

We've mailed this appendix separately in advance of the main Tax Information Bulletin, to get the depreciation information to you as soon as possible. We will post the main TIB to you shortly.

Depreciation

Introduction - why the Government introduced the new provisions

A new depreciation regime was introduced on the recommendation of the Valabh Committee (a private sector Consultative Committee).

There are now new economic depreciation rates, which result from a comprehensive review which Inland Revenue carried out. This review included an extensive mail survey, interviews with businesses and reports from registered valuers.

The new rates are intended to:

- Achieve fairness between different industries
- Provide descriptions of asset classes which are sufficiently detailed to be relevant to each particular industry

Application dates

The new rates can be used for assets acquired on or after 1 April 1993.

However you can choose the new rates or the existing depreciation rates for assets you acquire in the next two years.

Depreciation on new assets acquired in the 1995-96 income year, and future income years, will generally be calculated using the new rates plus a 20% loading. Depreciation on used assets acquired from the 1995-96 income year onwards will be calculated using the new rates with no loading.

Summary of contents

Part One of this TIB appendix explains how depreciation works and the methods available. It also gives details about specific property and circumstances.

Part Two sets out the rates to be used for assets you acquired before 1 April 1993.

Part Three explains the rules relating to assets acquired during the two year transitional period.

Part Four lists the rates to be used for calculating depreciation in the 1995-96 and future income years.

When you calculate your depreciation deduction it is important to remember that the date you acquired an asset determines which rates are available to you.

This appendix provides a general guide to depreciation. For a comprehensive guide to the legislation of the new depreciation regime as enacted by the Income Tax Amendment Act 1993, see the main part of TIB Volume Four, No.9.

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Part One - How depreciation works

Chapter One - General

1.1 What depreciation is

Depreciation is an allowance for tax purposes, to take account of the fact that assets used in a business eventually wear out or become out of date, even though they are maintained and repaired. This reducing value of assets is recognised for tax purposes by allowing a deduction against income for depreciation for the time the assets are used in a business.

From the 1993-94 income year how much depreciation can be claimed, and which assets qualify, is determined by law. When the property is sold or disposed of, generally the difference (if any), between the sale price and the adjusted tax value is either a gain or a loss. This difference has to be accounted for in the year of disposal.

1.2 Assets that cannot be depreciated

To claim a depreciation deduction on an asset, you must own it (or lease it under a specified lease - see section 5.2), and it must decline in value while you use it or have it available for use in your business.

Some assets cannot be depreciated for tax purposes, and the reducing value of some other assets is calculated in a special way. These assets include:

- trading stock
- land
- financial arrangements under the accrual rules
- goodwill.

Until now intangible assets such as the right to use a trademark could not be depreciated. The rules for these types of assets have changed, as section 5.3 explains.

1.3 Records that you need to keep

As with all tax matters you must keep good records of the purchase and sale of your business assets so that Inland Revenue can check that your deductions.

You must keep your records for at least seven years unless you have approval from Inland Revenue to keep them for a shorter time.

1.4 GST implications

If you are not registered for GST, you base your depreciation on the actual price you pay for an asset, including the GST component.

If you are registered for GST, you can claim the GST component of an asset's cost price as an input tax deduction. In this case you claim depreciation on the GST-exclusive price that you actually paid for the asset.

Chapter Two - Depreciation methods

2.1 Available methods

There are three ways you can depreciate property; diminishing value, straight line and the pool method.

From the 1993-94 income year onwards, depending on the type of property and its value, you may choose the method which best suits your circumstances and property.

Before the 1993-94 income year, the method and rate you must use for a particular asset are shown in section 7.2 by the rate highlighted in the appropriate column.

2.2 Diminishing value method

Using this method means that depreciation is calculated each year by using a constant percentage of the property's adjusted tax value. This way your depreciation deduction progressively reduces each year.

Example

Your office equipment cost \$10,000 and the diminishing value depreciation rate is 33%.

	adjusted tax value at beginning of year	depreciation
Year 1	\$10,000	\$3,300
Year 2	\$ 6,700	\$2,211
Year 3	\$ 4,489	\$1,481

2.3 Straight line method

This is when a constant percentage of the cost of the asset is deducted each year from its adjusted tax value. This method is sometimes referred to as the cost price basis. The amount of depreciation claimed is the same each year.

Example

For the same asset as in the above example, using the equivalent straight line depreciation rate of 24%, the depreciation is calculated as follows:

	adjusted tax value at beginning of year	depreciation
Year 1	\$10,000	\$2,400
Year 2	\$ 7,600	\$2,400
Year 3	\$ 5,200	\$2,400

2.4 Pool method

The pool method allows a number of low-value assets to be grouped together (or pooled) and depreciated. Pooling is available for the 1993-94 income year onwards. Buildings cannot be pooled.

To pool property the following criteria must be satisfied:

(i) Value - the pooled asset must have a value equal to or less than the "maximum pooling value". This is currently set at \$2,000. Assets which meet this criteria are:

- those which individually cost you \$2,000 or less, or
- those which have been depreciated and their adjusted tax value has been reduced to \$2,000 or less.

You can apply to Inland Revenue for a greater maximum to be set. When deciding whether to allow a greater maximum, we will consider these things:

- whether the particular asset is similar to the other assets it would be pooled with
- whether your compliance costs would be reduced by allowing this asset to be pooled
- how often you buy and sell those assets.

(ii) Assets in globo account - you may also pool assets which you depreciated in the 1992-93 income year using the "globo accounting method" (a similar method to the new pool method). This is regardless of whether their adjusted tax value exceeds \$2,000.

However if you decide to pool these assets, they must all be brought into the same pool. You will not be able to use the globo accounting method to depreciate assets from the 1993-94 income year onwards.

(iii) Business use - all assets in the pool must:

- be used 100% for business, or
- be subject to FBT if their business use is less than 100%.

If your assets (excluding buildings) meet these requirements, you may pool any number of them and you may have as many pools as suit your circumstances and assets.

Each pool is depreciated at a single rate using the diminishing value method. Because you must use the lowest single rate applying to any asset in the pool, you may decide it's best to only group assets with the same or similar depreciation rates. You can combine several pools at any time.

However once you include an asset in a pool you can't generally isolate it from that pool at a later stage (An exception to this is where an asset must be isolated from a pool because it is used privately - see section 4.12 for more information).

2.5 Changing methods

From the 1993-94 income year you can change the method you use to calculate depreciation of your assets from year to year, except when the asset is included in a pool. You may group any assets which have been

depreciated using the straight line or diminishing value method to form a pool, or add them to an existing pool in any year, provided they meet the pool criteria.

From the 1993-94 income year onwards you have the choice each year between using the straight line or diminishing value methods for non-pooled assets, regardless of when you bought them. However, once you've filed your tax return you can't change methods for that income year.

When you change calculation methods, the value that you calculate depreciation on is the current adjusted tax value, not the original cost price of the asset.

2.6 Converting rates for assets owned before 1 April 1993

If you decide to switch from the diminishing value method to the straight line method (or vice versa) for assets owned before 1 April 1993, use the chart below. You can also use this chart to convert a special rate from diminishing value to straight line (or vice versa). Select the nearest rate in the column for the method used previously. The other column gives the rate for the alternative method.

Conversions for diminishing value and straight line rates - assets owned before 1 April 1993

DV %	SL %	DV %	SL %	DV %	SL %	DV %	SL %
1	1	17.5	12	32.5	23	48	36.5
2	1.5	18	12.5	33	24	48.5	37
2.5	2	19	13	34	24.5	49	39
3	2.5	20	13.5	34.5	25	50	40
4	3	20.5	14	35	25.5	50.5	41
5	3.5	21	14.5	36	26	51	42
6	4	21.5	15	37	27	52	43.5
7	5	22	15.5	38	27.5	53	44
7.5	5.5	23	16	39	28	54	45
8	6	24	16.5	39.5	29	55	45.5
9.5	6.5	24.5	17	40	30	56	46
10	7	25	17.5	41	31	57	47
11	7.5	26	18	42	32	58	47.5
12	8	27	18.5	43	32.5	60	48
13	8.5	27.5	19	44	33	61	49
13.5	9	28	19.5	45	33.5	62	50
14	9.5	28.5	20	45.5	34	63	51
15	10	29	20.5	46	34.5	63.5	63.5
16	10.5	30	21	46.5	35	64	64
16.5	11	31	22	47	35.5	DV = SL to 100%	
17	11.5	32	22.5	47.5	36		

2.7 Converting rates for assets acquired between 31 March 1993 and the end of the 1994-95 income year

The following chart shows the conversions for assets acquired after 31 March 1993, for switching between methods. There are fewer rates because the general rates are grouped into bands.

You cannot use this chart for converting special rates; use the chart in section 2.6 for this.

Conversions for diminishing value and straight line rates - assets acquired after 1 April 1993

Banded DV dep'n rate %	Banded SL dep'n rate %	Banded DV dep'n rate %	Banded SL dep'n rate %
2	1.5	22	15.5
4	3	26	18
6	4	33	24
7.5	5.5	40	30
9.5	6.5	50	40
12	8	63.5	63.5
15	10	100	100
18	12.5		

2.8 Calculating depreciation under the pool method

Depreciation is calculated on the average of the value of the pool for the income year, using the diminishing value rate.

To average the value of the pool, add together the values at the beginning and at the end of the income year (before deducting depreciation) and divide by two.

Example

You have a pool of assets with an adjusted tax value at the beginning of the year of \$18,000. During the year you purchase 3 assets for \$2,000 each and include these in the pool. The value of the pool at the end of the income year (before deducting depreciation) is \$24,000. The pool value is:

$$\frac{\$18,000 + \$24,000}{2} = 21,000$$

The depreciation deduction is calculated as follows, assuming a diminishing value rate of 22%:

average pool value \$21,000
 @ 22% DV = \$ 4,620
 adjusted tax value of pool \$16,380

Where you create a pool during an income year (for example when you start business) the annual depreciation is reduced to the number of whole or part calendar months the pool existed.

Example

Using the example above, if you started business on 15 May 1995 and assuming a 31 March balance date, the depreciation deduction would be calculated as follows:

$$\$4,620 \times \frac{11}{12} = \$4,235$$

When the assets in the pool have different depreciation rates the lowest rate is to be used.

This situation could occur when a variety of assets are included in a pool, for example the assets of a shop.

Cash register	33%
Electric sign	18%
Fittings	18%
Furniture	18%

The rate for this pool is 18%.

In a case such as this, you may decide to pool only those assets with the 18% depreciation rate and depreciate the cash register separately or as an asset in another pool.

Another situation when this could happen is when the depreciation rate changes, for example, selected assets at an amusement arcade.

Billiard tables purchased 30 June 1990	10%
Billiard tables purchased 31 December 1993	15%

The rate for this pool is 10%.

Because of the different rates, you may decide not to group the new tables into the existing pool, but to create a new pool for them.

Chapter Three - Depreciation rates

3.1 How rates are calculated

Depreciation rates for assets are set by Inland Revenue. From 1 April 1993, the basis for calculating the diminishing value depreciation rate is set out in the formula below.

Where it is appropriate, a single depreciation rate has been set for similar types of assets to simplify the calculation of depreciation. Once the rates are calculated they are rounded up or down to the nearest band.

The bands are shown in the chart in section 2.7 in the previous column.

The depreciation formula is:

$$1 - \frac{\text{residual value}}{\text{cost}}^{\frac{1}{n}}$$

where "n" in the exponent is the estimated useful life in years.

The estimated useful life of an asset is the time over which the asset might be expected to be useful in earning income. This time is calculated taking into account wear and tear, exhaustion and technological, market and legal obsolescence.

The estimate takes into account the period the asset is used by all its New Zealand business owners.

Example

You buy a brand new piece of equipment but it's your usual practice to sell that type of equipment after you've used it for three years. However the business that buys it from you second-hand might use it for a further five years after which time it is scrapped. If this is typical of that type of equipment then the estimated useful life of this asset is eight years.

The useful life for each asset-type has been determined after studying and averaging various asset profiles of all business users. It is listed with the economic rates in section 10.5

3.2 Residual value

The residual value is the greater of an estimate of an asset's market value at the end of its estimated useful life or 13.5% of the cost.

To estimate this value we assume that normal and reasonable maintenance is carried out on the asset during its use.

3.3 What rate to use

The correct depreciation rate to use is largely dependent on when you acquired the asset.

- assets acquired before 1 April 1993 - Part Two of this appendix gives the rates for these assets
- assets acquired after 31 March 1993 and before the end of your 1994-95 income year - Part Three explains your options in choosing a rate
- assets acquired during your 1995-96 and future income years - Part Four explains the rules and lists the rates for these assets.

3.4 Special rates

General depreciation rates have been calculated by taking into account the way assets are normally used. For example, the general rate for certain manufacturing machinery, which is normally used in two or three shifts a day, has been set to reflect this heavier usage.

If you believe that something you own is used more heavily than is usual, you may apply in writing to Inland Revenue for a special rate.

When calculating a special rate, Inland Revenue will use the formula in section 3.1 and take into consideration the depreciation rate used for that asset in your own financial reporting.

We will only set a special rate when the special rate calculated comes at least half way between the banded rates set out in the chart in section 2.7.

Example

A taxpayer applies for a special rate for an asset which ordinarily has a diminishing value depreciation rate of 18%. As the next banded rate is 22% (i.e., 4 points difference), to have a special rate set, the calculation must result in a rate of 20% or more (i.e. 2 points or more).

Where you've had a diminishing rate special rate set and you choose to convert it to the straight line method (or vice versa), use the chart in section 2.6 to convert the rate.

If you wish to apply for a special rate we will need this information in order to consider and calculate a special rate:

- reason(s) for the request for a special rate
- a description of the asset, including literature, pamphlets etc
- the cost of asset
- in what industry the asset is used, how it is to be used and the amount of use it will have
- the estimated useful life of the asset (see section 3.1 for more information about this.)
- the estimated residual value (see section 3.2 for more information about this.)
- the asset's depreciation rate used for your own financial reporting

An application form will be available from Inland Revenue towards the end of May 1993.

Inland Revenue will review the application and advise you within six months:

- whether the special rate you have applied for has been accepted
- whether a different rate has been determined
- whether your application for a special rate has been declined.

If we decline an application you have objection rights. See section 3.6 for more information.

When a special rate has been set because of particular circumstances and those circumstances change or cease to exist, Inland Revenue may withdraw the special rate.

3.5 Provisional rates

Where an economic depreciation rate is not set for an asset you may apply for a provisional rate to be set. This could be necessary when an asset has been newly invented, or it has not been used in New Zealand before and it does not fit well with an existing asset description. In these cases, you may apply for a provisional rate to be set.

Provisional rates are applied for and calculated in the same way as special rates. See the previous section for details.

The provisional rate will lapse once a general rate is set for a particular asset.

3.6 If we decline your application for a special or provisional rate

Inland Revenue will decline an application for a special rate when

- the rate calculated is too close to the general rate (as explained in section 3.4)
- The general rate is under review
- You have not supplied enough information.

We will decline an application for a provisional rate when:

- a general rate applying to the asset already exists
- a general rate is in the process of being set
- you have not supplied enough information.

You may object when Inland Revenue:

- declines to set a special or provisional rate
- revokes a special or provisional rate
- sets a special or provisional rate you don't agree with.

If you want to object you may find the booklet "Objection Procedures" (IR 266) useful since the objection procedures for income tax assessments are much the same as objecting to special or provisional rate decisions.

Chapter Four - Adjustments

4.1 How to calculate depreciation when you first acquire an asset

When either the straight line or diminishing value methods are used, depreciation can be claimed for each calendar month or part month the property is owned.

Example

You buy an asset on 27 January 1994 for \$7,000. Assuming a 31 March balance date, the 1993-94 depreciation deduction, using diminishing value rate of 22% is calculated:

$$22\% \times \$7,000 \times \frac{3 \text{ months}}{12 \text{ months}} = \$385$$

Even though the asset was owned for only a few days in January depreciation for the entire month can be claimed.

4.2 When private assets become business assets

Where a private asset becomes a business asset after the beginning of the 1993-94 income year, the value on which depreciation is first calculated is the market value of that asset at the time it is introduced into the business.

Example

You purchased a personal computer for \$5,000 in 1993. In October 1995 you begin to use this full time in your business. The market value of the computer in October 1995 is \$3,200. This is the value on which depreciation will be calculated in your 1995-96 income tax return.

This rule does not apply to buildings.

Sections 4.10 and 4.11 covers the situation where assets are used privately and in business.

4.3 When assets are added to a pool

When an asset is added to an existing pool, the adjusted tax value of the pool is increased by

- the cost price of the asset (if it's newly acquired), or
- the adjusted tax value of the asset (if it was previously accounted for separately).

The value of the additions is therefore taken into the calculations of the average pool value for the year.

4.4 When you dispose of assets

When you sell or dispose of an asset (other than a pooled asset) for an amount different from its adjusted tax value, you must make an adjustment to account for the loss or gain. You cannot claim a deduction for depreciation in the year you dispose of an asset, except for buildings.

Costs incurred in selling an asset, such as commission and advertising, can be deducted from the sale price before you work out the loss or gain on sale.

The adjustment is generally made in the year of sale or disposal, except when the disposal is because business has ceased. Section 4.8 deals with depreciation when a business ceases.

When a group of business assets is sold for a lump sum, Inland Revenue may determine the sale price for an individual asset included in the group. This determination will usually be based on an apportionment of the sale price between the assets as agreed upon by the seller and buyer, or it may be based on an independent valuation.

4.5 When you make a loss on disposal

When an asset is sold or disposed of (e.g. discarded through obsolescence) for an amount less than its adjusted tax value, the difference is allowed as a deduction in the income year of sale or disposal. This does not apply to buildings.

If an asset is sold for less than its market value Inland Revenue can fix the sale price as the market value of the asset. Situations when this may occur is when you sell an asset to someone close to you or your business (for example, to a relative of a shareholder of the company).

In this situation, the actual sale price may be ignored and the calculations made as if the property was sold for its market value.

4.6 When you make a gain on a sale

If you sell an asset for an amount greater than its adjusted tax value, the depreciation recovered on sale is assessable income in the year of sale.

If the sale price is greater than the original cost price, the excess is a capital gain and is not taxable.

Example

Purchase price	\$15,000
Depreciation allowed as a deduction	<u>\$ 3,000</u>
Adjusted tax value	\$12,000
Asset sold for	<u>\$16,000</u>
Total gain on sale	\$ 4,000
Dep'n recovered - assessable income	<u>\$ 3,000</u>
Capital gain - exempt	\$ 1,000

There is an exception to this in relation to pool property, see section 4.7.

4.7 When you dispose of pooled assets

When you dispose of pooled assets, the sale price must be deducted from the adjusted tax value of the pool before calculating depreciation for the next pool period. If the asset is dumped or lost the adjusted tax value of the pool is not reduced.

Where deducting the sale price from the adjusted tax value of the pool makes the adjusted tax value negative, the balance will be treated as depreciation recovered and assessable income.

The adjusted tax value of the pool will then be nil, and no further depreciation deductions will be allowed until new assets are added to the pool.

Example

20 assets in the pool, adjusted tax value of pool on 30/9/94 =	\$34,000
15 assets sold on 30/10/94 for total of	<u>\$36,000</u>
Depreciation recovered (This will be assessable income in 1994-95 income year)	\$ 2,000
Adjusted tax value of pool on 31/3/95 (although 5 assets still remain in the pool)	nil

Once they are pooled, assets lose their individual identity, so any capital gain made on the sale of pool property cannot be separated from depreciation recovered. The entire proceeds of any sale of pool assets must be accounted for, and any gains are assessable income.

Therefore, it may be a disadvantage to pool any asset which may subsequently be sold for more than its original purchase price.

When all the assets in a pool are sold and the sale proceeds are less than the pool's adjusted tax value, the balance is deductible.

Example

Adjusted tax value	\$34,000
All assets sold for	<u>\$26,000</u>
Additional tax deduction	\$ 8,000

4.8 When you cease business

When you cease business and the business property is not sold immediately or is kept for private use, the loss or gain must be accounted for using the market value of the asset as at the beginning of the next income year.

The adjustment is made to the income tax return for the year after the business ceased, even where the loss or gain is not realised until a later income year.

4.9 If assets are lost or damaged

You must take into account any insurance proceeds, indemnity damages or compensation payments you receive when assets are lost, destroyed or damaged.

When an asset is damaged, and the insurance or other payments exceed the cost of repair, the excess must be deducted from the asset's adjusted tax value.

An asset which is irreparably damaged is treated for depreciation purposes as though it were sold. The loss or gain on disposal is calculated by taking into account the adjusted tax value of the asset and the amount of the insurance or other payment.

In most cases, fire and general insurance payments that a GST-registered person receives are subject to GST. In these cases, the GST component (that is, one ninth of the insurance receipt) is excluded when calculating the loss or gain.

4.10 Private use of motor vehicles

When a motor vehicle is used for non-business purposes, and that use is subject to FBT, there is no requirement to adjust the depreciation deduction to exclude the private use. This is because FBT is itself an apportionment mechanism.

However, self-employed people (including partners of partnerships) who use a business vehicle for private purposes must apportion the vehicle depreciation between deductible and non-deductible. The method used to calculate the apportionment for depreciation is the same applying to vehicle running costs. When an accurate and complete vehicle log book is kept, a factual apportionment can be made. Alternatively you may keep a record for 3 months to establish an apportionment which may then be used for three years, provided the business use of the vehicle does not change by more than 20%.

Example

A self-employed salesperson's car is used 85% for business purposes. The adjusted tax value at the beginning of the income year is \$18,000 and it is used for business during the entire year. Assuming a depreciation rate of 26% the calculations are:

Total dep'n	\$18,000 x 26% x 12/12	=	\$4,680
Deductible dep'n	\$4,680 x 85%	=	\$3,978

The adjusted tax value at the end of the income year is \$13,320, since the total depreciation must be taken into account, not just the deductible proportion.

When a vehicle which has been used privately is sold, and either depreciation is recovered, or a loss is made on sale, an apportionment is necessary to exclude the private element.

Example

If the vehicle in the example above is sold for \$15,000 the calculations are:

Adjusted tax value	\$13,320
Sale price	<u>\$15,000</u>
Depreciation recovered	\$ 1,680
Apportionment for private use (\$1,680 x 15%)	<u>\$ 252</u>
Assessable income	\$ 1,428

4.11 Private use of other business assets

For working out the business use in relation to private use of assets other than motor vehicles, the type of measurement used will depend on the asset and the circumstances.

The more common measurements are square metres for buildings, and time (i.e., hours, days, months) for assets used periodically.

However any appropriate method can be used as long as it accurately calculates the apportionment.

Example

You use your house for business purposes as well as living in it. By calculating the area used for business in relation to the total area of the house, you work out that the use is 20% business and 80% private. Assuming the cost price is \$150,000 and the straight line depreciation rate is 3%:

	Adjusted tax value at start of year	Annual depreciation	Adjustment for private use	Allowable deduction
Year 1	\$150,000	\$4,500	\$3,600	\$900
Year 2	\$145,500	\$4,500	\$3,600	\$900
Year 3	\$141,000	\$4,500	\$3,600	\$900

Assets which are used privately cannot be pooled.

4.12 When pool property is used privately

Where an asset stops meeting the 100% business test after it has been pooled, it must be isolated from the pool.

At the time the asset is first used privately, for depreciation purposes it is to be treated as though it was bought and sold for market value.

Example

A pool with an adjusted tax value at 1 April 1994 of \$18,000 includes an asset which on 5 December 1994 you start using for private purposes 20% of the time. The market value of the asset on 5 December 1994 is \$1,500

(i) Pool depreciation	
value at beginning	\$18,000
value at end (\$18,000 less deemed sale at \$1,500)	<u>\$16,500</u>
	\$34,500
average pool value (divide by 2) =	\$17,250
assuming a rate of 22%, depreciation on the pool for the year will be:	\$3,795

(ii) Depreciating ex-pool asset separately, assuming a depreciation rate of 22%

$$\$1,500 \times 22\% \times \frac{4 \text{ months}^*}{12 \text{ months}} = \$110$$

* (number of months from December 1995 to March 1996)

total depreciation	\$110
less 20% personal use	<u>\$ 22</u>
deductible depreciation	<u>\$ 88</u>
total depreciation for 1995-96 income year	\$3,883

Chapter Five - Special rules for some assets

5.1 Buildings

(i) Land and buildings

Depreciation cannot be claimed on land. Where land and buildings are purchased and the price does not specify the cost of the buildings, the Government Valuation may be used for apportionment purposes as follows:

$$\frac{\text{Value of improvements}}{\text{Capital value}} \times \text{Purchase price}$$

(ii) Sale of buildings

When a building is sold after 28 July 1988 for more than its adjusted tax value, the depreciation recovered is assessable income. The recovery is the smaller of:

- The original cost price of the building, less the adjusted tax value
- The sale price, less the adjusted tax value.

This ensures that any capital profit made on the sale of a building is not included as assessable income.

Losses made on the sale or disposal of buildings are not deductible.

5.2 Leased assets

(i) Specified leases

A specified lease is a lease agreement which was entered into after 5 August, 1982, and which meets certain tests.

The main test is that under the lease agreement the ownership of the asset passes to the lessee.

With these types of leases, the lessee is treated as the owner and is entitled to the deduction for depreciation. Depreciation is based on the cost price of the asset to the lessor. When the lease is terminated the deemed sale price is largely dependent on the terms of the lease.

(ii) Non-specified lease

When the lease is not a specified lease, the owner (lessor) of the asset claims the deduction for depreciation.

5.3 Intangible assets

Certain intangible assets created or purchased on or after 1 April, 1993, now qualify for an annual depreciation deduction.

Intangible assets which qualify for a depreciation deduction are:

- Patents
- The right to use land
- The right to use plant and machinery
- The use of or right to use a copyright, trademark, design or model, plan, secret formula, process, or other like property
- Software (see section 5.4).

The method of calculating depreciation for intangible assets depends on whether they are fixed life intangible property or economic life intangible property.

Fixed life intangible property is intangible property whose life is limited by law or by contract to a number of years or months, and this period is expected to be the same as the estimated useful life of the property.

The owner must use the straight line method to calculate depreciation. This means that the cost can be claimed evenly over the life of the asset. To calculate the straight line rate, divide 1 by the number of years (and part year, if applicable) and convert to a percentage.

Example

Life of asset is 30 months

$$\frac{1}{2.5 \text{ years}} = .4 \text{ or } 40\%$$

If a right to use a trademark is purchased for \$5,000 for a thirty month period commencing

1 August 1994, the depreciation is calculated as follows (assuming a 31 March balance date):

Year ended 31 March 1995	
40% x \$5,000 x 8/12 months =	\$1,333
Year ended 31 March 1996	
40% x \$5,000 x 12 months =	\$2,000
Year ended 31 March 1997	
40% x \$5,000 x 10/12 months =	<u>\$1,667</u>
Total depreciation over life of asset	<u>\$5,000</u>

For economic life intangible property (such as computer software), Inland Revenue will set a diminishing value rate (which can be converted to a straight line rate).

5.4 Computer software

Inland Revenue has been allowing an immediate deduction for the development of computer software. However, we now consider that some software is an asset which should be depreciated. It is proposed that from 1 July 1993 the following be capitalised and depreciated:

- Software purchases, including the right to use software
- Upgrading software to a new version
- Developing software "in house".

The depreciation rates proposed for software are a diminishing value rate of 40%, and straight line rate of 30% based on a life of four years.

The final policy has not yet been announced.

5.5 Loose tools

Loose tools means consumable items of the type that are left on the shelf or in a chest when not in use. It does not include electrical test equipment or specialised items or gauges.

(i) 1992-93 income year and earlier

The cost of the basic stock of loose tools and any additions to it was not deductible nor depreciable. Where a loose tool was replaced, the cost up to a maximum of \$250 for any one item was allowed as a deduction in the year of purchase. Depreciation could be claimed on items costing more than \$250.

(ii) 1993-94 income year onwards

With the introduction of the new depreciation rules the treatment explained above no longer applies. Purchases of loose tools in the 1993-94 income year and onwards are to be treated in the same way as other asset purchases. For loose tools costing \$200 or less see section 5.6. Loose tools which cost more than \$200 must be depreciated. The pool method (as described in section 2.4) is a particularly suitable method to use for these assets, although you may depreciate them individually.

The book value of loose tools purchased before 1 April 1993 can be brought into the pool or depreciated separately.

Where the cost of a replacement item has been allowed as a deduction and that item is later sold, the sale price, up to the amount of the original cost, is assessable income in the year of sale.

5.6 Assets costing \$200 or less

From the 1993-94 income year onwards the cost of assets acquired for \$200 or less may be claimed as a deduction provided that:

- they are not purchased from the same supplier at the same time as other assets to which the same depreciation rate applies (unless the entire purchase costs less than \$200)
- the assets will not become part of property that is depreciable (for example, expenditure on materials to build a wall in a factory)

- the cost of those assets is not specifically deductible.

Where any property for which this deduction has been claimed is later sold, the entire sale proceeds are assessable in the year of sale.

5.7 Assets which can no longer be used

Where you have an asset which you can no longer use, you can apply to Inland Revenue to have the adjusted tax value written off as a deduction.

To qualify for this write-off the cost of disposing of the asset must be greater than the price you would get if you sold it.

Inland Revenue will also consider whether the asset could be used by someone else in a business.

If we give approval for the adjusted tax value of the asset to be written off and you later sell the asset, the sale price up to the original cost is assessable income in the year of sale.

Part Two - Assets Acquired before 1 April 1993

Chapter Six - Assets acquired before 1 April 1993

6.1 Rates applying

The rates listed in section 7.2 apply to assets which you owned on or before 31 March 1993.

The highlighted rate indicates the method that is to be used to calculate depreciation for the 1992-93 and earlier income years. From 1 April 1993 you may choose to depreciate the asset using an alternative method. Section 2.6 explains how to convert a rate from the diminishing value method to the straight line method, or vice versa.

6.2 Assets acquired between 16 December 1991 and 31 March 1993

A depreciation rate with a 25% loading applies to assets which meet certain criteria. These special rules came about as an interim measure before the full review of depreciation was completed.

To qualify for the 25% loading the assets must either be new assets never used in New Zealand or imported second-hand assets used in New Zealand for the first time, and:

- acquired between 16 December 1991 and 31 March 1993 (inclusive) and
- used on or before 31 March 1994.

The 25% loading does not apply to buildings or to imported used cars.

The increased depreciation rate applies for every income year the asset is owned and used in business.

Each year from the 1993-94 income year onwards you can choose between the straight line and diminishing

value methods. If switching from one method to the other, convert the ordinary depreciation rate first (i.e. without the 25% loading) using the chart in section 2.6 and then add 25%.

Example

Ordinary rate	10% DV
Convert to Straight Line	7%
Add 25%	1.8%
Straight line rate with 25% loading	8.8%

The rates incorporating the 25% loading where applicable are listed in section 7.2 (columns 2 and 4).

6.3 Shift incentive

Plant and machinery purchased before 1 April 1993 which is used in two or three shift operations qualifies for an increased depreciation rate.

This incentive applies to new and second-hand plant and machinery and is available each year for the first five income years it is owned.

Some assets are excluded from this incentive and these include:

- Motor cars, taxis, rental cars, ships, aircraft
- Loose tools and similar items
- Plant and machinery used in petroleum refining and aluminium smelting
- Plant and machinery operating 16-24 hours a day for which a higher than normal depreciation rate has not been fixed. This means that plant designed to operate continuously, such as refrigerators, lifts and boilers are excluded from the incentive.

The incentive is calculated:

- 2 shifts (i.e. average of 16 hours each working day)
= ordinary depreciation plus additional 3% DV.
- 3 shifts (i.e. normally used for 24 hours each working day)
= ordinary depreciation plus additional 6% DV.

Example

	DV	SL
General plant and machinery rate	10%	7%
Qualifying for 2 shift incentive	13%	9.5%
Qualifying for 3 shift incentive	16%	11%

When plant or machinery qualifies for the 25% loading, as explained in section 6.2., the shift incentive is added to the depreciation rate, including the loading.

Example

	DV	SL
General plant & machinery rate	10%	7%
Including the 25% loading	12.5%	8.8%
Qualifying for 2 shift incentive	15.5%	11.3%
Qualifying for 3 shift incentive	18.5%	12.8%

Chapter Seven - Rates

7.1 Using the schedule

Column 1 shows the diminishing value (DV) rate.

Column 2 shows the DV rate including the 25% loading where applicable (see section 6.2 for details).

Column 3 shows the straight line (SL) rate.

Column 4 shows the SL rate with the 25% loading where applicable (see section 6.2 for details).

SV means standard value. For specific assets a standard value has been negotiated with Inland Revenue. This value generally provides an average of the original cost.

***** means that you have the option of using the following methods:

- replacement value
- annual value
- standard value

Where you used one of these methods for depreciating your assets in the 1992-93 income year, to calculate depreciation for the 1993-94 and future income years you may:

- use the economic rates listed in section 10.5, or
- use the pool method as explained in section 2.4.

High-lighting indicates the method to be used for calculating depreciation for income years 1992-93 and earlier