Reintroduction of depreciation deductions on commercial and industrial buildings

On 17 March 2020, the Government released an economic response package with the aim of assisting businesses following the Covid-19 outbreak. It was initially costed at $12.1 billion, which is equivalent to around 4% of New Zealand's annual GDP. The package has since been expanded to ensure it keeps up with the evolving impact the virus is having on the economy.

Of the numerous support measures, $2.1 billion is being allocated towards reinstating depreciation on commercial and industrial buildings, including hotels and motels, but excluding residential properties.

Before 2010, owners of residential, commercial and industrial property in New Zealand were able to claim a tax deduction for building depreciation. This was an important feature of property investment, as it enabled the investor to claim an annual expense reflecting the assumed deterioration of the building, thereby spreading the cost of buying and improving a building over its useful life.

Tax depreciation for buildings was removed in 2010 in conjunction with a number of other tax changes such as increasing the rate of GST and lowering the corporate tax rate. This was on the basis that (amongst other things) Treasury's analysis of QV data over the preceding 15 year period indicated that, on average, residential buildings in New Zealand, and arguably also commercial buildings, did not depreciate.

In 2018, the Tax Working Group observed the limitations of Treasury's 2010 analysis and concluded that:

- buildings do in fact depreciate and the international evidence is especially strong for industrial and commercial buildings;
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New Zealand is a clear outlier in the OECD in not allowing any depreciation deductions for commercial or industrial buildings, resulting in an effective marginal tax rate for ownership of these assets which is higher than in every other OECD country; and

- tax depreciation for commercial, industrial and multi-unit residential buildings should be reinstated at a 2% straight-line or 3% diminishing value rate.

The Government has now adopted this recommendation in respect of commercial and industrial buildings and, from 1 April 2020, these buildings are once again able to be depreciated, although at lower rates of 1.5% straight-line or 2% diminishing value. The capital cost of seismic strengthening is now depreciable – a matter which has been the subject of much debate over the last decade. These depreciation measures are being announced as permanent changes.

The depreciation deductions will assist hotel and motel owners impacted by the pandemic and building owners affected by reduced rental income. The intention is to encourage investment in new and existing buildings and improve business confidence. While this might be difficult to achieve in the short term, those with a longer investment horizon should benefit from the return to depreciation allowances which make this asset class a more tax efficient investment than many others.

On 15 April 2020, the Government announced further tax changes which will apply to small to medium enterprises (SMEs) only. These include:

- a loss carry-back scheme which allows SMEs which experience losses in either the 2020 or 2021 tax year to carry the loss back and offset against profits in the preceding tax year (estimated to cost $3.1 billion over the next two years); and

- relaxing the tax loss continuity rules so that SMEs which experience a change in ownership of greater than 51% do not have to forgo their tax losses, as previously required, and can use these to offset profits in later years (estimated to save SMEs $60 million per year).