax at stake. As stated in the commentary to the *Taxation (Business Tax, Exchange of Information, and Remedial Matters) Bill*, the purpose of s DB 18AA is to *allow taxpayers to use a simplified method for the calculation of deductions for premises ... that are used for both business and personal purposes. This will reduce compliance costs for taxpayers.*
2. The square metre rate option provides a simplified process that removes the requirement for a taxpayer to:
  - Keep detailed records of the utility costs (electricity, gas, home and contents insurance, telephone, mobile and internet charges) incurred on their private residence, and

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<sup>1</sup> This section was subsequently amended by the Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Act 2019 (2019/5). Royal Assent: 18 March 2019.

<sup>2</sup> Search term: OS 19/03 (*Technical results*)

- Apportion these utilities costs between the business and private use of their residence.

Premises costs (mortgage interest, rates and rent) are still required to be claimed based on the business proportion of the actual expenditure incurred by the taxpayer.

A taxpayer using this simplified process is not able to claim deductions in respect of any other expenditure (or depreciation loss) that they may have incurred in respect of their private residence.

3. In order to avail themselves of the square metre rate option a taxpayer firstly calculates the percentage of their private residence that is used primarily for business purposes. Using this calculation, they then calculate the available deduction for both the utilities and premise costs that they have incurred.
4. There are no restrictions on the use of this simplified method for calculating the deduction available for the business use of a taxpayer's private premises, nor is its use mandatory. If a taxpayer chooses not to claim a deduction using the simplified calculation method allowed by s DB 18AA (because, for instance, they wish to claim for expenditure that is not included in the square metre rate calculation), they may still be able to claim a deduction based on:
  - the business proportion of the actual amounts of expenditure outlaid on their private residence. Note that if a taxpayer chooses to make a claim based on their actual expenses, the Commissioner would expect them to use the methodology set out in this statement to calculate the area of their private residence that is used primarily for business purposes, or
  - the expenditure apportionment methods set out in Interpretation Statement *IS 17/02 Income Tax – Deductibility of farmhouse expenses*<sup>3</sup>, if the private residence is a farmhouse.

## Discussion

5. Section DB 18AA<sup>4</sup> provides a calculation methodology for determining the amount able to be deducted by a taxpayer to take into account the business use of their private residence. There are three steps required to calculate the amount of the deduction.
6. The first step is to calculate the area of the buildings on the premises used primarily for business purposes. In this step the taxpayer determines the area of their buildings (in square metres) that are both ***separately identifiable parts of the buildings on the premises*** and ***that are used primarily for business purposes***. This dual calculation results in the identification of the ***business square metres***. The business square metres are then multiplied by the ***square metre rate*** to give the first part of the deduction amount. This first step is further discussed at [13] – [26].
7. Per [6], the business square metres are multiplied by the square metre rate to give the first part of the deduction amount. The square metre rate is:

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<sup>3</sup> A copy of this Interpretation Statement is available on the Inland Revenue website. Search term: farmhouse (*Technical results*)

<sup>4</sup> See Appendix for a copy of this legislation

- set by the Commissioner, based on the national average annual cost of utilities per square metre of housing, but excluding mortgage interest and rates or rent, and
- updated each year.

The square metre rate is further discussed at [21] – [25].

8. The second step is to calculate the business proportion of total premises costs. The starting point for this second step is the business square metres that were calculated at [6]. The business square metres are divided by the total area of all the ***buildings on the premises***. The result of this calculation is known as the ***business proportion*** and is expressed as a percentage. This percentage is then applied to the ***total premise costs*** of all ***the buildings and their curtilage on the premises*** to provide the second part of the deduction amount for the square metre rate method. This second step is further discussed at [27] – [36].
9. The *total premises costs* are the total amount of actual mortgage interest, rates and rent that the taxpayer has paid for their residential premises in the income year. The reason this part of the deduction is calculated separately from the Commissioner's square metre rate is because annual mortgage interest, rates and rental costs are too variable for a meaningful national average to be produced.
10. The third step in the calculation involves the amounts calculated at steps 1 and 2 above being added together to give the total amount of the deduction.
11. Note that where a taxpayer chooses to use the square metre rate method, no other deduction in relation to their residential premises can be claimed.
12. To fully understand the calculation methodology that has been outlined in the above 3 step approach, it is necessary that the calculation and some of the words and phrases used in the legislation are explained further.

### The first step

13. The desired outcome of the first step of the calculation is to identify the business square metres and apply this to the annual square metre rate that is published by the Commissioner. To complete this first step a taxpayer must determine the area of their buildings (in square metres) that are both *separately identifiable parts of the buildings on the premises* and *that are used primarily for business purposes*; the business square metres. Multiplying the business square metres by the Commissioner's square metre rate provides the first element of the square metre rate deduction available to a taxpayer.

#### ***Separately identifiable parts of the buildings on the premises ...***

14. For an area to be separately identifiable it does not need to be physically separate from any other area. It does not, for example, have to be enclosed by walls. It is not a room by room test, but merely looks to identify those parts of the buildings that are separately identifiable as being used for a business purpose.
15. The use of the phrase *separately identifiable* means that it needs to be obvious that a particular area is "identifiable" as being used for a business purpose that is separate from any other purpose. Whether an area meets this test is considered objectively. It is a positive test, in that the area cannot, objectively, be identifiable as being used for another purpose (a private purpose, for instance), or for a

“neutral” purpose; that is, for no particular identifiable purpose. This is discussed further at Steps 2 and 3, at [17] below.

16. In practical terms, it will be easier to see that an area of a building is separately identifiable as an area being used for a business purpose if it has a business asset of some kind within it (computer, business records, inventory for instance) that marks out that area in some way.
17. The Commissioner suggests that a taxpayer take the following step by step approach to this identification process:
  - Step 1: Identify an area (or areas) which may have a business purpose (a potential business area).
  - Step 2: Ignore any part of that potential business area that cannot be used for a business purpose. Generally, this will be because that area is set aside for a non-business purpose. In the context of a family home, this will usually be for a private purpose.
  - Step 3: Would it be obvious to a reasonable person that all the area that remains is separately identifiable as being used for a business purpose? If not, is there a smaller area that is “separately identifiable” as being used for this purpose? For instance, does part of the remaining area have a “neutral” purpose? For example, it may simply be an empty space or a traffic area that is passed through, rather than being “used” for any particular purpose, either business or non-business.

The following example illustrates this three-step approach to identifying those areas that are “separately identifiable” parts of the buildings on the premises used for business purposes:

### Identifying an area that is “separately identifiable”

Many modern homes have an open plan living area that includes the kitchen, dining and communal living areas. Where part of this area is used for business purposes, it is necessary to calculate how much of this space is being used for business purposes.

Per [17], the first step is to *identify an area (or areas) which may have a business purpose (the potential business area)*. In this example, this will be the entire open plan living space.

The second step is to *ignore any part of that potential business area that cannot be used for a business purpose*. That is, those parts of the open plan living space that are clearly used for a private purpose; the area taken up with household furniture and appliances and the area required for the furniture and appliances to be used.

Removing from further consideration the area identified at step 2, the third step asks, would it be obvious to a reasonable person that all the area that remains is separately identifiable as being used for a business purpose? In answering this question we need to exclude so much of the remaining area that is used for neither a business nor private purpose. Generally, this will be areas that are

used as “traffic” areas; parts of the open plan living space that are used to get from one area to another. It will also include any areas that are not used at all, areas that are simply empty spaces.

The area that remains is the area that is separately identifiable as being for a business purpose. This will generally equate to the space used to physically store any business furniture/equipment and the area that is required to use that furniture/equipment. We now test whether that area is used primarily for business purposes.

### *... that are used primarily for business purposes*

18. To identify the business square metres, a taxpayer must first determine the area of the buildings on the premises (in square metres) that are both separately identifiable parts of these buildings (per [14] – [17]) and *that are used primarily for business purposes*.
19. In the context of this legislation the word *primarily* takes its ordinary meaning, *for the most part, mainly*<sup>5</sup>. The Commissioner accepts that a part of the premises can be said to be used primarily for a business purpose when it is used for a business purpose (rather than any other purpose) more than 50% of the time.
20. The area that is identified by following the 3-step process (at [17]) and that is also used primarily for business purposes, is the *business square metres* for the purposes of the s DB 18AA calculation.

### *Square metre rate*

21. The business square metres is multiplied by the square metre rate that is published by the Commissioner<sup>6</sup>. This square metre rate will be set and published by the Commissioner on an annual basis.
22. The square metre rate is set by using information obtained from Statistics New Zealand. The Commissioner uses this information to calculate the national average, annual cost of utilities for the average sized New Zealand household. For the purposes of the square metre rate calculation, “utilities” are limited to gas/electricity, telephone/mobile/internet services, and house/contents insurance costs. To arrive at the final square metre rate, this average cost of utilities is divided by the average square metre size of a New Zealand house<sup>7</sup>.
23. Annual mortgage interest, rates or rental costs are excluded from the national, averaging methodology of the square metre rate calculation. This is because, unlike utilities costs these costs are too variable to be included with any accuracy and are best left for a taxpayer to include separately in the second step of the deduction calculation. See [27] – [36] for further discussion.
24. Those taxpayers who use the square metre rate are not able to claim deductions in respect of any other expenditure (or depreciation loss) that they may have incurred on their private residence.

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<sup>5</sup> Concise Oxford English dictionary, eleventh edition, revised.

<sup>6</sup> S DB 18AA(5)

<sup>7</sup> From information available from Quotable Value Limited

25. For the purposes of section DB 18AA(5), the Commissioner has advised that the square metre rate for the 2017 – 2018 income year is \$41.10 per square metre and \$41.70 per square metre for the 2018 – 2019 income year. A copy of these determinations and the notes to them can be found on the IR website<sup>8</sup>.
26. The first step of the s DB 18AA calculation is completed by multiplying the business square metres (per [20]) by the square metre rate that has been set and published by the Commissioner for the income year in question.

### The second step

27. The desired outcome of the second step is the identification of *the business proportion* and applying this to the *total premise costs of the buildings and their curtilage on the premises*. The result of this calculation provides the second element of the square metre rate deduction available to a taxpayer.

#### *The business proportion*

28. The business proportion is calculated by dividing the total area of all the buildings on the taxpayer's premises by the business square metres that was calculated previously (at [20]) and expressing the result as a percentage.

#### Example of calculating the business proportion

Total area of all the buildings on the taxpayer's premises = 150 square metres.  
Business square metres = 10 square metres.

$$\frac{10}{150} \times \frac{100}{1}$$

$$= 6.7\%$$

In this example the business proportion is 6.7%

When undertaking this calculation, the following definitions are relevant:

#### *Buildings*

29. What constitutes a building is discussed in Interpretation Statement *IS 10/02 – Meaning of "building" in the depreciation provisions* (IS 10/02). In summary, IS 10/02 states that a building:
  - is a structure of considerable size;
  - is permanent in the sense that it is intended to last a considerable time;
  - 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;
  - is enclosed by walls and a roof;
  - can function independently of any other structure. However, a building is not necessarily a physically separate structure.

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<sup>8</sup> Search term: square metre rate (*Technical results*)

30. To arrive at the *business proportion* requires the calculation of the total area of all the buildings on the taxpayer's property. This will often include buildings other than the taxpayer's residence. For instance, it is the Commissioner's view that a standalone garage is a building, but that many small residential garden sheds are too small to be considered buildings; they are structures<sup>9</sup>. It is relatively common that a taxpayer's premises will include a dwelling and a standalone garage. Where this is the case, the area of both the dwelling and the garage needs to be included in the calculation, whether or not there is any business use of the garage.
31. There is more information on this topic in IS 10/02. This can be found on the IR website<sup>10</sup>.

### **Premises**

32. For the purposes of DB 18AA, "*premises*" is a reference to the taxpayer's entire property. In an urban, residential setting this will generally equate to the buildings and their curtilage, though this may not be the case in a rural setting. The question of what constitutes curtilage is further discussed at [34] and [35].

### **Total premise costs**

33. Total premise costs are arrived at by adding together any amount of mortgage interest, rates or rent that the taxpayer has paid in respect of "the buildings and their curtilage on the premises" in the income year. These costs are then multiplied *by the business proportion* (see [28]) to arrive at *the premise costs*. As previously explained, the reason that these expenses are not considered at step 1 is because these costs are too variable for a national average to be struck with any accuracy.

### **Curtilage**

34. In the phrase *the "buildings and their curtilage on the premises"* the word "curtilage" takes on its usual meaning; *an area of land attached to a house and forming one enclosure with it; a small court, yard, or piece of ground attached to a dwelling house and forming one enclosure with it* (Concise Oxford English dictionary, 11<sup>th</sup> edition)<sup>11</sup>.
35. For an urban, residential property, the Commissioner accepts that *the buildings and their curtilage* will likely equate to the area of the entire property; *the premises*. In a rural setting, what constitutes the curtilage will be a matter of fact (viewed objectively) in each case but bearing in mind the above definition.
36. The second step of the s DB 18AA calculation is completed by multiplying the total premise costs (at [33]) by the business proportion percentage (at [28]).

### **The third step**

37. The third and final step in calculating the quantum of the deduction available under s DB 18AA is to add the amount calculated under the first step (at [26]) with the amount calculated under the second step of the calculation (at [36]). For those

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<sup>9</sup> IS 10/02, at [126]

<sup>10</sup> Search term: meaning of building (*Technical results*)

<sup>11</sup> See also *Black's Law Dictionary*, 2<sup>nd</sup> edition: *The curtilage of a dwelling is a space, necessary and convenient and habitually used for the family purposes, and the carrying on of domestic employments. It includes the garden, if there be one, and it need not be separated from other lands by fence* (State v. Shaw, 31 Me. 523; Com. v. Rarney, 10 Cush. (Mass.) 480; Derrickson v. Edwards, 29 N. J. Law, 474. SO Am. Dec. 220;

taxpayers that wish to use s DB 18AA, this is the amount that they can claim as a deduction.

### *Part year claims and changes in circumstances*

38. By taking account of annualised costs, the amount calculated in the third step presupposes that the business area is used primarily for business purposes for the entire year, and the area used primarily for business purposes does not change at some time during the year. Where this is not the case and the business area and/or the primary use of that area changes, the amount of the deduction will need to be adjusted to take these changed facts into account.
39. The Commissioner accepts that any adjustment required can be completed based on the number of complete weeks that the separately identifiable area is used primarily for business purposes; the apportionment does not need to be completed on a daily basis.

#### **Calculating the adjustment for a part year**

For instance, if the business area is used for only 32 weeks in a year, the adjustment required would be:

Available deduction (after completing the 3-step calculation at [26], [36] and [37])/52 x 32

40. A similar adjustment calculation will be required when the size of the business area alters during the year. For instance, the separately identifiable area that is used primarily for business purposes may change from 6 square metres at the beginning of the year to 9 square metres during week 16. In this case 2 part-year calculations will be required; the first for the initial 15-week period and the second for the remaining 37 weeks. Both calculations start by applying the three-step process to arrive at the initial annual deduction amounts. Each calculation is then adjusted by using the part year calculation shown at [39].

#### **Calculating the adjustment when the size of the business area alters**

In respect of the example used in this paragraph, the full calculations would be as follows:

Available annual deduction for first 15-week period (after completing the 3-step calculation at [26], [36] and [37])/52 x 15 = A

Available annual deduction for second 37-week period (after completing the 3-step calculation at [26], [36] and [37])/52 x 37 = B

This Operational Statement is signed by me on 4 July 2019

Rob Wells  
Manager, Technical Standards, OCTC

## Example 1: Use of garage for storage

### Background

Because of a lack of suitable, secure storage facilities at her business premises, the taxpayer stores excess inventory along one wall of a separate double garage at her residential address. Also stored in this garage are personal items; the family motor vehicle, children's bikes, gardening equipment and miscellaneous boxes of personal items. No other part of the taxpayer's residence is used for business purposes.

The taxpayer has calculated the quantum of all interest and rates payments on the property to be \$22,000.00 for the year ended 31 March 2019.

The total area of all the buildings on the premises is the 35 square metre separate double garage and a 180 square metre dwelling – a total of 215 square metres.

### Calculating the business square metres

*Separately identifiable parts of the buildings on the premises...*

Although the potential area of business use is the entire 35 square metre garage, a 20 square metre area is used to store the family's personal effects and can therefore never be used for business purposes. Of the remaining 15 square metres, the taxpayer believes that a reasonable person would see the area that is *separately identifiable* as being used primarily for business purposes, as that area that physically stores the inventory (7 square metres) together with the area immediately surrounding the inventory that allows access to it. She calculates this to be a total area of 9 square metres<sup>12</sup>. The remaining 6 square metres is either empty space or traffic areas.

*...that are used primarily for business purposes*

Given that the sole use of the 9 square metre area is to either store or access the inventory, this area can be said to be primarily used for business purposes.

**In this example the area that can be said to be used primarily for business purposes and is the business square metres is 9 square metres.**

### Step 1

The first step in the calculation process is completed by multiplying the 9 square metres (the business square metres) by the amount of the Commissioner's square metre rate for the year in question; in this case the year ended 31 March 2019. This provides the taxpayer with the first component of their deduction. For the year ended 31 March 2019 the Commissioner's square metre rate was \$41.70.

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<sup>12</sup> The remaining area (6 square metres) is not "separately identifiable" as being for any specific purpose, either business or personal, it is simply either an empty space or a traffic area.

In this example the calculation of the amount of deduction available under step 1 is:

2019 Commissioner's square metre rate x the business square metres

$$\$41.70 \times 9 = \$375.30$$

In this example the amount of deduction available under step 1 is \$375.30

### Step 2

This step calculates the amount of premise costs (mortgage interest, rates or rent) that can be allowed as a deduction. This deduction is calculated by taking the percentage of the premises that is used primarily for business use; the business proportion and applying this percentage to the premise costs; in this case \$22,000.00 in interest and rate payments that have been made by the taxpayer.

Following the calculation at [28], [33] and [36], the information required to arrive at the deduction available at step 2 is:

The total area of all of the buildings on the taxpayer's premises	215 sq. metres
Business square metres (from Step 1)	9 sq. metres
Premise costs	\$22,000.00

These facts are then applied to the following formula:

$$\frac{9}{215} \times \frac{100}{1}$$

$$= 4.2\% \times \$22,000.00 = \$924.00$$

In this example the amount of deduction available under step 2 is \$924.00

### Step 3

The final deduction is calculated by combining the results of the first two steps.

In this example the total amount of the square metre rate deduction is:

$$\$375.30 + \$924.00 = \$1299.30$$

## Example 2: Use of dedicated home office

Mr and Mrs Smith have a small room in their home which they use as an office. The room is furnished with a desk that holds a computer and printer, a computer chair, and filing cabinets that holds business records and stationery. The computer is used daily by the Smiths to update the business accounts but also occasionally for private purposes. Their daughter sometimes uses the computer and printer to complete university assignments. However, she has her own laptop for day-to-day use.

The Smiths have calculated the quantum of all interest and rates payments on their property to be \$18,700.00 for the year ended 31 March 2019.

The total area of the Smith's dwelling is 160 square metres (inclusive of an attached single garage). There are no other buildings on the property.

### Calculating the business square metres

#### *Separately identifiable parts of the buildings on the premises...*

The area of the room is 8 square metres, with the desk, chair and filing cabinets taking up approximately 4 square metres of this space. When looking objectively at the room, the Smiths believe that a reasonable person would view the whole of the room as being *separately identifiable* as being used for business purposes. They have reached this conclusion because all of the room is available for business use (in that none of the area is used solely for a non-business purpose) and the area of the room is small enough so that none of the area can be said to have no specific purpose; the whole room is either taken up by the furniture or allows the furniture to be accessed and used.

#### *...that are used primarily for business purposes*

Other than for record storage, the separately identifiable area (in this case, the 8 square metre room) is mainly used for computer work by members of the Smith family. While their daughter occasionally uses the computer for university assignments, and the Smiths sometimes use the computer for private purposes, this occasional use is outweighed by the everyday use of the computer for business purposes. As the use of the computer is the primary use of the separately identifiable area, and the computer is used primarily for business purposes, the separately identifiable area can be said to be used primarily for business purposes.

**In this example the area that can be said to be used primarily for business purposes and is the business square metres is 8 square metres.**

### Step 1

The first step in the calculation process is completed by multiplying the 8 square metres (the business square metres) by the amount of the Commissioner's square metre rate for the year in question; in this case the year ended 31 March 2019.

This provides the taxpayer with the first component of her deduction.

In this example the calculation of the amount of deduction available under step 1 is:

2019 Commissioner's square metre rate x the business square metres

$$\$41.70 \times 8 = \$333.60$$

In this example the amount of deduction available under step 1 is \$333.60.

### Step 2

This step calculates the amount of premise costs (mortgage interest, rates or rent) that can be allowed as a deduction. This deduction is calculated by taking the percentage of the premises that is used primarily for business use; the business proportion and applying this percentage to the premise costs. In this case \$18,000.00 in interest and rate payments that have been made by the Smiths.

Following the calculation at [28], [33] and [36], the information required to arrive at the deduction available at step 2 is:

The total area of all of the buildings on the taxpayer's premises <sup>13</sup>	160 sq. metres
Business square metres (from Step 1)	8 sq. metres
Premise costs	\$18,700.00

These facts are then applied to the following formula:

$$\frac{8}{160} \times \frac{100}{1}$$

$$= 5\% \times \$18,700.00 = \$935.00$$

In this example the amount of deduction available under step 2 is \$935.00

### Step 3

The final deduction is calculated by combining the results of the first two steps.

In this example the total amount of the square metre rate deduction is:

$$\$333.60 + \$935.00 = \$1268.60$$

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<sup>13</sup> For the purposes of s DB 18AA the word *premises* includes building curtilage. For urban, residential properties the Commissioner accepts that the area of building and curtilage on the property will equate to the area of the entire property. See further at [34] and [35]

### Example 3: Use of a main living area

As with many contemporary homes, the residence occupied by Mr and Mrs Jones and their two teenage children has a living area that is “open plan”; it includes the kitchen, dining room and lounge. This open plan living area accounts for approximately 50 square metres of the total floor area. Mr and Mrs Jones need to regularly undertake business related work from their home and have located a computer desk, chair and filing cabinets in one corner of this open plan area for this purpose. When not being used for business purposes, the computer is available for the private use of the family.

Mr and Mrs Jones have calculated the quantum of all interest and rates payments on their property to be \$26,300.00 for the year ended 31 March 2019.

The total area of the Smith’s dwelling is 155 square metres (inclusive of an attached single garage). There are no other buildings on the property.

#### Calculating the business square metres

*Separately identifiable parts of the buildings on the premises...*

When looking objectively at the open plan living area, Mr and Mrs Jones note that although the potential area of business use is the 50 square metre open plan living area, the majority of this area could not be said to be “separately identifiable” as being available to be used for business purposes. The majority of this large area is used exclusively as the family’s personal living space (35 square metres).

Of the remaining area (15 square metres), 9 square metres is not used for either a business or private purpose. It is either empty space or traffic area. The computer desk, chair and filing cabinets take up 4 square metres of the 50 square metre living area. In their view, the area that is “separately identifiable” as being used for a business purpose is that area taken up by the computer desk, chair and cabinets, together with the area that immediately surrounds this furniture that allows it to be used. In total they estimate this to be the remaining area of 6 square metres.

*...that are used primarily for business purposes*

The separately identifiable 6 square metre area is largely used for either business or private computer work by members of the Jones family. While they sometimes use the computer for private purposes, this use is minimal compared to the computer’s everyday business use. All members of the family prefer to use other means to access the internet; the teenagers use their smartphones and x-boxes, and Mr and Mrs Jones generally use their smartphones. Because the use of the computer is the primary use of the separately identifiable area, and the computer is used primarily for business purposes, the separately identifiable area (6 square metres) can be said to be used primarily for business purposes.

**In this example the area that can be said to be used primarily for business purposes and is the business square metres is 6 square metres.**

#### Step 1

The first step in the calculation process is completed by multiplying the 6 square

metres (the business square metres) by the amount of the Commissioner's square metre rate for the year in question; in this case the year ended 31 March 2019. This provides the taxpayer with the first component of their deduction. For the year ended 31 March 2019 the Commissioner's square metre rate was \$41.70.

In this example the calculation of the amount of deduction available under step 1 is:

2019 Commissioner's square meter rate x the business square metres

$$\$41.70 \times 6 = \$250.20$$

In this example the amount of deduction available at step 1 is \$250.20.

### Step 2

This step calculates the amount of premise costs (mortgage interest, rates or rent) that can be allowed as a deduction. This deduction is calculated by taking the percentage of the premises that is used primarily for business use; the business proportion and applying this percentage to the premise costs. In this case \$26,300.00 in interest and rate payments that have been made by the Jones family.

Following the calculation at [28], [33] and [36], the information required to arrive at the deduction available at step 2 is:

The total area of all of the buildings on the taxpayer's premises	155 sq. metres
Business square metres (from step 1)	6 sq. metres
Premise costs	\$26,300.00

These facts are then applied to the following formula:

$$\frac{6}{155} \times \frac{100}{1}$$

$$= 3.9\% \times \$26,300.00 = \$1025.70$$

In this example the amount of deduction available under step 2 is \$1025.70.

### Step 3

The final deduction is calculated by combining the results of the first two steps.

In this example the total amount of the square metre rate deduction is:

$$\$250.20 + \$1025.70 = \$1275.90$$

### *Example 4: Use of a spare bedroom*

Following on from Example 3, time has moved on and one of the Jones teenagers has moved out of the house and gone flatting. As one of the bedrooms is now vacant, the Jones decide to move some of the furniture out to the garage and move the computer desk, chair and filing cabinets into this bedroom. They retain some bedroom furniture in the room in case they have guests (or the teenager returns). The area of the bedroom is 12 square metres. As with Example 3, the computer is available for both business and personal use.

#### Calculating the business square metres

##### *Separately identifiable parts of the buildings on the premises...*

The retained bedroom furniture (bed, bedside cabinet, chest of drawers and wardrobe) take up approximately 5 square metres of the 12 square-metre room. The computer desk, chair and filing cabinets take up 4 square metres (the same as it did when these were situated in the living area of the house).

The 5 square metre area of the room taken up by the bedroom furniture could not be said to be "separately identifiable" as being available to be used for business purposes; its use is as a personal living space and therefore not available for business use. The area that is "separately identifiable" as being used for a business purpose is that area taken up by the computer desk, chair and filing cabinets (4 square metres), together with the area that immediately surrounds this furniture that allows it to be used. Mr and Mrs Jones estimate this to be an area of 6 square metres.

Note: Although this is the same area that was separately identifiable when this furniture was situated in the family's open plan living area (at example 3), this is merely a coincidence. The principle to be taken from this is that in what room the furniture is situated is generally **not** relevant in deciding how much of an area can be said to be "separately identifiable" as being used for business purposes; it is a matter of objective fact in each case.

##### *...that are used primarily for business purposes*

The facts regarding the use of the computer have not changed from Example 3; it is primarily used for business purposes. Because the use of the computer is the primary use of the separately identifiable area, and the computer is used primarily for business purposes, the separately identifiable area can be said to be used primarily for business purposes.

**In this example the area that can be said to be used primarily for business purposes and is the business square metres remains as it was in example 3; 6 square metres**

As the *business square metres, the business proportion and the premise costs* applicable to the Jones's residence has not altered from example 3, the quantum of the square metre rate deduction remains as it was in example 3.

## APPENDIX

### LEGISLATION

#### **Premises or land costs**

##### **DB 18AA Square metre rate method**

*When this section applies*

- (1) *A person may choose to apply this section to determine the amount of a deduction, in an income year, for the proportion of business use of premises that is used partly for business purposes and partly for other purposes.*

*Amount of deduction*

- (2) *The amount of the deduction allowed in an income year for the business use of the premises is calculated using the formula—*  
*(total premise costs × business proportion) +*  
*(business square metres × square metre rate).*

*Definition of items in formula*

- (3) *In the formula,—*
- (a) **total premise costs** *is the total amount of actual mortgage interest, rates, and rent that the person has paid with respect to buildings and their curtilage on the premises in the income year:*
  - (b) **business proportion** *is determined by dividing business square metres by the total area of buildings on the premises in square metres:*
  - (c) **business square metres** *is the total area, in square metres, of any separately identifiable parts of buildings on the premises that are used primarily for business purposes:*
  - (d) **square metre rate** *is the applicable square metre rate that is published by the Commissioner.*

*No other deductions allowed*

- (4) *A person who makes an election to apply this section under subsection (1) is not entitled to claim any other deductions for the business use of the premises.*

*Setting square metre rates*

- (5) *For the purposes of this section, the Commissioner must from time to time set and publish square metre rates.*

*Defined in this Act:* [amount](#), [business use](#), [Commissioner](#), [deduction](#), [income year](#)

History: Section DB 18AA inserted on 1 April 2017 (applying for the 2017 – 18 income years) by section 71(1) of the Taxation (Business Tax, Exchange of Information, and Remedial Matters) Act 2017 (2017 No 3). Royal assent: 21 February 2017.

Amended by the Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Act 2019 (2019/5). Royal Assent: 18 March 2019.