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Income Tax – Depreciation

Depreciation is allowed as a deductible expense for tax because assets decline in value and wear out as they are used.

The depreciation regime creates a statutory right for a taxpayer to claim depreciation. Inland Revenue sets the depreciation rates and, in some circumstances, a taxpayer can apply to Inland Revenue for a special rate.

Some assets cannot be depreciated for tax purposes, including:

- Trading stock;
- Land;
- Financial arrangements under the accrual rules;
- Goodwill; and
- Some types of intangible assets.

Goods and services tax (GST)

If the taxpayer is not registered for GST, they can base their depreciation on the actual price they pay for an asset, including the GST component.

If the taxpayer is registered for GST, they can claim the GST component of an asset's cost price as an input tax deduction. In this case, they claim depreciation on the GST exclusive price of the asset.

Depreciation methods

There are two ways that a taxpayer can account for depreciation on their assets – either as an individual asset or as part of a group of assets (a 'pool').

If a taxpayer wishes to calculate depreciation on individual assets they can use either of the following methods of depreciation:

- Diminishing value; or
- Straight line.

Alternatively, if the taxpayer wishes to depreciate a group of assets as a pool, then the diminishing value method must be used.

Diminishing value method (DV)

Depreciation is calculated each year by using a constant percentage of the property's adjusted tax value. The depreciation deduction progressively reduces each year.

Straight line method (SL)

Depreciation is calculated in each year at a constant percentage of the cost of the asset. This method is sometimes referred to as the cost price basis. The amount of depreciation claimed is the same each year.

Pool depreciation method

When property is pooled it must be depreciated using the diminishing value method on the average value of the pool for the year.

There is no restriction on the number and/or types of pools that a taxpayer may set up. Different pools may be set up for the same types of assets. This may be useful where the assets are used in different locations or different rates apply. Different rates may apply because of different acquisition dates.

The amount of depreciation that can be deducted is largely dependent on whether the property is a qualifying asset and the date on which the property was acquired.

A ‘qualifying asset’ includes new assets (other than buildings) never used in New Zealand or elsewhere, or imported second-hand assets (excluding motor cars and buildings) used in New Zealand for the first time.

Changing depreciation rates

A taxpayer can choose between the diminishing value (DV) and the straight line (SL) method of calculating depreciation for any income year (except for fixed-life intangible property).

The taxpayer can change the method they use to calculate depreciation of the taxpayer's assets from year to year, except when the asset is included in a pool.

When the taxpayer changes calculation methods, the value that they calculate depreciation on is the current adjusted tax value, not the original cost price of the asset.

New assets

Irrespective of which depreciation method is used, depreciation is claimed for each calendar month or part of a calendar month that the taxpayer has owned the asset in the income year and in which the asset has been available for use to derive gross income.

Sale of assets

Depreciation may not be claimed in the year of sale of an asset, except for buildings. Depreciation can be claimed based on the number of months that the building is owned in that calendar year.

When an asset that has been depreciated is sold for an amount different from its written down value (adjusted tax value) then a gain or loss on sale must be recognised for tax purposes.

In calculating the gain or loss on sale, the costs incurred in selling the asset, such as commission and advertising, can be deducted from the sale price before the gain or loss is determined.

Depreciable intangible property acquired

The following types of assets are depreciable intangible property:

- The right to use a copyright;
- The right to use a design or model, plan, secret formula or process, or other like property or right;
- The right to use land;
- The right to use plant or machinery;
- The copyright in software, the right to use the copyright in software, or the right to use software;
- The right to use a trademark;
- Management rights and licence rights created under the Radiocommunications Act 1989; and
- Resource Management Act 1991 consents.

Subject to some restrictions these assets may be depreciated over their legal life on a straight-line basis.

Ceasing business

When the taxpayer ceases business and the business property is not sold immediately or is kept for private use, the loss or gain must be accounted for using the market value of the asset as at the beginning of the next income year.

The adjustment is made in the income tax return for the year after the business ceased, even where the loss or gain is not realised until a later income year.

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- Before making any financial decisions.
- To assist you in meeting the necessary legal or financial requirements, or you consider that any of the issues contained in this fact sheet may affect you.

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