Inland Revenue
Te Tari Taake

QUESTIONS WE'VE BEEN ASKED | PĀTAI KUA UIA MAI

Income tax: Can I claim a deduction for expenses I incur on repairing a recently acquired capital asset?

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QB 25/17

This question we've been asked is about whether a taxpayer can deduct for income tax purposes the amount of expenditure they have incurred to repair a capital asset that they have recently acquired. The repairs in question are those that essential so that the taxpayer can use it in their business or income-earning activity

Key provisions | Whakaratonga tāpua

Income Tax Act 2007 – ss DA 1 (general permission), DA 2(1) (capital limitation)

REPLACES | WHAKAKAPIA

- Case law: Repairs and maintenance – capital or revenue expenditure? *Tax Information Bulletin* Vol 5, No 9 (February 1994): 3 (example 4 and discussion of *Law Shipping* and *Odeon Associated Theatres*)
- IS 12/03: Income tax – Deductibility of repairs and maintenance expenditure – general principles *Tax Information Bulletin* Vol 24, No 7 (August 2012): 68 (paragraphs [26], [212]–[218], [232] and example 21)
- IS0025: Dairy Farming – deductibility of certain expenditure *Tax Information Bulletin* Vol 12, No 2 (February 2000): 10 ("Recently acquired plant" at 40–41).

Question | Pātai

Can I claim an income tax deduction for expenses I incur on repairing a capital asset I recently acquired where the repairs are essential to ensuring I can use it in my business or income-earning activity?

Answer | Whakautu

No. The capital limitation in s DA 2(1) prevents you from claiming a deduction because the expenses are of a capital nature.

However, where the capital asset is an item of depreciable property, you may be able to claim a depreciation loss based on the amount of the expenses.

Explanation | Whakamāramatanga

Introduction

1. This question we've been asked (QWBA) is about a particular aspect of the income tax treatment of expenditure taxpayers may incur in carrying out work on an item of tangible property other than trading stock or revenue account property they use in a business or profit-making activity (ie, a "capital asset").[1] It clarifies when the recent acquisition of the capital asset may affect the income tax treatment of expenses incurred in carrying out repair work that might otherwise be deductible. This QWBA supplements existing guidance on the deductibility of expenditure on such work carried out in other circumstances.

2. This QWBA assumes the expenditure on repairs meets the requirements of the general permission in s DA 1. Its focus is on the sole issue of whether the expenditure is capital in nature. If it is, the capital limitation in s DA 2(1) does not permit a deduction for the amount of the expenditure.

Definitions used in this QWBA

3. "**Essential initial repairs**" in this QWBA means repairs a taxpayer carries out on a capital asset they have recently acquired where the expenditure is non-deductible capital expenditure, as explained in this QWBA. Broadly, these repairs involve work on the capital asset that is essential to make it suitable for the taxpayer's intended long-term use. This work does not need to be the first work carried out on the capital asset since acquisition. The expenditure is non-deductible even though, given the nature, scale and extent of the repair work, the expenditure would have been of a revenue

[1] Generally, revenue account property is defined in s YA 1 to include trading stock (as defined in s EB 2) and property that would produce income if disposed of. The term "capital asset" is not defined in the Act.

nature and a deductible expense if the previous owner of the asset had incurred it (assuming the general permission was met).

4. "Essential initial repairs" do not include expenditure on work that would otherwise be characterised as capital in nature under general principles, regardless of whether the expenditure was incurred immediately after acquiring the asset or at a later time. Generally, such capital expenditure relates to work variously described from time to time as involving an alteration, extension or replacement of the asset, including expenditure that is part of an overall capital project.

5. By definition, "essential initial repairs" do not include work carried out to a recently acquired asset that is not essential to make it suitable for the taxpayer's intended long-term use. The tax treatment of the cost of such non-essential repair work is determined under general principles, unless the work is part of an overall project to undertake essential initial repairs. In that case, all the costs are treated together as essential initial repairs.

6. Unless otherwise indicated, this QWBA uses the term "**repair**" (or variants) for convenience to refer in a tax neutral way to expenditure a taxpayer incurs on carrying out work on a capital asset.

7. "**Acquisition**" (or variants) of a capital asset in this context includes acquiring the asset through purchase or inheritance.[2]

Depreciation

8. Although depreciation is not the focus of this item, as the answer suggests, if the capital asset is an item of depreciable property, any non-deductible repair costs (ie, the costs of essential initial repairs) may be able to be included in calculations of depreciation losses from the date the repairs are completed.[3]

9. The depreciation rules are found in subpart EE of the Act. Broadly, the requirements that must be met before a depreciation loss arises are that the:

- taxpayer owns the item of property;

[2] **Note:** leased assets are not included because other factors outside the scope of this item may then be relevant. However, the concept of essential initial repairs has arisen in the context of leased premises. See, for example: *Case W93* 89 ATC 785 (AATA) and *Jackson (Inspector of Taxes) v Laskers Home Furnishers Ltd* [1956] 3 All ER 891 (EWHC).

[3] Either because the entire capital asset or, where the expenditure is an "improvement", the asset or improvement is unable to be used or available for use prior to their completion (See ss EE 1(2)(c), EE 16(5), EE 37(2)(a) and s EE 67 "improvement").

- property is depreciable property as defined;
- property is used, or available for use, to derive assessable income; and
- depreciation loss is calculated in the correct manner (ie, using the correct method and rate).[4]

The general principles for distinguishing capital from revenue expenditure

10. The income tax treatment of essential initial repairs arises from the distinction made between expenditure that is considered to be of a:
    - capital nature (and not deductible due to the capital limitation); or
    - revenue nature (and deductible under the general permission).
11. The courts have drawn this distinction on numerous occasions. Their decisions have given rise to a number of principles, summarised in this section as follows.[5]
12. The decisions in *Hallstroms* and *Nchanga* provide the best guides to the general principles that require distinguishing between:[6]
    - the acquisition of the means of production (capital) and the use of them (revenue); or
    - the reform or more effective establishment of the organisation by which income will be produced (the "profit-yielding subject") (capital) and the means by which that organisation will be used (revenue); or
    - the costs of creating, establishing, acquiring or enlarging the permanent structure of the business (capital) and the costs of using the structure to earn income or of performing the income-earning operations (revenue).
13. Based on these principles, it is necessary to consider what the expenditure is calculated to effect from a practical and business point of view (*Hallstroms*).

[4] Note that from 1 April 2024 a 0% depreciation rate applies to all buildings (see: *Taxation (Annual Rates for 2023-24, Multinational Tax, and Remedial Matters)* Act 2024).

[5] This summary is adapted from the Court of Appeal's summary in *CIR v Trustpower Ltd* [2015] NZCA 253 from [51] to [76].

[6] *Hallstroms Pty Ltd v FCT* (1946) 72 CLR 634 (HCA) and *Commissioner of Taxes v Nchanga Consolidated Copper Mines* [1964] AC 948 (PC).

14. The Privy Council adopted the general principles of *Hallstroms* and *Nchanga* in *BP Australia*.[7] It suggested five factors could be considered to help decide whether expenditure is capital or revenue in nature. These factors are guides only. In the end, the answer will depend on a close examination of the facts of the particular case and the character of the particular payment.

15. The Court of Appeal summarised the "*BP Australia* factors" in *McKenzies*:[8]

- the need or occasion which called for the expenditure;
- whether the payments were made from fixed or circulating capital;
- whether the payments were of a once and for all nature producing assets or advantages which were of an enduring benefit;
- how the payments would be treated under ordinary principles of commercial accounting; and
- whether the payments were expended on the business structure of the taxpayer or whether they were part of the process by which the taxpayer earned income.

16. The Court of Appeal considered that the general principles arising from *Hallstroms* and *Nchanga* remain the best guide for distinguishing between income and capital and may be sufficient for that purpose without resort to the *BP Australia* factors.[9]

Essential initial repairs are an example of how these general principles apply

17. As mentioned, essential initial repairs are considered capital in nature meaning a deduction for their cost is prevented by the capital limitation in s DA 2(1). Deciding whether repairs are essential initial repairs involves applying the principles for distinguishing between capital and revenue as set out above. In the particular circumstances of essential initial repairs, the date of the acquisition of the relevant capital asset will be pertinent. In this context, the courts have also referred to other potentially relevant matters (see from [33]).

18. Under the general principles, essential initial repairs are those repairs that, from a practical and business point of view, the taxpayer must undertake so that they can use the capital asset they recently acquired as intended. This conclusion is consistent with the view that the cost of those repairs:

[7] *BP Australia Ltd v Commissioner of Taxation for the Commonwealth of Australia* [1966] AC 224 (PC).

[8] *CIR v McKenzies (NZ) Ltd* [1988] 23 NZLR 736 (CA).

[9] *Trustpower* (CA) at [76].

- is part of the taxpayer acquiring the means of production, establishing or extending a business organisation, or acquiring the implements of work or the enterprise itself (*Hallstroms*);
- is part of the cost of "creating, acquiring or enlarging the permanent … structure of which the income is to be the produce or fruit" (*Nchanga*);
- alters the framework within which the income-producing activities are for the future to be carried on (with the asset) (*Foley Bros*[10]);
- is incurred with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade (*British Insulated and Helsby Cables Ltd v Atherton*[11]).

19. In terms of the various "*BP Australia* factors" listed at [15], the need or occasion which called for the expenditure on essential initial repairs is the necessity to restore or maintain the functionality of an asset recently acquired so it can form part of the business structure of the taxpayer's income-earning activity. Also, the payments for essential initial repairs are usually of a once and for all nature, especially when made in catching up on a previous owner's lack of maintenance (see deferred repairs discussed from [35]).

When will the work undertaken involve essential initial repairs?

20. A number of court decisions are commonly cited in the context of essential initial repairs.[12] However, as Woodhouse J stated in one of these cases, these lines of authority "might seem to provide convenient sign-posts" for the characterising of expenditure but "it is not easy to derive help from particular facts of decided cases".[13]

21. Despite Woodhouse J's caution, the cases mentioned (and others) do provide some assistance as to a court's likely approach to the treatment of essential initial repairs. From those cases, the Commissioner considers the following matters are relevant to determining if the work undertaken involves essential initial repairs.

[10] *FCT v Foley Bros Pty Ltd* (1965) 13 ATD 562 (HCA) at 563.

[11] *British Insulated and Helsby Cables Ltd v Atherton* [1926] AC 205 (HL) at 213–214.

[12] Including: *Law Shipping Co Ltd v Commissioners of Inland Revenue* (1923) 12 TC 621 (IH (1 Div)); *Inland Revenue Commissioners v Granite City Steamship Co Ltd* (1927) 13 TC 1 (IH (1 Div)); *Jackson (Inspector of Taxes) v Laskers Home Furnishers Ltd*; *Collector of Inland Revenue, Cook Islands v AB Donald Ltd* [1965] NZLR 679 (HC); *W Thomas & Co Pty Ltd v FCT* (1965) 14 ATD 78 (HCA); and *Odeon Associated Theatres v Jones (Inspector of Taxes)* [1972] 1 All ER 681 (EWCA).

[13] *Collector of Inland Revenue, Cook Islands v AB Donald Ltd* at 684.

22. Expenditure a taxpayer incurs in carrying out repairs on a recently acquired capital asset will be essential initial repairs and, as a result, capital in nature where the work was "due" at the time that the taxpayer acquired the asset.

23. Repairs will be considered due when the repairs are required to restore or maintain the asset's functional effectiveness, including its ongoing functionality, where this is essential to make the asset suitable for use as intended by the taxpayer. The relevant use is the specific manner in which the taxpayer ultimately intends, in the long-term, to use the asset in their business or income-earning activity.

24. When assessing the taxpayer's intended use, it is irrelevant whether in the short-term, the asset is used or is capable of some use in some way pending the repairs being completed.[14] It is also not necessary to establish whether the taxpayer was aware of the need to carry out the repairs at the time they acquired the asset when assessing whether work carried out involved essential initial repairs given the taxpayer's ultimate intended use.[15]

25. However, essential initial repairs do not arise simply because the need for the repairs may have arisen before the taxpayer acquired and used the asset. All assets start to deteriorate from the date of their manufacture or construction and this period may not coincide with the taxpayer's use of the asset. Similarly, essential initial repairs do not arise simply because the purchase price of the asset was affected by the asset's state of disrepair (see further at [34]). The important consideration is how any deterioration that may have occurred before the taxpayer acquires the asset affects their intended use of it.

26. By definition, essential initial repairs do not include work carried out to a recently acquired asset that is not essential to make it suitable for the taxpayer's intended long-term use (referred to here as "non-essential repairs"). While the need for the non-essential repairs may have arisen due to wear and tear that occurred prior to the asset being acquired, the tax treatment of the cost of such work is determined under the general principles, depending on the particular facts of each case.[16]

27. However, when non-essential repair work is part of one overall capital project the courts have indicated that the proper approach is to consider all the work carried out as a whole. It may not be correct to separate out part of the project for separate

[14] See, for example, *Law Shipping* where the asset was used for 6 months prior to repair. See also *Case W7* 89 ATC 161 (AATA) at [22] where the taxpayer's intended long-term use was considered determinative.

[15] See *W Thomas & Co Pty Ltd v FCT* (HCA) at 88.

[16] See *Odeon Associated Theatres* (EWCA) per Buckley LJ at 693.

consideration.[17] If the non-essential repair work is carried out as part of an overall project to complete essential initial repairs, all the costs are treated as capital in nature.

28. Whether repairs are essential initial repairs will be a question of fact in each case. The answer is not simply the product of applying a temporal test comparing the date of acquisition with the date when expenditure was incurred. This means a "recently" acquired asset is not one defined in terms of whether the repairs are made within some set period following acquisition. Nor is it necessarily the case that an initial repair is the first repair made to a recently acquired asset.

29. However, the shorter the time between purchasing the asset and undertaking repairs, the stronger is the inference that the repairs were essential to restore and maintain the asset's relevant functionality to enable the taxpayer's intended use. Conversely, the longer the time between purchasing the asset and undertaking the repair, the less likely essential initial repairs will arise. For example, in the Australian Administrative Appeals Tribunal *Case W93,* Senior Member PM Roach considered repairs carried out some 15 years after acquisition and intense use by the taxpayer were "hardly appropriately described as initial repairs".[18]

Apportionment

30. An essential initial repair will not include expenditure to the extent it is for work that remedies normal wear and tear arising from the taxpayer's actual use of the asset in carrying on a business or an income-earning activity, whether this is the intended long-term use or not.

31. This means that apportionment or dissection of expenditure may be appropriate where the taxpayer may have made some use of the asset since acquiring it or uses it partially in their business or income-earning activity.[19] However, if the repair element is simply ancillary to an essential initial repair, the entire amount is treated as capital in nature.

32. If apportionment is appropriate, the taxpayer must apportion the expenditure on a fair and reasonable basis (such as time, area or some other quantifiable measure). A time basis may be appropriate where defects arise gradually over an extended period.

[17] See for instance, *Colonial Motor Co Ltd v CIR* (1994) 16 NZTC 11,361 (CA) at 11,399.

[18] At 789.

[19] "Dissection" in this context means where a composite payment relates to several things or services that may be able to be separately identified as for different purposes (such as an itemised invoice). In contrast, "apportionment" of an amount of expenditure applies where a single payment achieves two or more purposes at the same time.

All the facts and circumstances must be assessed

33. As with any decision on the character of an item of expense, all the surrounding circumstances must be considered. As mentioned, determining whether essential initial repairs arise is an example of where the general principles for distinguishing capital from revenue expenditure apply and those principles are the most relevant guides. However, in the particular facts of a recently acquired asset, a range of other matters may be relevant to determining if repairs involve essential initial repairs, including, but not limited to:

- the amount of time that has elapsed between acquiring the capital asset and undertaking the repairs;
- the state of repair or disrepair of the asset at the time the taxpayer acquired it;
- whether the asset was in a fit state for use as intended in the taxpayer's business or income-earning activities;
- the price of the asset or its value at acquisition and whether this was, or can be assumed on a reasonable basis to have been, affected by the state of repair or disrepair of the asset;
- the previous use of the asset in comparison with the taxpayer's intended use;
- the nature and extent of the repair work carried out; and
- whether the taxpayer has made any use of the asset before or during the period between acquisition and when the relevant work is completed (which may be relevant to any questions over whether the repairs arose from that use or in respect of apportionment).

34. Of these matters, the price or value of the asset at the time of acquisition is often referred to in the context of essential initial repairs. The purchase price of any secondhand asset will usually be reflective of a number of factors, and this may include its state of disrepair. The purchase price may then be relevant in the context of essential initial repairs to the extent that it is indicative of the state of the asset at the time. This may, in turn, be indicative of whether or not the repairs in question were "due" in the sense described above at the time of the asset's acquisition.

Essential Initial repairs as distinct from "deferred repairs"

35. Finally, it is of note that this QWBA is about essential initial repairs. At times, essential initial repairs have been called "dilapidation repairs" because the previous owner may have deferred repair work on the asset, with the result that the new owner acquired it in a dilapidated state.

36. However, the situation where essential initial repairs arise is distinct from the situation where the asset may have become dilapidated because repairs that have arisen **during** the taxpayer's ownership and use of the asset have been deferred and accumulated with other work and subsequently undertaken as part of a larger project (ie, "deferred repairs"). The revenue character of a repair is not usually lost because a taxpayer has deferred the work to a more convenient time. However, deferred repairs in this sense should not be confused or conflated with the essential initial repairs that are the subject of this QWBA.

Examples | Tauira

Example | Tauira 1 – Where repairs are part of the cost of acquiring a business asset

Transit Gurus Ltd operates a road transport business and acquires a trailer at a discounted price to use in that business. The trailer is cheap because it has been stored outside and sitting unused for many years. It is now in a rundown condition and requires repairs to make it roadworthy.

After buying the trailer, the company incurs expenditure to repair it. The repairs include fitting new tyres, repairing structural rust damage, replacing broken or missing taillights, rewiring, cleaning and repainting. Once the repairs are completed, the trailer is re-registered and obtains a warrant of fitness.

The repair costs are for essential initial repairs and are capital in nature because they are essential to restoring and maintaining the trailer's function for its intended use as part of Transit Gurus' road transport business.

No deduction for the amount of the repairs is allowed for income tax purposes because the capital nature of the expenditure means the capital limitation in s DA 2(1) prevents deductions.

However, Transit Gurus may be able to add the total cost of repairs to the purchase price of the trailer and include it in the calculation of any depreciation losses the company may be entitled to for the use of the trailer in its business. Depreciation entitlements would arise once the essential initial repairs were completed and the trailer was able to be used or be available for use.

Example | Tauira 2 – Where repairs are part of the cost of inherited rental property

James inherited a 100 year-old tenanted residential rental property. At this time, the property was in an extremely poor state of repair. Its condition was such that only a sleepout at the rear of the property was being rented on a short-term basis, with a high turnover of tenants and poor rental returns.

The property was located in a desirable neighbourhood and James decided to keep the property because he considered that if he restored it to a good condition, the rental return could be substantially increased by attracting a different calibre of tenant for longer-term letting of the entire property.

In the months following the inheritance, James carries out repairs to the property while it remains tenanted. These include repairing the leaking roof, replacing damaged ceilings, replacing some of the guttering and downpipes and repainting portions of the interior and exterior of the property. The main water supply pipe from the road to the building, which was leaking under the house, is also replaced. The gardens are tidied up and the boundary fences repaired and repainted. After the existing tenant vacates the property, James undertakes further internal repainting and other internal repairs including to the sleepout, such as replacing or repairing broken and damaged light fittings.

Once the repairs are completed, James is able to re-let the property to new tenants on a long-term basis and the rental income increases substantially.

The expenditure James incurred was essential to restore and maintain the functionality of the property to the level required for his intended use of letting it on a longer-term basis at improved rental yields. When he acquired it, James recognised he would need to incur further expenditure to bring the property to the condition he desired for its long-term use.

For these reasons, James' expenditure is on essential initial repairs and is capital in nature. No deduction for the expenditure is possible because of the capital limitation in s DA 2(1).

The fact that James used the property to derive rental income before completing all the repair work, does not alter this outcome. However, if some of the repairs, such as those made to the sleepout, were caused by the tenant and attributable to the period when James owned and rented the property before completing the repairs, there may be a case for dissecting or apportioning some of the expenditure on some reasonable basis. James is able to deduct any amount so dissected or apportioned from the rental income he receives.

Example | Tauira 3 – Where repairs are part of the cost of business premises

The Joyous Greeting Card Company operates a long-established business of manufacturing greeting cards and gift wrappings. To expand that business, Joyous acquired larger premises in the same city. When company personnel inspected the premises before purchase, they did not notice any maintenance issues with the building. It was apparent, however, that the former owner's use of the premises for manufacturing bread had left considerable amounts of flour and other residues coating all the interior surfaces of the building.

On taking up possession, Joyous incurred significant expenses in cleaning and repainting all the interior surfaces of the building. This work was essential to make the building useable in the company's business because cleanliness is a paramount concern when dealing with paper and related stocks and products.

During the cleaning and repainting, it became apparent that it was necessary to repair some parts of the interior lining of the ceilings and walls before repainting could begin.

It may not be common for cleaning and repainting to be thought of as involving expenditure of a capital nature. However, in these particular circumstances, considering the premises' previous use and the company's intended use, the expenditure involves essential initial repairs. No deduction is allowed for the expenditure because of the capital limitation in s DA 2(1).

The extraordinary costs on this type of work arose because the company incurred them to restore and maintain the functionality of the property to the level essential for the company's intended use in its business. The other repairs to the walls and ceilings were required for the same reasons and the fact that the company did not know of the need for this repair work at the time of acquisition, does not change the outcome.

Example | Tauira 4 – Where repairs to a building in a commercial complex are essential initial repairs

MetroHub Properties Ltd acquired a commercial complex comprising several separate buildings. MetroHub intended to use the complex for the purpose of deriving commercial rental income as part of its existing commercial property portfolio.

When MetroHub acquired the complex, all but one of the buildings were tenanted and producing rental income. One multi-storey building, however, had been unoccupied for years and was in a run-down condition.

MetroHub incurred expenditure in the year of purchasing the complex to repair the multi-storey building so it was in a condition for renting out. The work comprised interior cleaning, rubbish removal and redecorating, repairs to the roof, guttering and downpipes, replacing broken windows and maintaining the exterior grounds.

The repairs in this case involved essential initial repairs because they were required to restore and maintain the functionality of the multi-storey building to the level that MetroHub could use it for the intended purpose of leasing. No deduction is allowed for the repairs because of the capital limitation in s DA 2(1).

This outcome applies even though parts of the complex were capable of functioning as intended and, as a whole, the complex could be seen as not in need of repair for that purpose.

However, in this case, the relevant asset identified for repairs and maintenance purposes, as the object of the expenditure, determines the relevant intended use. In this case, the object of the work was the multi-level building and its surrounding land, not the entire commercial complex.

Example | Tauira 5 – Where repairs to a building do not involve essential initial repairs

Fredcount Apparel Ltd acquired business premises for the purposes of using it in its garment manufacturing business. At that time, the building had been on the market for a long time because its design and construction limited its range of potential uses. The company was not worried by these matters because it was aware that the vendor was a former business competitor who had been using the building for the same purpose that it intended to use it for.

Fredcount acquired the building at a significant discount on its government valuation that reflected the building's limitations and a general downturn in the commercial property market occurring at the time. The price was not discounted because the building was considered to be in need of repair. A visual pre-purchase inspection of the building by company personnel revealed no apparent issues with the state of the building.

However, a year later the company noted the roof was leaking and it carried out repairs. Soon after, it also noted issues with the floor and carried out repairs to rotten floor joists. The repair was ineffective so further repairs to the floor were made 6 months later. It then became apparent that stormwater was causing the flooring issues because a stormwater drain had been leaking. Fredcount repaired the drain and carried out further repairs on the floor, which involved cutting out more rotten portions and laying a new floor over the top.

The repairs in this case are not essential initial repairs and not otherwise capital in nature due to their nature and extent, so their cost is a deductible expense under the general permission to the taxpayer.

While the repair work was the result of gradual deterioration of the building before Fredcount acquired it, this alone does not mean any repairs shortly after acquisition are essential initial repairs. The important consideration in the context of essential initial repairs is how any deterioration that may have occurred by the date of acquisition may affect the company's use or intended use of the asset. The repair work was not essential to put the premises into a condition it could function and continue to function for the intended purpose for which the company had acquired the premises. The building had been suitable for that intended use when Fredcount acquired it, no repairs were evident at purchase and the previous owner had used it for identical purposes.

Example | Tauira 6 – Where repairs do not involve essential initial repairs but are still capital in nature

Tina purchased a tenanted residential rental property divided into two flats and immediately started to derive rental income. A few months after purchase, during a drought, cracks open up in the ground surrounding the house, causing it to subside. Substantial excavation and restoration of the land and repairs of the house were urgently required.

To prevent further subsidence, Tina replaces the main support wall of the house so that it is in a different position and enlarges the size of one of the flats in the process. Tina replaces the floor with a reinforced concrete floor and installs new drainage. She also adds a reinforced concrete terrace.

Substantial internal work also occurs because Tina takes the opportunity to carry out additional work on the property. Tina removes internal partitioning that would have needed replacement due to borer damage and replaces it with a new and improved layout.

Some of the work in this case may otherwise have been in the nature of repairs of a revenue nature. If the work had been limited to these repairs, the expenditure is unlikely to have involved essential initial repairs, even though the need for repair (borer damage) arose before Tina acquired the property. The work would not have been required at the time Tina acquired it in order to restore and maintain the required functionality of the property essential for her intended use.

However, all the expenditure, including any expenditure that would otherwise have been for deductible repairs, is capital in nature because it is part of an overall capital project that has altered the character of the property.

As such, the expenditure is capital in nature. The amount of the expenditure is not deductible because of the capital limitation in s DA 2(1). This would be the case regardless of whether Tina had carried out the work shortly after purchase or at some later date.

Accordingly, Tina's expenditure does not involve essential initial repairs but, despite this, still involves expenditure of a capital nature.

References | Tohutoro

Legislative references | Tohutoro whakatureture

Income Tax Act 2007: ss DA 1, DA 2(1), EB 1, EE 1(2)(c), EE 16(5), EE 37(2)(a), EE 67 "improvement", YA 1 "revenue account property"

Case references | Tohutoro kēhi

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About this document | Mō tēnei tuhinga

Questions we've been asked (QWBAs) are issued by the Tax Counsel Office. QWBAs answer specific tax questions we have been asked that may be of general interest to taxpayers. While they set out the Commissioner's considered views, QWBAs are not binding on the Commissioner. However, taxpayers can generally rely on them in determining their tax affairs. See further Status of Commissioner's advice (Commissioner's statement, Inland Revenue, December 2012). It is important to note that a general similarity between a taxpayer's circumstances and an example in a QWBA will not necessarily lead to the same tax result. Each case must be considered on its own facts.