BUDGET 2010 Update

Well, what a day!!! To be sitting at a café yesterday debating the possible budget changes to last night, reflecting on the changes and today handling a barrage of calls and emails. We have the answers and yet the media got it wrong, it is not until today that they seem to be giving some clarity.

Last night, Budget Day, the media comment in summary was "Depreciation, here today gone tomorrow" In reality it is a very different storey. The media often takes a holistic approach which is fine for the majority, but to investors the details of the story is key!

Overall we're very very happy! We think it is the best possible budget investors could have hoped for given the commentary leading up to it. Yes a reduction in total depreciation claimable will result in changes to cash-flow, but the ring fencing of losses, which has not been introduced, would have been far more detrimental!!!!!!

What frustrates us the most is the media portrayal that as an investor you can no longer claim depreciation - this is rubbish! You can still claim depreciation on anything that the IRD deems is not part of the building. For those of us with 31 March tax year end, the depreciation rate for buildings will reduce from 3% DV (Diminishing Value) to NIL from 1 April 2011. Most importantly, you still claim depreciation on the assets that the government agrees go down in value, namely the chattels and most fit-out items. There are a number of positives to be gained from this! Although investors will not get the cash-flow advantages they have been used to, new investors will not be faced with is the DEPRECIATION RECOVERY when they sell the property, meaning far less uncertainty come sale time..

For residential investors the path is now clear and we have every answer needed. A few weeks ago the IRD released an interpretation statement that clarifies what is "Buildings" and what is separately identifiable for depreciation purposes. The answer in summary is that the Structure, plumbing, plumbing fixtures, electrical reticulation, kitchen cabinets, non load bearing walls, tiles, vinyl and garage doors are considered by IRD to be part of the "Buildings" for depreciation purposes. From 1 April 2011 these items depreciate at 0% but almost everything else can be claimed at higher rates. Fantastic!

For commercial property however, there is still confusion. The interpretation statement that came out for residential does not apply in full to commercial. This was highlighted in the budget, with commentary that commercial property is now to undergo a review to determine what constitutes "Buildings", and what can be separately depreciated.

To us at Valuit, (specialists in providing investment property depreciation schedules), the key aspects of the budget are;

- The reduction of the depreciation rate for commercial and residential buildings from 3% to 0% (effective from start of next financial year) where they have a useful life of 50 years or more
  - CONS – reduction in cash-flow (Note, for the majority of investors most of the reduction should be countered by personal tax reductions)
  - PROS – you can still claim depreciation on most fit-out and all chattels.
  - PROS – you will not be faced with a large depreciation recovery bill when you sell, due to the excessive building depreciation you have claimed.
  - PROS – when it comes to asset protection, the potential depreciation recovery will not hinder your decision to protect your assets by transferring them to a trust.
- The income within an LAQC will be taxed as per a "Limited Partnership".
  - CONS – When making a profit the income will be taxed at the personal marginal tax rate, which may be higher than the company tax rate.
  - PROS – You can still utilise the losses you may have and reduce your personal tax rate. (Note the accounting requirements to do this may have now changed a little)

    There are a few other finer details here to be sorted!
- The 20% loading currently applied to new property has been removed for property purchased after budget day. Yes this will have an impact on the purchase of a new property but we think the key here is to reflect on why this loading was introduced - to incentivise business investment into new plant and machinery, and NOT to incentivise people to invest in new property.

Overall we think the budget has been very fair. It could have been worse and as always it could have been better. But from a depreciation perspective we think it has been OK.

The key for investors is to remember that despite the reduction in depreciation, most of this should be offset through tax rate reductions and some minor rents increases, but above all, make sure you are claiming the maximum depreciation you can! If you haven't yet had a split on your purchase price get it done now and make sure you are taking full advantage of our new taxation system.

Steve Tucker
Managing Director
Valuit – the depreciation specialists
www.valuit.co.nz