Yes, depreciation rules for Residential Property Investors will be changing.

Well Tuesday 23rd of May 2006 is a day I will remember for a while. Why? I fielded endless calls and enquiries after an email release from the Institute of Charted Accountants (ICANZ) alerted and subsequently confused people of possible changes to depreciation. Yes I think most of them then called me.

I was also confused after reading the email as it was a little unclear over the level of changes. The general understanding from the email has been that all items listed under "building fit-out" would be reduced to the building depreciation rate of 3%. This was not my understanding after communicating with ICANZ and IRD in recent weeks so I spent the day following up on this as well as taking enquiries.

At around 2pm I spoke with the "National Advisor of Technical Standards" from IRD and confirmed the following with him:

- He confirmed it will not be all items within the building Fit out category, only items that are permanently affixed to the structure such as Partitions, Electrical wiring, plumbing and vinyl flooring. There may also be a few other items. This is far more inline with what I was expecting.
- Official announcement from IRD is due some time this week.
- He also mentioned that the Issues paper prepared by Adjudications and Rulings in December 2005 will be turned into an Interpretation statement that can be expected in 4-6 weeks, with a couple of months to make comment. I was emailed a copy of this paper and within the conclusion of this it indicates the items that it proposes to reduce back to the Building rate of 3%. These are as follows;
    - "......that the 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 of a residential rental building are part of the building itself and cannot be depreciated as items which are separate from a building, and should instead be depreciated at the same rate as the building."

The negative

- It will mean a reduced depreciation claim in the early years of ownership and that means an initial reduced cash-flow benefit. Reducing the depreciation rate simply means it takes longer to get the full depreciation claim it does not remove all the benefit. The positives are far greater.

The positives

- We will have confidence in knowing IRD's stance and can continue to maximise depreciation.
- With recent changes to the depreciation rates, being transferred to "double declining" all of the depreciation on chattels has increased significantly which helps to counter the reduced cash-flow due to the new rules, i.e.carpets did have a 33% depreciation rate which has increased to 40%.
- It has been indicated that there will be no penalties imposed for investors that have been claming the higher rate of depreciation on items now clarified as Building Fit out. The investor will be able to reduce the depreciation rate on these items when they file their next tax return. For those investors currently under review by the IRD we believe they will be given the opportunity to take up the IRD's approach to settle the matter.
- There is still considerable cash-flow advantage for most investors when depreciation is maximised.

The following table illustrates the cash-flow advantages still to be had by maximising depreciation. Remember these are year one advantages only and the benefits to cash-flow are achieved for the life of the asset.

Price	$295,000	$455,000	$246,500 (cost to build, no land)	$445,000	$130,000
Age	4 Years	20 Years	New	New	20 Years
Floor Area	175m2	270m2	170m2	175m2	80m2
Location	West Auckland	Tawa, Wellington	Hamilton	West Auckland	Hawkes Bay
Depreciation in year one					
Without Apportionment	$5,400	$9,550	$7,380	$7,825	$3,300
With Appotionment	$8,300	$15,400	$18,000	$19,000	$5,200
INCREASED DEP WITH APPORTIONMENT	$2,900	$5,850	$10,620	$11,175	$1,900
Year One Cashflow advantage @39% tax rate	$957.00	$1,930.50	$3,504.60	$3,687.75	$627.00

In the meantime if your accountant mentions the email from ICANZ please forward this onto them. My accountant database is postal rather than email so I'm holding off contacting them until the announcement has been made by IRD later this week.

Note at this stage we do not have the above in writing from IRD as their official announcement has not yet been made. From conversation with IRD we expect these points to be noted.

I'll keep you informed

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Valuit - Specialists in depreciation