

QUESTIONS WE'VE BEEN ASKED

Elections not to depreciate commercial buildings

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This question we've been asked sets out the position for taxpayers making an election to not depreciate their commercial building since the depreciation rate of 0% was removed from commercial buildings with effect from the 2021 income year.

All legislative references are to the Income Tax Act 2007 (the Act) unless otherwise specified.

Key provisions

Income Tax Act 2007 – s EE 8

Question

The depreciation rate for buildings with a useful life of at least 50 years was reduced to 0% from 1 April 2011, the start of the 2012 tax year. With effect from the 2021 income year, the ability of taxpayers to claim a depreciation loss on the commercial buildings they own was reinstated, at a rate of 2% (using the diminishing value (DV) method) or 1.5% (using the straight-line (SL) method).

Given this change, what are the consequences for taxpayers who elected, before the 2012 income year, to treat their commercial building as not being depreciable property and so not claim the relevant depreciation loss?

Answer

Where a taxpayer makes an election to treat their commercial building as not being depreciable property, that election is irrevocable, and the taxpayer is bound by that election until the building is disposed of. For the election to be effective, the taxpayer must make it “in writing”.

A taxpayer who does not make an election and who claims a depreciation loss for their commercial building must continue to depreciate that building at the rate the Commissioner has set.

A taxpayer who does not make a written election and has never claimed a deduction for a depreciation loss on their commercial building may make a retrospective election not to depreciate that building. The retrospective election will apply from the date the taxpayer acquired the building.

Key terms

Commercial building means (for the purpose of this item) a building that is not a “residential building”.

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

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

¹ s EE 8(4) of the Act.

² s YA 1 of the Act.

Explanation

Background

The depreciation regime

1. Taxpayers are allowed a deduction for a depreciation loss on items of depreciable property³ that a business uses to gain assessable income.⁴
2. It is mandatory for a taxpayer to claim a deduction for a depreciation loss where one is allowed. The deduction is calculated by using the most appropriate rate of depreciation for that asset as set out in the Commissioner's table of depreciation rates⁵ and applying it to the cost of the asset.⁶
3. When they dispose of the asset, the taxpayer is generally considered to have claimed the applicable depreciation loss, even in circumstances where they have chosen not to claim the loss. For the purposes of calculating the depreciation recovery income or loss on sale, taxpayers are considered to have claimed the allowable depreciation loss. The quantum of income or loss on disposal is calculated accordingly.
4. A taxpayer may have valid commercial reasons for not wishing to claim a deduction for a depreciation loss. It was with this in mind that, in 1997, Parliament introduced s EE 8 of the Act⁷ to allow taxpayers to elect to treat certain assets as not being depreciable property. The effect of making such an election is that a taxpayer cannot claim a deduction for the depreciation loss on the elected asset(s) that they otherwise would have been entitled to.
5. An election to treat an asset as not being an item of depreciable property must be made in the year that the taxpayer acquired the asset, or the year in which the use of that asset in the taxpayer's business changed. A change in use can occur when, for instance, a private asset is introduced into a business and is able to be depreciated. Once made, an election is irrevocable.

³ **Depreciable property** is defined in s EE 6 of the Act.

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

⁵ See Inland Revenue's booklet *General depreciation rates* IR 265 (July 2021), available at ird.govt.nz

⁶ s EE 16(3) of the Act.

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

6. After making an election, a taxpayer is unable to “pick and choose” which years they claim a deduction for a depreciation loss on those assets. An election can only be made:
 - prospectively at the time that the taxpayer acquires the asset, or its use changes, or
 - retrospectively, but only if the taxpayer has not claimed a deduction for a depreciation loss in any year since they acquired the asset (or its use changed).
7. Once a taxpayer has claimed a deduction for an amount of depreciation loss on their asset or made an election to treat that asset as not being depreciable property, they are bound to follow that treatment until they dispose of the asset. The taxpayer therefore chooses “once and for all” whether to claim a deduction for a depreciation loss on that asset.
8. A taxpayer can only make an election to treat an asset as not being depreciable property by giving “notice” to the Commissioner of their intention to do so in their return of income. The Commissioner must be “notified”.
9. Given the election requirements stated at [6], a taxpayer needs to provide the Commissioner with the following information:
 - Where the taxpayer is making a prospective election, the notice needs to advise the Commissioner of the asset(s) they are making the election for and of that asset’s acquisition date (or the date that its use in the business changed and how it changed).
 - Where the taxpayer is making a retrospective election, the notice will need to advise the Commissioner of the asset(s) they are making the election for, and the asset’s acquisition date or the date that its use changed.

The notice must also include a statement that the taxpayer has not made a claim for a depreciation loss for the asset(s) since that date. A taxpayer can make a retrospective election in any income year after the year they acquired the asset, including the year that they dispose of the asset and the years following its disposal.
10. Although the taxpayer must make the election in their return of income, the election also needs to provide notice to the Commissioner of the election. Given that a taxpayer’s return does not provide the Commissioner with any of the required information, the Commissioner does not expect taxpayers to literally attempt to provide notice “in” their return of income. It is the Commissioner’s view that an election under s EE 8 must be in writing; it may take the form of a letter, email or

webmail and be either attached to the return or provided separately to the Commissioner at or close to the time when the taxpayer provides the return.

11. Simply choosing not to depreciate an asset in a taxpayer's tax accounts does not notify or provide notice to the Commissioner that the taxpayer wishes to elect to treat that asset as not being an item of depreciable property. This is because tax accounts are not supplied to the Commissioner with a taxpayer's return of income. In addition, per [2], unless taxpayers make an election, they must claim an amount of depreciation loss where one is allowed and (per [3]) incorrectly not claiming an amount of depreciation loss will have consequences when the taxpayer disposes of the asset.

The depreciation of commercial buildings

12. Before the 2012 income year, it was possible to depreciate buildings with an estimated useful life of at least 50 years for tax purposes. This included commercial buildings. However, the budget of 20 May 2010 introduced several changes to the depreciation regime, including replacing the then applicable rates of depreciation for most buildings with a rate of 0%.
13. This change was included in the Taxation (Budget Measures) Act 2010⁸ and was effective from the beginning of a taxpayer's 2011–2012 income year. It is important to note that the Act did not remove the ability for taxpayers to claim a depreciation loss. What changed was the rate at which the amount of any depreciation loss was calculated.
14. Commercial buildings remained depreciable at the rate of 0% until the beginning of the 2020–2021 income year.⁹ The COVID-19 Response (Taxation and Social Assistance Urgent Measures) Act 2020 amended the rate at which commercial building owners were able to claim a depreciation loss. It provided for a depreciation rate for these buildings of 2% DV or 1.5% SL.¹⁰

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

15. Before the depreciation rate for commercial buildings was reduced to 0%, most taxpayers claimed the depreciation loss on their commercial buildings. However, some

⁸ See *Tax Information Bulletin* Vol 22, No 7 (August 2010) for more information.

⁹ For more information on the application date for this change, see [QB 21/05: The application date for the depreciation of commercial buildings](#).

¹⁰ See *Tax Information Bulletin* Vol 32, No 5 (June 2020) for more information.

taxpayers made a written election to treat their building as not being depreciable property and so did not claim a deduction for a depreciation loss on that commercial building.

16. Other taxpayers, while deciding not to depreciate their commercial building, did not give adequate notice to the Commissioner of their election (which they needed to do by notifying the Commissioner in writing, per [5] – [11]). Instead, they did not claim a deduction for the depreciation loss on their commercial building in their tax accounts in the mistaken belief that this was all that was required to make an “election”.
17. The following sections summarise the effect of these previous decisions to depreciate (or not depreciate) commercial buildings now that taxpayers can depreciate their commercial buildings at a rate other than 0%.

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

18. Unless a taxpayer first elects to treat an asset as not being depreciable property, they must claim a deduction for an allowable depreciation loss (per [2]). Once a taxpayer has made a claim for an amount of depreciation loss for that commercial building in any income year, they are no longer able to elect to treat that asset as not being depreciable property until a “disposal event” occurs (per [20]). As stated, (at [6]), a taxpayer can only make a retrospective election where they have never made a claim for a depreciation loss on that asset.
19. A taxpayer in those circumstances must therefore continue to claim a deduction for the depreciation loss on their commercial building in each income year. If a taxpayer does not claim a deduction for the depreciation loss on their commercial building in an income year, they will be considered to have made a claim for the applicable amount of depreciation loss (per [2] and [3]).

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

20. When a taxpayer makes an election to treat their commercial building as not being an item of depreciable property, that election is irrevocable. It has effect for the income year in which the taxpayer acquired the building (irrespective of when the election is made) and in all future income years until a disposal event occurs. A disposal event is an event where:

- the commercial building is disposed of,¹¹ or
- the use of the building changes and, as a result, the taxpayer is denied a deduction for a depreciation loss on the building,¹² or
- the nature of the taxpayer's activities changes to one of gaining exempt income, or
- the building suffers irreparable damage or damage that makes it useless, or
- the building is subject to acquisition by a person acting under statutory authority.

21. Until a disposal event occurs, a taxpayer who has previously made an election to treat their commercial building as not being an item of depreciable property cannot claim a depreciation loss on that building. This condition applies despite the possibility that the rate of depreciation may change for the elected asset (which, for commercial buildings it has; to 0% from the 2012 tax year, and then to 2% DV or 1.5% SL from the 2021 tax year).

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

22. This circumstance may arise because the taxpayer acquired their commercial building:
- before 1 April 2011 and mistakenly believed that they could make an election by simply not claiming a deduction in their tax accounts for the depreciation loss that was allowed on their building, or
 - before 1 April 2011 and was unaware that claiming an amount of depreciation loss that is allowable is mandatory, or
 - between 1 April 2011 and 31 March 2020, at a time when the depreciation rate was 0%. Because the rate of depreciation was 0%, it is highly unlikely that a taxpayer in this circumstance would have made an election to treat that building as not being an item of depreciable property.

Taxpayers acquiring a commercial building prior to 1 April 2011

23. If either of the first two bullet points above applies, the effect is that the taxpayer has failed to claim a mandatory deduction.

¹¹ s EE 8(5) of the Act.

¹² s EE 47 of the Act.

24. Given this, the taxpayer in either of these categories has two options. Either:
- (if they wish to claim the allowable depreciation loss) the taxpayer starts to claim the relevant depreciation loss on their commercial building and request that the Commissioner reassess the relevant back year returns to claim the appropriate amount of depreciation loss in those years¹³ (as far as they are able before the time-bar rules contained in s RM 2 of the Act take effect), or
 - (if they do not wish to claim the allowable depreciation loss) as the taxpayer has not claimed a deduction for any amount of depreciation loss for the commercial building, they can now provide the Commissioner with a written election to retrospectively treat the commercial building as not being an item of depreciable property.¹⁴

Taxpayers acquiring a commercial building between 1 April 2011 and 31 March 2020

25. In the final circumstance set out at [22], where a taxpayer has acquired their commercial building during the time that the depreciation rate for their building was 0% (between 1 April 2011 and 31 March 2020), they have not failed to claim a depreciation loss (as none was available). The reassessment of prior returns of income is therefore not required. If the taxpayer wishes to claim the allowable depreciation loss on their commercial building they can simply commence to do so.
26. Because the taxpayer has not claimed a deduction for any amount of depreciation loss for the commercial building, if they do not wish to claim the amount of allowable depreciation loss on their commercial building, they can provide the Commissioner with a written election to retrospectively treat the commercial building as not being an item of depreciable property.

Effect of retrospective elections

27. Retrospective elections are effective for all years from the year that the taxpayer acquired the commercial building. Making a retrospective election therefore rectifies the errors made in the taxpayer's past returns of income.
28. As stated at [9], a taxpayer can make a retrospective election in any income year after the year they acquired the asset. This includes the year that they disposed of the asset and the years following its disposal.

¹³ Such a request can be made in terms of s 113 of the Tax Administration Act 1994. See also standard practice statement [SPS 20/03: Requests to amend assessments](#).

¹⁴ s EE 8(3) of the Act.

References

Legislative references

Income Tax Act 1994 – s 16A

Tax Administration Act 1994 – s 113

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

Other references

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

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

About this document

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