IMPORTANT UPDATE

IRD stall on making changes to depreciation

In Feb 2007 IRD released the IS0064 discussion paper on depreciation. Since then IRD seem to have stalled. In my discussions with them I had been advised to expect a decision in June 2008 and there were rumblings that someone had mounted a legal challenge. It is now November and no changes have been confirmed so I thought it time to give you an update on what we do know…………oh and with Christmas approaching I thought it was timely to run a special promotion also.

Exposure draft ISOO64

This document was open for submissions from the public with submissions due on the 20th April 2007. This Exposure draft raised two areas of interest;

1. Whether where certain items in a residential rental property are distinct from the building can it be separately depreciated if it meets the definition of depreciable property. If an item is part of the building, can it be separately depreciated, or should it be depreciated with the building.

   The conclusion proposes that the following items should be considered as part of the building for depreciation of Residential Investment property and have the same depreciation rate applied as the building. "The plumbing and piping, electrical wiring, internal walls, internal and external doors, garage doors (when the garage is part of the residential rental building), wardrobes and cupboards (built into the wall), kitchen and bathroom cupboards, linoleum, and tiles (floor and wall) are not separate assets, but rather are part of the building."

2. What was intended by including the building fit-out (when in books separately from building cost) asset category?

   IRD considers the intent was that the meaning of building fit-out (when in books separately from building cost) requires some actual action of fitting out, as well as being in the books (i.e. it is something that is physically done, rather than just existing items being re-categorised). It is considered that what was intended by the words was that such expenditures made subsequent to the acquisition of the property were by the owner or a tenant. However, such assets that would properly be considered part of the building under the combined asset vs component assets approach could still not be separately depreciated under the legislation.

It has become clear upon discussion with accountants that some are applying these changes immediately but many will apply the changes upon confirmation of exact details from IRD. To assist we have made several changes to the report including the following:

- Reintroduction of published IRD depreciation rates,
- Details of IRD depreciation categories for each asset
- Revised breakdown showing items IRD have indicated would be included with the Building
- Reports are now emailed and House reports include an excel spreadsheet of the assets and rates

Valuit also recommends prior to any person submitting a tax return that professional advice from an accountant be sought in relation to the IRD's stance on residential depreciation at the time of submitting their tax return.

Assuming as a worst case scenario the exposure draft was to go ahead in its entirety, we foresee the following changes

- Some items in residential rental properties will be classified as part of the building for depreciation. Items indicated are; plumbing/piping, electrical wiring, internal walls, internal/external doors, wardrobes/cupboards (built into the wall), bathroom and kitchen cupboards, linoleum, and wall and floor tiles

- The “building fit-out” category may be deemed to only allow for separation of these assets if purchased separately to the building.

- Additional items such as fences and clotheslines etc that are common with residential property and do not form part of the building may also be included in the “Residential Rental” depreciation category.

As the specialists in the area of depreciation apportionments we have done a large amount of analysis on the impact of the foreseen changes detailed above. On a worst case scenario it will result in approximately a 30% reduction in the depreciation claim. The 2005 budget changes that saw the rates for fixtures, fittings and chattels increase has gone some way to reducing the impact a little.

There are still considerable benefits to cash-flow for property investors in claiming the depreciation they are entitled to.

I have put a calculator on our website that estimates the depreciation levels on a worst case scenario so check it out. www.valuit.co.nz

EXAMPLE - *Worst case*

Purchase Price:	$350,000
Age:	15 years
Land Value :	$180,000

Year one depreciation	
With apportionment:	$7,416
Without apportionment:	$5,040
ADDITIONAL	**$2,376**

Over 5 years close to $8,000 additional depreciation is claimed, this does still have positive benefits on an investor’s cash-flow!

Remember a detailed breakdown can also help to minimise recovery.

I hope this is of help to you. If you have any questions please feel free to email me at steve.t@valuit.co.nz

Steven Tucker
Managing Director
Valuit Asset Appraisals Limited