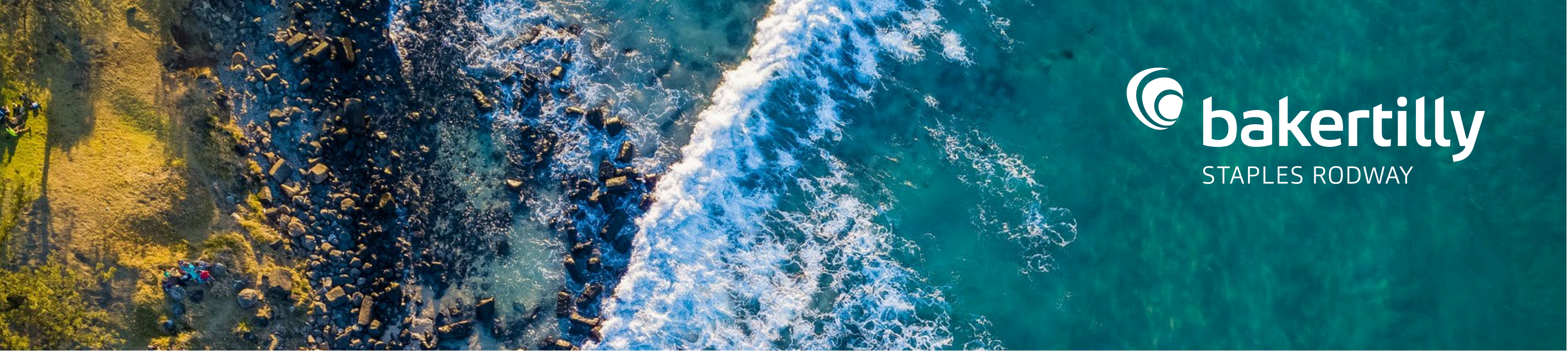


Removal of tax depreciation on commercial and industrial buildings – accounting impacts

This Information Sheet outlines the accounting impacts of the removal of tax depreciation deductions on commercial and industrial buildings. The impact could be significant for some entities, with particular consideration required for those reporting in accordance with NZ International Financial Reporting Standards (NZ IFRS) or Public Benefit Entity Standards (Tier 1 and 2), It is therefore important to ensure that you account correctly for the changes.

Introduction

From 1 April 2024, tax depreciation deductions on commercial buildings will again be at 0%. The ability to claim depreciation for income tax purposes was removed in 2010 and then reinstated in 2020 as part of the Government's COVID-19 Stimulus Package. The reinstatement saw significant changes to deferred tax liabilities, and we expect that significant changes will occur again with this subsequent removal.

Below we outline the potential accounting impacts that arise from the subsequent removal, which is effective from the 2024/25 income year. We also explore some of the broader impacts arising from this change.

Accounting impacts

The removal of tax depreciation on buildings will affect the deferred tax provision recognised as well as the tax expense. The significance will depend on a number of considerations, including:

Considerations for different reporting dates

The law change received Royal Assent on 28 March 2024, so the impact of the change is required to be accounted for in financial statements with reported dates on or after 31 March 2024.

For 31 December 2023 balance dates, disclosure of the likely change should be provided, depending on how significant the value of commercial buildings is to your business's financial statements. This disclosure should quantify the expected change if possible, or if not, then note this.

Which deferred tax balances will be impacted?

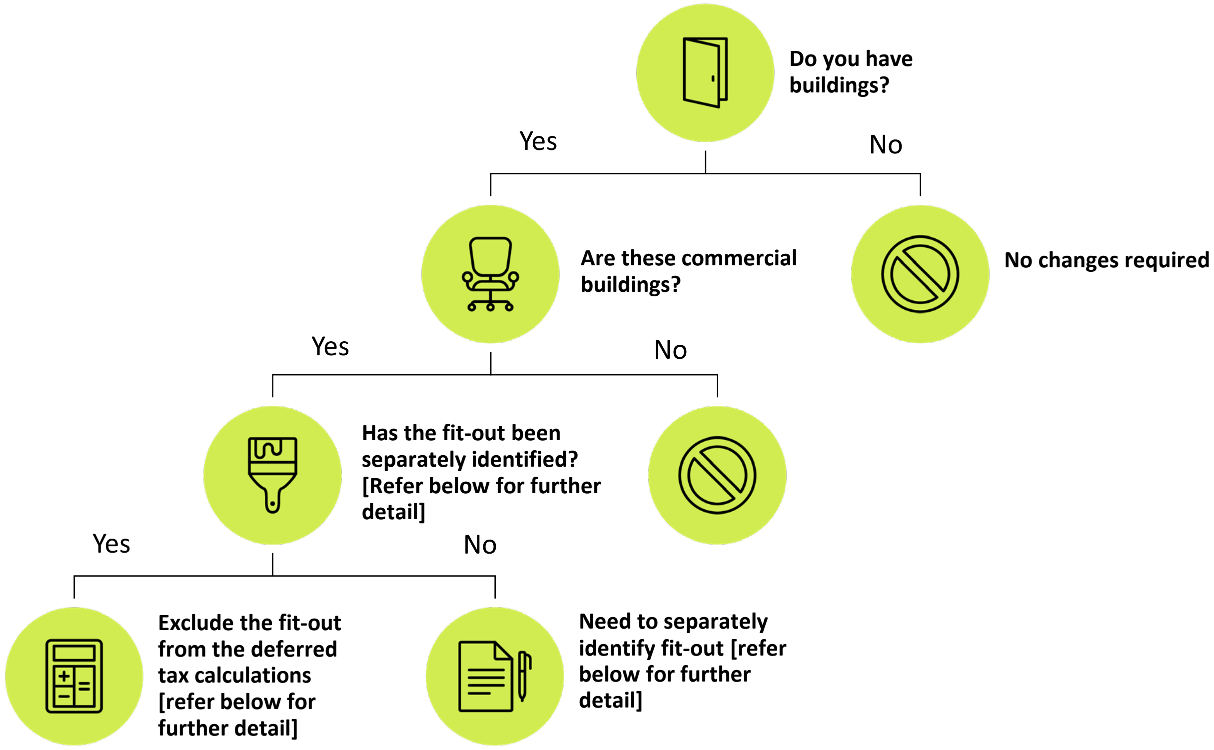
Deferred tax on buildings recognised on a "recovery through sale" basis under NZ IAS 12 continues to be measured based on the expected tax consequences of sale and is therefore not impacted by this tax change. You will need to review your accounting and taxation fixed asset registers to identify buildings where deferred tax is recognised on the "recovery through use" basis. This may include investment properties, where the rebuttable presumption that the carrying value will be recovered through sale has been rebutted.

When was the building acquired?

The deferred tax implication of this tax change will depend on whether a building was acquired before the 2010 law change, between the 2010 and the 2020 law change, or after 2020; and whether the initial recognition exception (IRE) was applied. For example, the IRE may have been applied to buildings acquired on or after the 2010 law change became effective, (which removed tax depreciation), but this will also depend on the method of acquisition. However, the IRE was not available for buildings acquired prior to the 2010 law change.

After the 2020 law change (which reinstated tax depreciation), different interpretations and divergences in practice arose in relation to accounting for the change for buildings acquired on or after the 2010 law change became effective. Therefore, with the tax depreciation being removed again, you will need to determine an appropriate accounting treatment for each “portfolio” of buildings depending on when these were acquired.

The following flowchart illustrates the key considerations:



When the building was acquired – and the appropriate accounting treatment

Before 2010/11	Between 2010/11 and 2020	Between 2020 and 2024
Initial recognition exemption not applied	Depends on deferred tax: - Treatment on initial recognition - And subsequent accounting in 2020	Temporary difference: - Initial recognition exemption could apply to all or only part of the difference.
Likely increase in deferred tax liability	If deferred tax was recognised in 2020, then the remaining tax base zeroed out and DTL arises on the zeroed-out amount (through tax expense).	If deferred tax was recognised on purchase or subsequently (as tax depreciation was claimed) then the remaining tax base zeroed out and DTL arises on the zeroed-out amount (through tax expense).
Recognise as tax expense	If deferred tax wasn’t recognised in 2020 (because initial recognition exemption applied), do not recognise.	If deferred tax wasn’t recognised on purchase or subsequently (because initial recognition exemption applied), do not recognise.

Tax impacts

The first step is to consider which buildings will be impacted by the change, which time period they fall under and whether initial recognition exemptions (IRE) have been applied. The removal of tax depreciation is for qualifying non-residential buildings. These are defined in section YA 1 of the Income Tax Act 2007 as any building that is not a residential building (i.e. dwellings and certain other short-term accommodation types). The 2024/25 opening tax book value for all qualifying buildings is nil.

The second step is to consider whether these buildings have been revalued. If so, it is likely that a deferred tax liability will have been recognised when the building was revalued (as the buildings' carrying value will be recovered through use and the tax depreciated amount is likely to be less than the revalued amount). For revalued buildings, the removal of tax depreciation is unlikely to have a significant impact on the deferred tax on the revaluation.

For buildings held for sale, deferred tax will continue to be calculated based on the amount of tax depreciation to be recovered on sale. Given the change, the amount of tax depreciation will now be significantly lower.

Once all of these factors have been considered, a deferred tax calculation can be undertaken.

Fit-out considerations

If you are purchasing a building, you need to ensure the purchase price allocation separately identifies the building and fit-out for tax purposes as your fit-out will still be depreciable for tax purposes. For buildings acquired from 2020 where fit-out was not separately depreciated, it is possible to apply to the Inland Revenue Commissioner to identify fit-out separately and depreciate this going forward (subject to evidence of value).

Broader impacts

The removal of tax depreciation deductions for commercial buildings may have broader impacts that you need to consider, such as:

- An impact on your business's overall profitability for the year once adjustments are recognised, and other key KPIs that may be impacted by the changes to your financial statements
- Impacts on future purchasing decisions (i.e. whether to purchase additional commercial buildings)
- Impacts on your banking covenants or thin capitalisation calculations as a result of the increase to your deferred tax liabilities
- NZX continuous disclosure requirements (i.e. if you are a listed entity).

We can help

Given the complexities involved in determining the appropriate accounting treatment (i.e. depending on when the building was purchased, whether it is used for residential or commercial purposes or a mixture of both) you may need further advice to help determine the correct accounting treatment and ensure it is reflected in your financial statements. Our team is more than happy to help – please contact your usual Baker Tilly Staples Rodway adviser.