DavidCo Limited
CHARTERED ACCOUNTANTS

Level 2, Shortland Chambers
70 Shortland Street, Auckland
PO Box 2380, Shortland Street
Auckland 1140
T +64 9 921 6885
F +64 9 921 6889
M +64 21 639 710
E arun.david@davidco.co.nz
W www.davidco.co.nz

2011 TO 2014 TAX DEPRECIATION CHANGES AND EARTHQUAKES RELIEF TAX MEASURES

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SECTION I: DEPRECIATION OF BUILDINGS

(1) Buildings that the 0% tax depreciation rate applies to	The 0% tax depreciation rate applies to all "buildings": **(a) <u>Buildings acquired in the 1995-96 income year or later</u>** The annual depreciation rate for a building that a person owns, is set by **section EE 31(2)(d)** or **EE 31(3)(c)** if it is building that: **(i)** Has an economic rate or provisional rate of more than 0% due to an estimated useful life of 50 years or more; and **(ii)** The person acquires it in their 1995-96 income year or later. <u>Under **section EE 31(2)(d)**</u>: The depreciation rate is **0%** for a building acquired on or before 20 May 2010, that has an economic rate or provisional rate of more than 0% due to an estimated useful life of 50 years or more. <u>Under **EE 31(3)(c)**</u>: The depreciation rate is **0%** for a building acquired after 20 May 2010, that has an economic rate or provisional rate of more than 0% due to an estimated useful life of 50 years or more. **[s. EE 61(3B)]** **(b) <u>Buildings acquired before the end of the 1994-95 income year that are not "special excluded depreciable property"</u>** The annual depreciation rate for a building that a person acquired before the end of the 1994-95 income year is **0%** for a building that has an economic rate or provisional rate of more than 0% due to an estimated useful life of 50 years or more. The pre-1993 depreciation rate is not available is not available for buildings that have an economic or provisional rate of more than 0% due to an estimated useful life of 50 years or more. **[ss. EZ 13(2)(c) & EZ 14]** **(c) <u>Buildings that are "special excluded depreciable property"</u>** Buildings that would otherwise be "excluded depreciable property" (either because the contract for their purchase or construction was entered into before 16 December 1991, or because they were used or available for use before 1 April 1993) are now "special excluded depreciable property" unless they are listed in **Schedule 39** (See **(4)** on **page 6**). "Excluded depreciable property" does not include "special excluded depreciable property". The annual depreciation rate for special excluded depreciable property is **0%** for all depreciation methods. **[s. EE 61(7B) & EE 64(3)]**
(2) Application date of the 0% rate	The 0% rate came into effect on **1 April 2011**, with application to the 2011-12 income year and later income years.

SECTION I: DEPRECIATION OF BUILDINGS (continued)

(3) Meaning of "building"	What is a building is not defined. The definition of building merely excludes the following from being a "building": **(a)** A grandparented structure. **(b)** Commercial fit-out. **[s. YA 1: definition of "building"]** The IRD has released interpretation statement IS 10/02 *Meaning of "building" in the depreciation provisions*, which states that: "In essence, a building is a structure that has walls and a roof, is of considerable size, is meant to last a considerable period of time and is generally fixed to the land where it stands." **[Page 13, TIB Vol.22, No7, August 2010]** **Link to IS 10/02:** **http://www.ird.govt.nz/resources/3/1/318d54804256ebdc9b0f9f82245c33b7/is1002.pdf**

SECTION I: DEPRECIATION OF BUILDINGS (continued)

(4) Buildings the 0% rate does *not* apply to	The 0% rate does not apply to the following types of buildings: **(a) <u>Grandparented structures</u>** *(effective from 30 July 2009 onwards)* A grandparented structure, for a person, is an item on the following list, if the person: acquired the item, or entered into a binding contract for the purchase or construction of the item, *on or before 30 July 2009*: (i) Barns, (including barns (drying); (ii) Carparks (buildings); (iii) Chemical works; (iv) Fertiliser works; (v) Powder drying buildings; (vi) Site huts. • These types of structures are not "buildings" and the 0% rate does not apply to them, unless the person acquires them after 30 July 2009. • However, <u>improvements to these structures made after 30 July 2009 must be separately depreciated. If the improvements are not within the definition of "commercial fit-out"</u>(see **(6)** on **page 8** below), the 0% rate will apply to the <u>improvements from the 2011-12 income year</u>. **[s. YA 1:** "grandparented structure", "building" **& ss. EE 37(3B) & (3)(ab)(ii)]** **(b) <u>Items listed in Schedule 39</u>** • The items listed in Schedule 39 are not "special excluded depreciable property", therefore they are "excluded depreciable property" (see **(1)** on **page 3** above). The 0% rate will not apply to them *provided they fit the definition of "excluded depreciable property" – i.e. <u>provided they were acquired before 1 April 1993</u>*. • Most, if not all, of the listed items will have estimated useful lives of less than 50 years in any case, so the 0% rate would not apply. • The definition of <u>"temporary building"</u> (a listed item in Schedule 39) has changed, so as to *exclude* a building, erected under a permit issued by a public or local authority that must be demolished or removed if the authority so requires. The 0% rate applies to the exclusion, from the 2011-12 income year. • **Note:** "Fish processing buildings" and "Tannery buildings affected by acid" were added to Schedule 39 from the 2011-12 income year by s.139 of the *Taxation (Tax Administration and Remedial Matters) Act 2011*. **[s. EE 67: "**special excluded depreciable property", **Sch. 39 & s. YA 1:** "temporary building"] **(c) <u>Buildings with a provisional rate and an estimated useful life of less than 50 years</u>** If the Commissioner issues a provisional rate for a class of building stating that it has an estimated useful life of less than 50 years, owners of such buildings can claim depreciation deductions. (See **(5)** on **page 7** below)

SECTION I: DEPRECIATION OF BUILDINGS (continued)

(5) Buildings a "special rate" can apply to	A special rate cannot be set for: (a) Excluded depreciable property. (b) Special excluded depreciable property. (c) A building. **[s. EE 35(2)]** However, a provisional rate can be set for a class of buildings, if the estimated useful life is less than 50 years. **[Page 13, TIB, Vol. 22, No 7, August 2010]** The IRD website *Technical Tax Area: Changes to building depreciation* contains this statement regarding the interpretation of estimated useful life: "An item's estimated useful life is the estimated useful life for that type of item, as set out in a determination issued by the Commissioner of Inland Revenue. Additionally, when interpreting an item's estimated useful life, the "whole of life" approach should be taken. For example, if a person purchases a second-hand item with an estimated useful life of 50 years, its estimated useful life will still be 50 years, regardless of how old the item actually is." **[**http://www.ird.govt.nz/technical-tax/legislation/2010/2010-27/leg-2010-27-building-depreciation/leg-2010-27-changes-building-depreciation.html**]**

SECTION II: DEPRECIATION OF COMMERCIAL FIT-OUT

(1) Commercial fit-out excluded from the definition of a "building"	**Commercial fit-out is excluded from the definition of a "building" and can be separately depreciated from the 2011-12 income year onwards.** In s. YA 1: **"Building"** in subparts EE and EZ, does not include- (a) A grandparented structure; (b) Commercial fit-out. **IRD website explanation:** The change is intended to ensure that the value of items of commercial fit-out do not form part of the value of a building for the purposes of the tax depreciation rules. **New s. DA 5** clarifies that when applying the capital limitation to expenditure, to the extent to which the expenditure relates to a building's item of commercial fit-out, the expenditure is treated as relating to the item of fit-out and not to the building. [**s. DA 5** as inserted by **s. 23** of the *Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters Act 2013*, applying from the 2011-12 income year onwards]
(2) Meaning of "commercial fit-out"	In s. YA 1: **"Commercial fit-out"** means an item to the extent to which it is– (a) Plant attached to a commercial building, but not used inside a dwelling within the commercial building. (b) Attached to, and nonstructural in relation to, a building, if the item is not used for weatherproofing the building and– (i) Is not used in relation to, and is not part of, a dwelling within the building; or (ii) Is used in relation to, but is not part of, a dwelling within the building, and the building is a commercial building. **IRD website explanation** A definition of "commercial fit-out" has been introduced in subpart YA 1. The definition clarifies that plant attached to a commercial building is generally an item of commercial fit-out and therefore can be depreciated separately from the building. An exception is when the item of plant is used inside a dwelling within the commercial building. The intention is for plant to be depreciable unless the item is used in residential premises. The second limb of the definition of commercial fit-out is intended to exclude items holding up the building or used to weather-proof the building ("building core") from being a commercial fit-out. This makes the building core of certain buildings non-depreciable. For a building with an estimated life of 50 years or more, the non-depreciable building core includes foundations, the building frame, floors, external walls, cladding, windows, external doors, internal stairways, the roof and load-bearing structures associated with the building such as pillars and load-bearing internal walls. Further, under the new definition of commercial fit-out, items attached to the building used within residential premises are not commercial fit-out. However, attached items used in relation to a residential dwelling are commercial fit-out if the building is a commercial building.

SECTION II: DEPRECIATION OF COMMERCIAL FIT-OUT (continued)

(3) Meaning of "commercial building"	In s. YA 1: **"Commercial building"** means a building that is not, in part or in whole, a dwelling, unless use as a dwelling is a secondary and minor use. **IRD website explanation** A definition of "commercial building" has been inserted in section YA 1. The definition is important to the definition of "commercial fit-out". A commercial building is one where the main use is for non-residential premises and any residential premises within the building are of a secondary and minor use. In most instances it will be obvious whether the main use of a building is to provide residential premises. However, if it is not clear what the main use of a building is, taxpayers will need to take a position based on their particular circumstances. One method for determining the building's main use could be to compare the area of the building that is used or set aside exclusively for residential accommodation with the remaining area of the building. In making this assessment, the taxpayer would need to consider how to allocate the shared areas (for example, lobbies, hallways and entranceways that commercial and residential tenants can normally access). If commercial and residential tenants have equal access to shared areas, one approach would be to count the shared areas as appurtenant to the residential accommodation and again as part of the rest of the building. However, in working out the most appropriate apportionment approach the particular circumstances of each building will be important. The definition of "commercial building" helps to define the boundary for the tax treatment of items of fit-out that are used for both commercial and residential purposes ("shared fit-out"). The dominant purpose of the building determines the tax treatment of items of shared fit-out, as illustrated by the following examples. **Example 1** If the dominant or main purpose of a building is commercial, items of shared fit-out will be depreciable as commercial fit-out. For example, most of the floor area of a building is occupied by commercial tenants but the top floor has a residential apartment. The shared items of fit-out, such as electrical cabling, fire protection equipment, sewerage and water reticulation, and the fit-out of lobbies that are not part of the residential premises are depreciable. However, the fit-out within the apartment is generally not depreciable property, as per the Commissioner's interpretation statement IS10/01. **Example 2** Most of the floor area of a building is used for residential purposes. The remainder is used for commercial purposes. Items of fit-out in the building that are used as a café and residential purposes will be mainly non-depreciable - as in the Commissioner's interpretation statement IS10/01. However, the fit-out of the café within the building will be depreciable as commercial fit-out because it is not used in relation to, and is not part of, a dwelling.

SECTION II: DEPRECIATION OF COMMERCIAL FIT-OUT (continued)

(4) "Plant" excludes structural items	In s. YA 1: **"Plant"** does not include an item that is structural in relation to the building. **IRD website explanation** Plant does not include an item that is structural in relation to a building. This definition has been introduced in section YA 1 to clarify that if an item, or part of an item, of plant is integrated into the structure of a building then the item or part of the item will be non-depreciable if the building has an estimated useful life of 50 years or more. Without this definition, it would be possible to argue that parts of a building's structure are also within the meaning of "commercial fit-out", as they are items of plant, and therefore depreciable. Items holding up the building or used to weather-proof the building are non-depreciable if the building has an estimated useful life of 50 years or more. In certain buildings some of these items may be specially constructed or strengthened to support, for instance, an item of plant. The definition of "plant" ensures for example, that a lift shaft is not treated as being part of the lift, as lifts are depreciable property and have an estimated useful life of 25 years. The definition of plant makes it clear that the estimated useful life of a lift shaft is not 25 years, but is the estimated useful life of the associated building or structure.

SECTION II: DEPRECIATION OF COMMERCIAL FIT-OUT (continued)

(5) Meaning of a "dwelling"	In s. YA 1: **"Dwelling":** (a) Means any place used predominantly as a place of residence or abode, including any appurtenances belonging to or enjoyed with the place. (b) Does not include any of the following: (i) A hospital. (ii) A hotel, motel, inn, hostel, or boarding house. (iii) A serviced apartment for which paid services in addition to the supply of accommodation are provided to a resident, and in relation to which a resident does not have quiet enjoyment as that term is used in section 38 of the Residential Tenancies Act 1986. (iv) A convalescent home, nursing home, or hospice. (v) A rest home or retirement village, except to the extent that, in relation to a relevant place, it is, or can reasonably be foreseen to be, occupied as a person's principal place of residence for independent living. (vi) A camping ground. **IRD website explanation** A definition of "dwelling" has been added to section YA 1 to help set the boundary between commercial and residential premises. The first limb of the definition is very broad and means any place used predominantly as a place of residence or abode. However, paragraph (b) of the definition excludes certain premises and types of activities that are more commercial in nature and the fit-out of these premises is more likely to depreciate when used in an income earning process. The new rules recognise that there are commercial buildings that provide residential-type accommodation by excluding a number of these types of buildings from the meaning of "dwelling". This ensures that fit-outs associated with these buildings will continue to be depreciable. The types of buildings that are specifically excluded from the meaning of "dwelling" are: • Hospitals; • Hotels, motels, inns, hostels, or boarding houses; • Certain serviced apartments, where additional services are provided and where the resident does not have quiet enjoyment; • Convalescent homes, nursing homes, or hospices; • Rest homes or retirement villages, except places that are characterised as places of residence for independent living; and • Camping grounds.

SECTION II: DEPRECIATION OF COMMERCIAL FIT-OUT (continued)

(6) Meaning of "independent living"	In s. YA 1: **"Independent living"** means occupancy of a place under an arrangement that– (a) Does not have a level of compulsory care. (b) Has a level of compulsory care that is merely incidental to the occupancy." **IRD website explanation** A definition of "independent living" has also been included in section YA 1. In relation to rest homes and retirement villages a distinction has been drawn between serviced apartments and premises that provide residents with independent living arrangements. Fit-out associated with rest homes, hospitals, community centres and serviced apartments will generally continue to be depreciable whereas fit-out associated with premises that provide for independent living will generally be non-depreciable. Serviced apartments are generally distinguishable from premises providing for independent living because the occupancy arrangements typically require the resident to purchase a bundle of care services (such as medical supplies, nursing care, meals, cleaning, provision of linen and laundry) in addition to a right of occupancy in order to be entitled to occupy the premises. In this situation, the fit-out of the serviced apartment will continue to be depreciable property. However, if the only compulsory services supplied to the resident are merely incidental to the occupancy (such as gardening, maintenance, management and security services) the fit-out of the serviced apartment will not be depreciable.

SECTION II: DEPRECIATION OF COMMERCIAL FIT-OUT (continued)

(7) Explanation of commercial fit-out	From the 2011-12 income year onwards, the following conclusions can be drawn based on the above definitions: (a) Plant is commercial fit-out if it is non-structural and attached to a building whose use as a place of residence (if so used) is secondary and minor, provided the plant is not used within the portion of the building that is a place of residence. (b) An item used for weatherproofing a building is not commercial fit-out. (c) An item (other than plant) is commercial fit-out if it is attached to a building, but not structural, and it is not used in relation to, or part of, a place of residence within the building. (d) An item (other than plant) is commercial fit-out if it is non-structural and attached to a building, even though it may be used in relation to a place of residence within the building, provided that the building's use as a place of residence is secondary and minor and the item is not part of the place of residence within the building. (e) Plant that is non-structural and other non-structural items, that are attached to a type of building that is a listed exclusion from the definition of "dwelling", will be commercial fit-out. (f) The level of compulsory care provided as part of an occupancy of a rest home or retirement village, will determine whether non-structural plant and other non-structural items used in relation to, or forming part of, that occupancy, can be depreciated as commercial fit-out.

SECTION II: DEPRECIATION OF COMMERCIAL FIT-OUT (continued)

(8) Commercial fit-out that has not been separately depreciated: transitional rule	**Where commercial fit-out has not been separately depreciated, a transitional rule applies to allow a small proportion of building depreciation to continue to be claimed in a year where:** (a) A person owns a commercial building depreciable at 0% in the year; and (b) The person had a depreciation deduction for the building in the 2010-11 income year and has not disposed of the building; and (c) Commercial fit-out, for which the person has never had a depreciation deduction, was acquired at the same time as the building and relates to the building; and (d) The building was acquired in the 2010/2011 income year or earlier; and (e) The person has no other deduction in relation to the building for the income year. From the 2011-12 income year onwards, the person is treated as having a depreciation loss for the income year equal to a formula amount: $$\textbf{starting pool} \times 0.02 \times \frac{\textbf{whole months used or available for use}}{12}$$ **starting pool** is: $$0.15 \times \left(\begin{array}{l}\textbf{2010-11}\\ \textbf{closing atv}\\ \textbf{of the building}\end{array}\right) - \left(\begin{array}{l}\textbf{2010-11 closing atv}\\ \textbf{of commercial fit-out}\\ \textbf{acquired after the building}\\ \textbf{and separately depreciated}\end{array}\right)$$ These formulae can be explained as follows: (a) The **starting pool** is 15% of the building's adjusted tax value as at the end of the 2010-11 income year. (b) This starting pool is reduced by the adjusted tax value of all items of commercial fit-out that had been separately depreciated (i.e. the items of commercial fit-out that were acquired after the building was acquired, or items of commercial fit-out acquired as part of the building but separately depreciated). (c) The starting pool is depreciated at 2% in the 2011-12 and later income years. **Note:** this formula will result in the same amount of depreciation loss each year, assuming the previously non-depreciated commercial fit-out is used for the same number of months each year. Hence, there is a terminating rule. If: $$\left[(\textbf{starting pool}) - (\textbf{total deductions already allowed})\right] < \left[\textbf{formula amount}\right]$$ Then the depreciation deduction is limited to the smaller amount: $$\left[(\textbf{starting pool}) - (\textbf{total deductions already allowed})\right]$$ No loss or recovery rules apply to the value of the pool when the building or fit-out is disposed of. (See also **(12)** on **page 17**) **[s. DB 65]**

SECTION II: DEPRECIATION OF COMMERCIAL FIT-OUT (continued)

(9) IRD website explanation of the transitional rule	**<u>IRD website explanation of the transitional rule</u>** A transitional rule, new section DB 65, allows a deduction for building fit-out that is embedded in the tax book value of certain buildings. The transitional rule applies to building owners that acquired a commercial building in the 2010-11 or earlier income years and who have not itemised the items of commercial building fit-out, acquired at the same time as the building, separately from the building in their tax asset register. Any subsequent commercial fit-out acquired and separately depreciated after the date that the building was acquired reduces the amount of the deduction allowed under section DB 65. The amount of the deduction is the lesser of 2% of the starting pool value or the residual value of the pool - taking into account all previous deductions taken under this provision. The opening value of the pool is 15% of the building's adjusted tax book at the end of the 2010-11 income year less the adjusted tax book value, at the end of the 2010-11 income year, of any fit-out associated with the building that has been separately depreciated for income tax purposes. **Example** Company ABC acquired a warehouse on 1 April 1999 for $1 million. Items of commercial fit-out within the building were not separately identified and depreciated at the time the building was acquired. Twelve months later a refurbishment of the warehouse was completed. The refurbishment was itemised and depreciation was applied to the various items of commercial fit-out. At the end of the 2010-11 income year the adjusted tax book value of the warehouse is $640,000 and the adjusted tax book value of the associated commercial fit-out is $64,000. The starting pool value is: $(15\% \times 640{,}000) - 64{,}000 = \$32{,}000$ The annual deduction, assuming that the building is held for the 2011-12 income year is: $\$32{,}000 \times 2\% \times 12/12 = \$640$ To reduce complexity and compliance costs there are no loss or recovery rules applying to the value of the pool when the relevant building or fit-out is disposed of. In the above example, the taxpayer is entitled to a deduction of up to $640 a year provided they own the commercial building. However, if the dominant purpose of a building changes from commercial to residential, no deduction is allowed under section DB 65, as subsection (1)(a) no longer applies to the building. However, the deductions would begin again if the building subsequently reverts to being a commercial building - provided the building ownership has been maintained.

SECTION II: DEPRECIATION OF COMMERCIAL FIT-OUT (continued)

(10) Re-characterising part of a commercial building into components of commercial fit-out in order to claim depreciation	The Commissioner expressed a viewpoint for comment and discussion only in a draft *Questions We've Been Asked* (QWBA ED 0140: *Depreciation Of Commercial Fit-out*) that was not issued in final form: (a) That there can be no retrospective re-characterisation of part of a building into various items of fit-out in order to claim depreciation deductions on those items. (b) The Commissioner contended that any retrospective re-characterisation and depreciation of fit-out would require the Commissioner to exercise his discretion under section 113 of the Tax Administration Act 1994 to adjust the depreciation deductions in previous assessments, based on the backdated valuations. However, the Commissioner cannot exercise section 113 in matters of "regretted choice" (as discussed in SPS 07/03 *Requests to amend assessments*). (c) The Commissioner concedes, however, that if a taxpayer can sufficiently demonstrate that an error did occur in the assessment, the Commissioner may consider exercising section 113. The taxpayer must show that there was a genuine error in the tax return. For example, items of building fit-out were recorded separately in the taxpayer's books but for some reason that was not reflected in the depreciation deductions claimed in the tax return. The deadline for comments on the draft QWBA was 18 November 2011. **[QWBA ED 0140 *Depreciation Of Commercial Fit-out* – not released in final form]**
(11) Treatment of expenditure on commercial fit-out (R&M)	When applying the capital limitation to expenditure, to the extent to which the expenditure relates to a building's commercial fit-out (the **item**), the expenditure is treated as relating to the item, and not the building. This means that in order to decide whether expenditure is deductible outright or must be capitalised and depreciated, the expenditure is treated as relating to the commercial fit-out (and not, for example, to the building). [**New s. DA 5** inserted by **s. 23** of the *Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013* applying from 1 April 2011]

SECTION II: DEPRECIATION OF COMMERCIAL FIT-OUT (continued)

(12) A building that was predominantly commercial switching to being predominantly residential	From the 2011-12 income year onwards, **the rules relating to depreciation recovery when there is a change of use have been adjusted to include**: (a) A change in use of an item for the purposes of the definition of commercial fit out. (b) A change in the status of a building related to an item for the purposes of the definition of commercial fit-out. **[s. EE 47(2)]** **Disposal events:** Therefore the following will constitute disposal events for the purposes of depreciation recovery: • Commercial fit-out that was not part of a place of residence in a commercial building becoming part of a place of residence in the building. • A building that was a commercial building becoming predominantly residential. In either of the above cases, any commercial fit out that has been separately depreciated will be treated as having been disposed of, for a consideration equal to its market value (less any output GST) on the first day of the income year following the change in status of the commercial fit-out or building. **[ss. EE 47(2) & EE 45(5)]** **Depreciation recovery income:** The depreciation recovery income, if the consideration exceeds the adjusted tax value on the deemed disposal date, will be equal to the lesser of: • The amount by which the consideration exceeds the adjusted tax value; and • The sum of the depreciation loss claimed on the commercial fit-out. **[s. EE 48]** **Section DB 65 deduction for previously non-depreciated commercial fit-out is not a depreciation loss:** Any amount deducted under **section DB 65** (the transition concession for previously non-depreciated commercial fit-out) is not "depreciation loss' as defined in section YA 1, as the deduction is allowed under **section DB 65** and not section **EE 1(2)**. (See also **(8)** on **page 14**) **[s. EE 48 & s. YA 1 definition of "depreciation loss"]**
(13) IRD explanation of change-in-use	**IRD website explanation** In the unlikely event that a building changes its dominant use, section EE 47 has been amended to clarify that the normal depreciation change-of-use rules apply to the items of shared fit-out. Thus, if the dominant purpose of a building changes from commercial to residential, the items of shared fit-out will be deemed to have been disposed of at their market value. The reverse applies when the dominant purpose of a building changes from residential to commercial. That is, the items of shared fit-out will be deemed to have been acquired for their market value. In these instances the normal depreciation recovery or loss-on-disposal rules apply to the items of shared fit-out. In this instance the change of use is treated as occurring on the first day of the next income year. Therefore, taxpayers need to have a view on the dominant use of their building throughout the income year.

SECTION III: AVAILABILITY OF THE 20% LOADING

(1) Depreciation loading only available for assets acquired on or before 20 May 2010	A person may claim the depreciation loading of 20% for an item that: (a) Either: (i) The person acquired on or before 20 May 2010; or (ii) The person decided to purchase or construct, meets the administrative requirements in **section EE 31(4)** (see below); and a. Entered into a binding contract for the purchase or construction of the item on or before 20 May 2010; or b. After deciding to purchase or construct the item, incurred expenditure in relation to its purchase or construction on or before 20 May 2010; and (b) Has not been used or held for use in New Zealand as an item of the depreciable property before the date on which the person acquired it; and (c) Is not a building; and (d) Is not a used imported car; and (e) Is not an international aircraft. **[s. EE 31(2) & EE 31(2A)]** The administrative requirements where the item was not acquired by 20 May 2010 are as follows: (a) The person must have available for the Commissioner documents dated on or before 20 May 2010 that evidence that the person had, on or before 20 May 2010, decided to purchase or construct the relevant item. (b) The person must send to the Commissioner a statutory declaration that the person had, on or before 20 May 2010, decided to purchase or construct the relevant item. **[s. EE 31(4)]**
(2) Treatment of improvements to assets being depreciated at a rate that includes the 20% loading	The 20% loading will not apply to an improvement to an asset, and the improvement must be separately depreciated, if: (a) The person uses the DV or straight-line method for depreciating the asset; and (b) Treating the improvement as a separate item, the person: (i) Acquires the improvement after 20 May 2010; or (ii) Decides to purchase or construct the improvement, and a. Enters into a binding contract for the purchase or construction of the improvement after 20 May 2010; or b. Incurs expenditure in relation to the improvement's purchase or construction after 20 May 2010. **[s. EE 37(3)(ab) & EE 37(3B)]** **Pool method:** There is no change to the treatment of improvements for assets that are depreciated as part of a pool. **[s. EE 37(3)(ab)]**

SECTION III: AVAILABILITY OF THE 20% LOADING (continued)

(3) Removal of loading for improvements to farmland and planting of listed horticultural plants	The 20% loading has been removed from 13 September 2012, the date of introduction of the *Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Bill*, for: (a) Expenditure on planting of listed horticultural plants (covered by s. DO 5); (b) Improvements to farmland (covered by s. DO 4); (c) Improvements to aquaculture (covered by s. DO 12). 1. The depreciation formula in s. DO 5(4), for expenditure on planting of listed horticultural plants, is being amended so as to remove the 20% loading from the date of introduction of the Bill (13 September 2012); and 2. Schedule 20, which sets out the depreciation rates for improvements to farmland and aquaculture dealt with in ss. DO 4 & DO 12 is being amended to reduce all the rates so that the 20% loading no longer applies ("6" is being reduced to "5", "12" is being reduced to "10", and "24" is being reduced to "20") from 13 September 2012, the date of introduction of the Bill: <u>Except, in both cases, if the person</u>: (a) Decides, on or before the introduction date, to purchase or plant the listed horticultural plant; and (b) On or before the introduction date: (i) Enters a binding contract for the purchase or planting of the listed horticultural plant: or (ii) After deciding to purchase or plant the listed horticultural plant, incurs expenditure in relation to the purchase or planting; and (c) For the person's decision to purchase or plant the listed horticultural plant: (i) Has available, for the Commissioner, documents dated on or before the introduction date that evidence that the person made the decision on or before the introduction date; or (ii) Sends to the Commissioner a statutory declaration that the person made the decision on or before the introduction date. [**Clauses 22 & 60** of the *Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Bill* to come into force from 13 September 2012, the date of introduction of the Bill under **clause 2(13)**.]

SECTION IV: TAX TREATMENT OF CAPITAL CONTRIBUTIONS

(1) Definition of "capital contribution property"	"**Capital contribution property** means, for a recipient of an amount: (a) Depreciable property owned or to be acquired by the recipient; (b) An improvement for which expenditure is or would be deductible for the recipient under section DO 4, DO 11, DO 12, or DO 13 (which relate to farming, horticultural, aquacultural, and forestry improvements); (c) A listed horticultural plant or land for which expenditure is or would be deductible for the recipient under section DO 5 or DO 6 (which relate to horticultural expenditure on land); (d) A listed horticultural plant or land to the extent to which some but not all expenditure for replacement plants is deductible under section DO 6. [**Section 98(10)** of the *Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013* effective from 1 April 2011]
(2) Meaning of "capital contribution"	A capital contribution towards capital contribution property is treated as income of the recipient and must be spread over 10 years. However, the taxpayer can instead elect to reduce the depreciable value of the property by the contribution. In the latter case, the capital contribution is added to the depreciation loss when calculating depreciation recovery income. **A capital contribution is defined for the purposes of ss. CG 8, DB 64 & EE 48** as meaning an amount that: (a) Is paid by a payer to a recipient under an agreement between them; if the agreement is a contract of insurance, the payment relates only to business interruption; insurance pay-outs to cover the replacement of damaged assets do not fall within this definition, as they are not capital contributions; and (b) Is not a settlement on a trust, a contribution by partner to a partnership, or a payment by a shareholder to a company; this ensures that payments by settlers, partners or shareholders who are introducing capital into their own businesses in their capacity as owners are not included; and (c) Is not income of the recipient, ignoring **s. CG 8** (under which a capital contribution received after 20 May 2010 is treated as income in the income year it is received and the nine following income years; from 1 April 2013, also ignoring **s. CC 1B** (consideration for transfer of a land right); and (d) Is paid, under the express terms and conditions of the agreement, as a contribution for capital contribution property. **[s. YA 1 "capital contribution"** as amended by **s. 98(8) & (9)** of the 2013 Act**]**
(3) A capital contribution is income	**The default treatment of a capital contribution is as income of recipient:** A capital contribution that is derived after 20 May is income in the year of receipt and for the nine income years after that year. The amount that is income in each year is given by the following formula: $\frac{\textbf{capital contribution}}{\textbf{10}}$ "capital contribution" is the entire amount derived by the person in the first year. **[s. CG 8]**

SECTION IV: TAX TREATMENT OF CAPITAL CONTRIBUTIONS (continued)

(4) Electing to reduce the depreciable cost base or the deductible expenditure of capital contribution property	**<u>Electing to reduce the depreciable cost base or the deductible expenditure of capital contribution property</u>** Instead of treating a capital contribution received after 20 May 2010 as income under s. CG 8, a person may elect, in a tax return, to deduct the capital contribution from: • The depreciable cost base under the tax depreciation rules of the capital contribution property: or • Any expenditure on the capital contribution property that is deductible under subpart DO (which applies to expenditure on improvements to farmland and aquacultural business or planting of listed horticultural plants). **Section DB 64 applies when** a person would be allowed a deduction for: (a) The relevant capital contribution property (by way of depreciation); or (b) The relevant expenditure for the capital contribution property (under subpart DO). It provides that for the purpose of quantifying the amount of depreciation loss (under subpart EE), or the amount of the deduction (under subpart DO), for expenditure on the capital contribution property: (a) The capital contribution property's adjusted tax value, base value, cost, or value (as applicable) under the tax depreciation rules, is reduced by the amount of the capital contribution; or (b) The relevant expenditure for the capital contribution property that is deductible under subpart DO, is reduced by the amount of the capital contribution. **If the person chooses to apply s. DB 64**, when capital contribution property is disposed of for a consideration that exceeds the item's adjusted tax value at the time of disposal, the lesser of the following amounts is depreciation recovery income in the year of disposal: • The amount by which the consideration exceeds the item's adjusted tax value on the date of the disposal; and • The sum of the depreciation loss on the item and the "DB 64 item amount" (the amount of the capital contribution for the item). **[s. DB 64** as amended in relation to expenditure under subpart DO by **s. 29** of the *Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013* – amendment applying from the 2011-12 income year onwards - **& s. EE 48]**

SECTION V: CANTERBURY EARTHQUAKES RELIEF – INCOME FROM LAND SALES

(1) 10 year rule for land disposals overridden for Crown purchases of Christchurch property: s. CZ 26	**New s. CZ 26: Land and buildings affected by Canterbury earthquakes—sections CB 9 to CB 12 and CB 14 overridden for Crown purchase** **(Note: s. CB 12 has been removed from this concession from 27 Feb 2014, the date on which the Foreign Superannuation Tax Act received the Royal assent)** Under ss. CB 9 to CB 12 and CB 14, an amount that person derives from disposing of land is income if, providing other specified conditions are met: • They dispose of the land within 10 years of acquiring it (ss. CB 9 & CB 10); or • They dispose of the land within 10 years of completing improvements to it s. CB 11); or • They dispose of land in relation to which an undertaking or scheme involving development or division work that is not minor was begun within 10 years of the date on which the person acquired the land (s. CB 12); or • They dispose of land within 10 years of acquiring it and the profit is not already income under s. CB 6 to CB 12, but at least 20% of the profit arises from one or more factors listed in s. CB 14(2) including zoning changes and resource management consents (s. CB 14). Persons affected by compulsory acquisitions by the government due to the Canterbury earthquakes could be inadvertently adversely affected by these rules. New s. CZ 26 addresses this problem. Under new s. CZ 26, ss. CB 9 to CB 12 (which relate to disposals within 10 years of acquisition) do not apply to a person and land or buildings purchased by the Government from the person under section 53(1) of the *Canterbury Earthquake Recovery Act 2011*. Under s. CZ 26 as substituted and replaced by s. 29(1) of the *Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Act 2014* (the "Foreign Superannuation Tax Act"), the concession has been extended to Crown purchases under s. 54 or 55 of the *Canterbury Earthquake Recovery Act 2011*, and income covered by s. CB 14, effective from 4 September 2010. However, effective from 27 February 2014, the date of assent of the Foreign Superannuation Tax Act, the concessions will no longer extend to income covered by s. CB 12 (schemes involving development or division work that is not minor), under s. 29(20 & (3) of the Foreign Superannuation Tax Act. The exception does not apply to land that was initially acquired with the intention of resale and development. The general rules in s. CB 6 and CB 7 will continue to operate. However, the rollover relief provisions in s. CZ 25 may apply. There is no requirement that a person to whom the concession in s. CZ 26 applies must purchase new land with the monies received under the compensation package. However if the do subsequently acquire new land, the 10-year period provisions in s. CB 9 to CB 12 may start afresh for the newly acquired land. [**S. 20** of the *Taxation (Annual Rates, Returns Filing, and Remedial Matters) Act 2012* & **s. 29(1)** effective from 4 September 2010 & **s. 29(2) & (3)** effective from 27 Feb. 2014, of the *Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Act 2014* and *Tax Information Bulletin Vol. 24 No. 10 (December 2012)* p. 30.

SECTION VI: CANTERBURY EARTHQUAKES RELIEF: DEFERRED DEDUCTIONS

(1) Deferral of interruption expenditure to year that income-earning activity resumes: s. DZ 20	**New s. DZ 20: Expenditure incurred while activity interrupted by Canterbury earthquake is deductible in the year the activity resumes** After the Canterbury earthquakes, some taxpayers were no longer able to deduct their expenses or losses relating to their income earning activity. Their activity was so disrupted by the earthquakes that there is no longer a sufficient nexus between the expenses or losses and their activity. Where a person has an income-earning activity in greater Christchurch that is interrupted by the Canterbury earthquake, the person is allowed a deduction for expenditure incurred in an income year before the 2016-17 income year during the period of interruption. The deduction is deferred to the year in which the income-earning activity resumes, providing the year the activity resumes is before the 2016-17 income year. The concession applies only if the activity is resumed before the 2016-17 income year. The specific requirements for the deferral and deduction are as follows: (a) The expenditure must be incurred in an income year (the current year) before the 2016–17 income year; and (b) The person must have an income-earning activity in greater Christchurch (as defined in section 4 of the Canterbury Earthquake Recovery Act 2011) immediately before a Canterbury earthquake (as defined in that section); and (c) The activity must be interrupted for a period (the period of interruption) as a result of the Canterbury earthquake; and (d) In the current year, during the period of interruption, the person incurs expenditure or loss (the interruption expenditure) in meeting an obligation relating to the income-earning activity; and (e) The interruption expenditure does not meet the requirements of the general permission for the person and the income-earning activity but would do so but for the interruption; and (f) The person resumes the income-earning activity in an income year (the resumption year) before the 2016–17 income year. **Example:** Victoria carries on a dry-cleaning business as a sole trader in the Christchurch CBD. She has a loan for the business that requires a $2,000 monthly interest payment. After the earthquake of 22 February 2011 she was no longer able to access her business premises and she temporarily stopped her business activity. Without new s. DZ 20, Victoria would not be able to deduct the interest payments on the business loan since February 2011 because there is no longer a sufficient nexus between the interest expenditure and an income-earning activity. In September 2012, Victoria resumes the same dry-cleaning business in Hoon Hay. She can deduct $40,000 ($2,000 x 20 months) interest incurred on the business during the period in the 2012-13 income year. [**S. DZ 20 as** inserted by **s 29** of the *Taxation (Annual Rates, Returns Filing, and Remedial Matters) Act 2012* coming into force on 4 September 2010 and applying for the 2010-11 to the 2015-16 income years, and *Tax Information Bulletin Vol. 24 No. 120 (December 2012)* p. 29.]

SECTION VII: EARTHQUAKE RELIEF: DEPRECIATION LOSS WHILE ACCESS RESTRICTED

(1) Item treated as being available for use while access restricted due to Canterbury earthquake: s. EZ 23E (and s. EZ 72)	**New s. EZ 23E (& s. EZ 72): Item treated as being available for use while access restricted due to Canterbury earthquake** **[From 1 April 2016 s. EZ 23E is being repealed and s. EZ 72 is being enacted in its place. New s. EZ 72 will apply if the income year is the 2018-19 income year or an earlier income year]** Under **s. EE 1(2)(c)** one of the requirements for a person to have an amount of depreciation loss for an item for an income year is that: • The item is used, or is available for use, by the person in the income year. Due to the Canterbury earthquakes it is likely that some items may not be available for use due to restricted access. New s. EZ 23E addresses this problem. An item of depreciable property is treated for an income year as being available for use while access to the item is restricted if: (a) The access is affected by a restriction imposed due to the effects of a Canterbury earthquake (as defined in section 4 of the Canterbury Earthquake Recovery Act 2011); and (b) The item was used or available for use immediately before the restriction was imposed; and (c) The item would be used or available for use in the absence of the restriction; and (d) The income year is the 2015–16 or an earlier income year (being extended to read "The income year is the 2018-19 income year" by s. EZ 67). [New **s. EZ 23E** inserted by **s. 59** of the *Taxation (Annual Rates, Returns Filing, and Remedial Matters) Act 2012,* applying for the 2010–11 to the 2015–16 income years. **S. EZ 23E** has been repealed by **s. 66** and **s. EZ 72** has been inserted by **s. 68** of the *Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Act 2014*, effective from 1 April 2016.]

SECTION VIII: CANTERBURY EARTHQUAKE RELIEF DEPRECIATION RECOVERY RULES

(1) General rules: Items or events that trigger depreciation recovery income or loss: ss. EE 46 & EE 47	**Items or events that trigger depreciation recovery income or loss on disposal** Depreciation recovery or loss on disposal can be triggered by: 1. A disposal of depreciable property set out in **s. EE 46**, including: (a) A depreciable asset (other than one accounted for in a pool); and/or (b) Fixed life intangible property for which a deduction for (1/legal life) was available under s. EE 33; and/or (c) Software acquired pre-1993 for which deductions were available on acquisition and the consideration on disposal is income under s. CZ 11. 2. An event (i.e. a deemed disposal); the events that are treated as disposals are set out in **s. EE 47**: **Event 1**: The change of use, or change of location of use, of an item of property, as a result of which a person is denied a deduction for an amount of depreciation loss for the item for the next income year. This includes a change in use of an item for the purposes of the definition of **commercial fit-out** and a change in the status of a building related to an item for the purposes of that definition. The event is treated as occurring on the first day of the next income year. [s. EE 47(2)] **Event 2**: The loss or theft of an item of property, if the item is not recovered in the income year in which the loss or theft occurs. [s. EE 47(3)] **Event 3(a)**: The irreparable damage of an item of property that is not a building or grandparented structure. [s. EE 47(4)(a)] **Event 3(b)**: The damage of an item of property that is a building or grandparented structure, or of the neighbourhood of the building or grandparented structure, causing the building or grandparented structure to be: (a) Useless for the purpose of deriving income; and (b) Demolished or abandoned for later demolition. [s. EE 47(4)(b)] **Event 4**: The seller's repossession of an item of fixed life intangible property to which s. EE 33 applies because the buyer fails to pay some or all consideration. The event is treated as occurring on the date on which the item is repossessed. [s. EE 47(5)] **Event 5**: A geothermal well that was previously unavailable for use, when the person starts to use the well or have the well available for use. [s. EE 47(6)] **Event 6**: The acquisition of an item by a person acting under statutory authority. [s. EE 47(7)] **Event 7**: The cessation of ownership of a fixture or improvement that a lessee is treated as owning under s. EE 4(2), or that a person the lessee sold the fixtures to is treated as owning under s. EE 5(3). [s. EE 47(8)] **Event 8**: An occurrence that has the effect that the owner of an item of intangible property is no longer able, and will never be able, to exercise the rights that constitute or are part of the item. [s. EE 47(9)] **Event 9**: The cessation of use in NZ and the taking out of NZ for use outside NZ of an item of property for which a first year allowance was granted under the Income Tax Act 1976. [s. EE 47(10)]

SECTION VIII: CANTERBURY EARTHQUAKE RELIEF DEPRECIATION RECOVERY RULES (continued)

(2) Earthquake relief modifications to general rules on events giving rise to deemed disposals: Changes to the definition of a "disposal event" to accommodate earthquake-related damage	**The definition of a disposal event that arises from irreparable damage to property has changed so as to include a building affected by neighbourhood damage (even if the building itself was relatively undamaged or repairable):** **Disposal event:** A disposal event now includes: 1. The irreparable damage of an item of property that is not a building or grandparented structure (this is not a new rule). 2. Damage to an item of property that is a building or grandparented structure, or damage to the neighbourhood of a building or grandparented structure, causing the building or grandparented structure to be: (a) Useless for the purpose of deriving income; and (b) Demolished or abandoned for later demolition. [**s. EE 47(4)** as amended by **s. 26** of the *Taxation (Tax Administration and Remedial Matters) Act 2011*] **Amount derived:** The amount that a person derives from an event described in **section EE 47(4)** (see above) is the amount of insurance, indemnity, or compensation they receive for the affected item. [**s. EE 45(8)** as amended by **s. 25** of the *Taxation (Tax Administration and Remedial Matters) Act 2011*] **Application date:** These amendments are treated as coming into force on 4 September 2010. [**S. 2(13)** of the *Taxation (Tax Administration and Remedial Matters) Act 2011*]

SECTION VIII: CANTERBURY EARTHQUAKE RELIEF DEPRECIATION RECOVERY RULES (continued)

(3) General rules: Consideration for a disposal or an event: s. EE 45	**General rules in s. EE 45: Consideration for a disposal or an event** Consideration = (amount derived) – (disposal cost in deriving the amount) (a) 'Amount derived' excludes GST for registered persons. (b) Disposal cost is the cost incurred in deriving the 'amount derived' excluding: (i) Any portion allowed as a deduction to the person other than as a deduction for an amount of depreciation loss; and (ii) Any portion already included in the 'amount derived'; and (iii) Any GST input tax deductible under s. 20(3) of the GST Act. (c) The consideration may be zero or a negative amount. (d) If the person has consideration that is not the item's market value, the amount that the person derives is the item's market value. ('Market value' means the GST exclusive market value if the person makes a taxable supply.) This market value rule does, however, not apply to: (i) Transfers under a relationship agreement; or (ii) Transfers upon a person's death to a person's spouse, close relatives or to a charity (i.e. transfers covered under ss. FC 3 & FC 4). **Special rules: Consideration for events giving rise to deemed disposals:** (a) Event in s. 47(2): In the case of a change of use, or change of location of use, other than because of a transfer under a relationship agreement, the consideration is the item's market value (GST exclusive if the person makes a taxable supply). (b) Event in s. 47(3): In the case of loss or theft, the amount that a person derives is the amount of insurance, indemnity, or compensation they receive for the loss or theft, excluding any GST if the consideration is for a supply of services by a registered person. (c) Event in s. 47(4): If property is irreparably damaged or a building is rendered useless, the amount that a person derives is the amount of insurance, indemnity, or compensation they receive for the affected item, excluding any GST if the consideration is for a supply of services by a registered person. (d) Event in s. 47(5): If property is repossessed by the seller, the consideration is the item's cost minus the net amount paid by the buyer to the seller, excluding any GST in the case of a registered person. (e) Event in s. 47(6): If a geothermal well is brought into use, the amount that a person derives is the amount of the deduction for depreciation loss allowed previously allowed under s. EE 39(4). (f) If the item is disposed of together with other items, other than because of a transfer under a relationship agreement, the amount that a person derives from the disposal of an item along with any other item, or from the occurrence of an event involving an item that also involves other items, is the item's market value (GST exclusive if the person makes a taxable supply). (g) Event in s. 47(10): For property for which a first year allowance was granted under the Income Tax Act 1976, the amount that a person derives is described in s. EZ 21(1)

SECTION VIII: CANTERBURY EARTHQUAKE RELIEF DEPRECIATION RECOVERY RULES (continued)

(4) Earthquake relief modifications to general rules on consideration for a disposal or an event: change to the tax treatment of disposal costs	**'Consideration' includes a deduction for disposal costs** **"Consideration"** from the disposal of an item, or from an event involving an item, equals "the amount that a person derives", excluding output GST charged, minus the amount (the "disposal cost") incurred in deriving that amount, to the extent to which the disposal cost: (a) Is not allowed as a deduction other than as a deduction for depreciation loss; and (b) Is not counted in "the amount that a person derives". **Consideration is a net amount:** The consideration is therefore now clearly a net amount – the amount derived less disposal costs. The consideration may be zero or a negative amount. **Amount derived distinguished from consideration:** Insurance proceeds and other amounts received are now referred to as "the amount that a person derives" whereas they were previously referred to as "consideration that a person derives". This clarifies that disposal costs are separately deducted when determining the "consideration". **Earthquake disposal and demolition costs deductible:** This change is consistent with the Minister of Revenue's announcement in October 2010 "that disposal and demolition costs incurred in relation to insured buildings irreparably damaged by the Christchurch earthquake would be dealt with as part of the disposal of the asset…The change ensures that the disposal and demolition cost of an insured earthquake damaged building are in effect deductible." (IRD *Fact sheet – Earthquake Depreciation Issues* April 2011) **Amendment is generic:** This amendment to the law relating to the deduction of disposal costs applies generally, not just to buildings damaged by the Christchurch earthquakes. **Retrospective application:** The amendment is retrospectively effective from 1 April 2008. [**s. EE 45**]
(5) Consideration for irreparable damage to property or damage rendering building useless	**Consideration for irreparable damage or damage rendering building useless** The amount that a person derives for irreparable damage to property other than a building, or damage to a building rendering it useless includes: The total of the amount of insurance, indemnity, or compensation, and the amount of proceeds from the disposal. (This includes, for example, scrap value.) (Previously, the amount of proceeds from the disposal was not specifically included.) [**Section EE 45(8)** as amended by **s. 36** of the *Taxation (Annual Rates, Returns Filing, and Remedial Matters) Act 2012*, effective from the 2011-12 income year onwards, except if a return has not been filed for 2010-11 under a Canterbury Earthquake extension of time – so includes taxpayers who have been granted an extension.]

SECTION VIII: CANTERBURY EARTHQUAKE RELIEF DEPRECIATION RECOVERY RULES (continued)

(6) General rules: Calculation of depreciation recovery income or loss on disposal: s. EE 48	**Calculation of depreciation recovery income or loss on disposal: s. EE 48** 1. Depreciation recovery income or loss on disposal depends on the consideration: (a) The amount of depreciation recovery income or loss on disposal depends on the consideration for the disposal. The rules for determining the consideration are set out in s. EE 45. (b) The person derives the depreciation recovery income in the income year that is the earliest income year in which the consideration can be reasonably estimated. 2. Depreciation recovery income if the consideration exceeds the adjusted tax value: If the consideration is more than the item's adjusted tax value on the date on which the disposal or the event occurs, the lesser of the following amounts is the amount of depreciation recovery income derived by the person: (a) The amount by which the consideration is more than the item's adjusted tax value on the date on which the disposal or the event occurs; and (b) The sum of: (i) The depreciation loss claimed for the item; plus (ii) Any deductions for software acquired pre-1993 (that are treated as income under s. CZ 11), if the item is software that was acquired pre-1993; plus (iii) Any capital contributions that were treated as reducing the item's adjusted tax value under s. DB 64. 3. Depreciation loss if the consideration is less than the item's adjusted tax value: If the consideration is less than the item's adjusted tax value on the date on which the disposal or the event occurs, the person has an amount of depreciation loss that is the amount by which the consideration is less than the item's adjusted tax value on that date. However, no depreciation loss can be claimed if the item is a building unless: (a) The building or grandparented structure has been rendered useless for the purpose of deriving income, and demolished or abandoned for later demolition as a result of damage to the building or grandparented structure or of the neighbourhood of the building or grandparented structure; and (b) The damage is caused: (i) By a natural event not under the control of the person, an agent of the person, or an associated person; and (ii) Other than as a result of the action or failure to act of the person, an agent of the person, or an associated person.

SECTION VIII: CANTERBURY EARTHQUAKE RELIEF DEPRECIATION RECOVERY RULES (continued)

(7) Earthquake relief modifications to general rules on calculation of depreciation recovery income and loss on disposal	**The rules regarding when depreciation recovery income is derived and when a depreciation loss must be claimed have been amended. The changes apply generally, and not just to assets affected by the Christchurch earthquakes.** The very specific exceptional circumstances in which a depreciation loss may be claimed on a building have also been changed, primarily to include buildings affected by the Christchurch earthquakes, but the changes could also apply in other very similar circumstances. **Depreciation recovery income derived when consideration estimated:** The rule that depreciation recovery income is derived in the income year in which the disposal or the disposal event occurs has been repealed. Depreciation recovery income is derived in the earliest income year in which the consideration can be reasonably estimated (the estimate year). [**s. EE 48(1)** as amended **& s. EE 48 (2B)** as inserted by **ss. 27(1) & 27(3)** of the *Taxation (Tax Administration and Remedial Matters) Act 2011*] **Timing rule for depreciation loss repealed:** The rule that a person has a depreciation loss in the income year in which the disposal or the disposal event occurs has been repealed. [**s. EE 48(2)** as amended by **s. 27(2)** of the *Taxation (Tax Administration and Remedial Matters) Act 2011*] **Depreciation loss for certain buildings:** A person does not have a depreciation loss for a building unless: (a) The building or grandparented structure has been rendered useless for the purpose of deriving income, and demolished or abandoned for later demolition as a result of damage to the building or grandparented structure or of the neighbourhood of the building or grandparented structure; and (b) The damage is caused – (i) By a natural event not under the control of the person, an agent of the person, or an associated person; and (ii) Other than as a result of the action or failure to act of the person, an agent of the person, or an associated person. [**s. EE 48(3)** as amended by **ss. 27(4) to 27(7)** of the *Taxation (Tax Administration and Remedial Matters) Act 2011*] **Application date:** These amendments are treated as coming into force on 4 September 2010. [**S. 2(13)** of the *Taxation (Tax Administration and Remedial Matters) Act 2011*]

SECTION VIII: CANTERBURY EARTHQUAKE RELIEF DEPRECIATION RECOVERY RULES (continued)

(8) Depreciation rollover relief when replacement property is acquired: s. EZ 23B **(As proposed to be amended by cl. 52B of SOP 257 to the Foreign Superannuation Tax Bill)**	**The requirements for depreciation recovery income rollover relief** for assets affected by the Canterbury earthquakes effective from 4 September 2010 are: 1. **There must be an excess recovery:** Depreciation recovery income must exceed depreciation loss in total for the items in each of **4 classes of affected property**: (a) A building or grandparented structure (not depreciated in a pool); (b) Commercial fit-out (not depreciated in a pool); (c) Depreciable property for which the pool method of depreciation is used; (d) Other depreciable property; [**s. EZ 23B(1)(c) & (d)** as replaced by **s. 64(1)** of 2014 No. 4 **& s. EZ 23B(10)(b)**] 2. **Basis for earthquake compensation:** Insurance receipts or compensation must be received in an income year before the **2019-20** income year, in relation to: **affected property** other than depreciable intangible property, in **1 of the (above) 4 classes,** that is not a class that is linked with a replacement interest under **s. EZ 23BB**, that is: (a) If not a building or a grandparented structure, irreparably damaged. (b) If a building or grandparented structure, rendered useless for the purpose of deriving income, and demolished or abandoned for later demolition as a result of damage to the building or grandparented structure or of the neighbourhood of the building or grandparented structure. (c) If not irreparably damaged, assessed as uneconomic to repair so that the property is deemed to be disposed of & reacquired under s. EZ 23C or EZ 65. **[s. EZ 23B(1)(a) & (b)** as replaced by **s. 64(1)** of 2014 No. 4 (the *Foreign Superannuation Tax Act*) applying for the 2010–11 to the 2019-20 income years.] 3. **There must be plans to acquire replacement depreciable property** that: If it replaces a building, grandparented structure or commercial fitout (other than pool-depreciated property) – i.e. property described in s. EZ 23(10)(b)(i) or (ii) - is itself a replacement building, grandparented structure or commercial fit-out and is located in "greater Christchurch", as that term is defined in s. 4 of the *Canterbury Earthquake Recovery Act 2011*. [**s. EZ 23B(1)(e) & EZ 23B(7)** as amended by **s. 64(6)** of 2014 No. 4**]** 4. **A written election notice must be given to the Commissioner every year:** beginning with the first year in which an excess recovery is realised (the estimate year), by the later of 31 January 2012 or the date on which the return of income is filed for the estimate year: (a) Specifying the affected property; (b) Indicating in which of the affected classes each item of affected property is included; (see 1. above) (c) Giving details of each item of replacement property acquired in the year and the affected class to which the item is linked; (d) Stating the amount of expenditure on each replacement item and the reduction of that expenditure for the purposes of determining adjusted tax value or depreciation loss; and (e) Stating the amount, for the affected class of the suspended depreciation recovery income at the end of the year. [**s. EZ 23B(1)(f)** as inserted by **s. 64(1)** of 2014 No. 4, **EZ 23B(9) & EZ 23B(10)**]

SECTION VIII: CANTERBURY EARTHQUAKE RELIEF DEPRECIATION RECOVERY RULES (continued)

(8) Depreciation rollover relief when replacement property is acquired: s. EZ 23B (continued)	**The method for allocating depreciation recovery income against the depreciable cost of replacement assets and for returning any remaining depreciation recovery income** is as follows: (a) Determine the net depreciation recovery income (the excess recovery). (b) Apply the excess recovery towards a reduction of the depreciable cost of replacement assets, using a specified formula approach. (c) Return any remaining depreciation recovery income (the suspended recovery income). **Excess recovery:** For each affected class of depreciable property (see **1. On page 12** above) for which insurance or other compensation is received, the amount by which total depreciation recovered exceeds total depreciation loss is the excess recovery: **[Total depreciation recovery income] – [total depreciation loss] = [excess recovery]** The excess recovery is the starting suspended recovery income (i.e. the potential depreciation recovery income if a decision is made not to replace any assets in the affected class). **Replacement asset cost reduction:** The excess recovery for an affected class of depreciable property is progressively applied to reduce the cost for depreciation purposes of replacement assets that are linked with the affected class of depreciable property. **[Cost of replacement asset for depreciation purposes] = [replacement cost] – [cost reduction]** The cost reduction is the portion of the excess recovery that is allocated to assets and consequently reduces the depreciable cost of those assets: (a) If the pool method was not used for property replaced: cost reduction is either a fraction of the excess recovery, or zero, determined as follows: (i) To the extent the cumulative replacement cost does not exceed the original cost of the property replaced (the limited replacement cost is the replacement cost up to a cumulative maximum of the original cost), the replacement cost is reduced by a fraction of the excess recovery calculated as follows: $$\frac{\textbf{Limited replacement cost}}{\textbf{Original cost of affected property}} \textbf{ x Excess recovery}$$ (ii) To the extent the replacement cost exceeds the original cost of the property replaced, the cost reduction is zero. (b) If the pool method of depreciation was used for the property replaced: cost reduction is the cumulative replacement cost up to a maximum of the excess recovery. **Suspended recovery income is** any excess recovery that remains after cost reduction of assets in the affected class and after deducting any suspended recovery income attributed to an earlier year by **s. EZ 23B(8)** (see **(10)** below). [**s. EZ 23B(2) to (6)** including replacement **s. EZ 23B(2) and (2B)** inserted by **s. 64(1)** of 2014 No. 4, and amendments **to s. EZ 23B(3) to (6)** in **s. 64(2) to (5)** of 2014 No. 4 to clarify that the rules apply to affected property class by class]

SECTION VIII: CANTERBURY EARTHQUAKE RELIEF DEPRECIATION RECOVERY RULES (continued)

(8) Depreciation rollover relief when replacement property is acquired: s. EZ 23B (continued)	**Return filing requirements for suspended recovery income** 1. Suspended recovery income is the excess recovery that remains at the end of each income year after cost reductions for replacements made in that year, and after attribution of suspended recovery income as depreciation recovery income to that year under s. EZ 23B(8). 2. An annual written notice of election to the Commissioner (see **4. On page 12** above) specifying the suspended recovery income at the end of each year, must be filed with the return of income for each year beginning from the estimate year (see **4. On page 12** above) and ending with: (a) The year in which there is no more suspended recovery income because the excess recovery has been completely allocated to replacement assets; or (b) The year in which a decision is made not to acquire any more replacement property and there is suspended recovery income because the excess recovery has not been completely allocated to replacement assets: in this case, there will be depreciation recovery income in that year equal to the remaining suspended recovery income; or (c) The year in which the person making the election goes into liquidation or becomes bankrupt while there is suspended recovery income because the excess recovery has not been completely allocated to replacement assets; or (d) The 2018-19 income year if any suspended recovery income remains at that time: there will be depreciation recovery income at the end of the 2018-19 income year equal to any remaining suspended recovery income. [**s. EE 1(3)(d), EE 44(2)(d) & EZ 23B(9) to (10)** as inserted by **ss. 23, 24 & 43** of the *Taxation (Tax Administration and Remedial Matters) Act 2011* and **s. EZ 23B(8)** as replaced by **s. 64(7)** of 2014 No. 4 (the *Foreign Superannuation Tax Act*)]
(8) Depreciation rollover relief for replacement property: s. EZ 23B (cont.)	**The depreciation recovery rules will treat cost reduction as depreciation**: The cost reduction allowed on a replacement item is treated as an amount of depreciation loss for the item for which a deduction was allowed. [**s. EZ 23B(11)** inserted by **s. 23, 24 & 43** of the *Tax Administration Act 2011*]
(8) Depreciation rollover relief when replacement property is acquired: s. EZ 23B (continued)	**Clarifying the transition between s. EZ 23B and EZ 23BB and order of acquisition of replacement property** 1. When a person has in the current year an amount of suspended recovery income for an affected class of buildings or grandparented structures, and has made an election under s. EZ 23B to link replacement property (the **linked property**) to the affected class, and has not incurred expenditure in acquiring the linked property, the person may choose, instead, to make an election under s. EZ 23BB linking the affected class with replacement property, which may include linked property. 2. When items of replacement property are acquired at the same time, and the effect of s. EZ 23B depends on the order in which the items are acquired, the items are acquired in the order chosen by the person in the first tax return in which the order of acquisition is taken into account. [**s. EZ 23B(11B) & (11C)** as inserted by **s. 64(8)** of 2014 No. 4]

SECTION VIII: CANTERBURY EARTHQUAKE RELIEF DEPRECIATION RECOVERY RULES (continued)

(9) Inland Revenue examples of how s. EZ 23B operates	**Inland Revenue has provided the following examples, on its website, of how s. EZ 23B operates:** **Example 1** Plant and equipment (not previously depreciated under the pool method) destroyed by the Canterbury earthquake had a cost of $1 million. On the day of the earthquake the plant and equipment had an adjusted tax book value of $700,000. The owner receives an insurance payment of $1 million. The net depreciation recovered is, therefore, $300,000. The replacement assets were acquired over two years at a cost of $400,000 per year. In year three the owner decides to acquire no more replacement assets, even though they originally expected to spend well over $1 million on the replacement assets. The $300,000 suspended recovery income is allocated in the following way • Year 1 ($400,000 x $300,000) ÷ $1,000,000 = $120,000 • Year 2 ($400,000 x $300,000) ÷ $1,000,000 = $120,000 • The balance of $60,000 is taxed in the year that the taxpayer decides to make no further investment in replacement property. **Example 2** Plant and equipment (not previously depreciated under the pool method) destroyed by the Canterbury earthquake had a cost of $1 million. On the day of the earthquake the plant and equipment had an adjusted tax book value of $700,000. The owner receives an insurance payment of $1 million. The net depreciation recovered is, therefore, $300,000. The replacement assets were acquired over two years at a cost of $400,000 per year. In year three the taxpayer decides to acquire a further $400,000 of replacement assets. As per the previous example, the taxpayer has already rolled over $240,000 of depreciation recovery income in years 1 and 2. Applying the formula in EZ 23B(4)(b) the limited replacement cost is the lesser of $1,000,000 - $800,000 = $200,000 and the $400,000 spent on acquiring the replacement property. The amount of the reduction to the item's opening adjusted tax value and the amount of suspended recovery income (under subsection (3)(a) or (b)) is $60,000 (($200,000 x $300,000) ÷ $1,000,00). One month later the taxpayer decides to acquire another item of plant for $10,000. Applying subsection (4)(a) the amount of the reduction under subsection (3)(a) or (b) is zero. This is because the cost of the affected property is less that the person's total expenditure in acquiring other replacement property. In this example the person has spent $1,210,000 replacing property that originally cost $1,000,000. http://www.ird.govt.nz/technical-tax/legislation/2011/2011-63/2011-63-canterbury-earthquake-relief-measures/

SECTION VIII: CANTERBURY EARTHQUAKE RELIEF DEPRECIATION RECOVERY RULES (continued)

(9) Inland Revenue examples on how s. EZ 23B operates (continued)	**Inland Revenue examples, on its website, of how s. EZ 23B operates (continued)** **Example 3** In February 2011, a 31 March balance date firm's building is destroyed in the Canterbury earthquake. The building originally cost $3 million. The book value is $2 million, reflecting accumulated depreciation of $1 million. The replacement insurance proceeds are $6 million and the insurance company "delivers" the replacement building on 15 June 2014. In the absence of any rollover relief the building owner will have depreciation recovered taxable income of $1 million. The insurance proceeds over the $3 million cost price are still a tax free capital gain. The law now allows the owner to roll the depreciation recovered into the replacement building, provided the replacement building is located in greater Christchurch. The insurance proceeds are known on 30 June 2011. The depreciation recovery income would be allocated to the tax year ending 31 March 2012. In the tax return for the tax year ending on 31 March 2011, the taxpayer files a written election to defer the depreciation recovered pending acquisition of the replacement building. Therefore the depreciation recovery income is suspended for taxation purposes. For the tax years ending on 31 March 2013 and 2014 this income stays suspended, provided the taxpayer continues to elect to defer the depreciation recovery income. The replacement building is delivered on 15 June 2014. The 31 March 2015 tax return will include this new building at a cost of $6 million, and, immediately upon acquisition, it will have an adjusted tax value of $5 million. However, for straight line depreciation purposes, its cost will be $5 million. Again notice will have to be filed with the 31 March 2015 tax return advising that the deferred depreciation recovered income has been allocated to the replacement building. When the replacement asset is sold the difference between the adjusted tax value and building cost, in this case $1 million, will be fully taxable as depreciation recovery income (provided it is sold for at least $6 million). Therefore the tax liability associated with disposal of the destroyed building has been rolled forward until disposal of the replacement building. http://www.ird.govt.nz/technical-tax/legislation/2011/2011-63/2011-63-canterbury-earthquake-relief-measures/

SECTION VIII: CANTERBURY EARTHQUAKE RELIEF DEPRECIATION RECOVERY RULES (continued)

(10) Inland Revenue QWBA on how s. EZ 23B operates	**Inland Revenue QWBA on how the formula in s. EZ 23B works for property that is not depreciated in a pool** **How the formula works** The formula applies to the following groups or classes of affected property: (a) A building or grandparented structure (not depreciated in a pool); (b) Commercial fit-out (not depreciated in a pool); (c) Other depreciable property (not depreciated in a pool) (s EZ 23B(10)). The following steps must be taken for each of these affected classes of depreciable property: *Step 1:* Calculate the depreciation recovery income (called the excess recovery). *Step 2:* Calculate, using the formula, how much of the excess recovery is available to be deferred (called the suspended recovery income) or deferred and allocated against the cost of the replacement item, or both. *Step 3:* Reduce the adjusted tax value of the replacement item by the amount calculated under the formula. *Step 4:* Reduce the suspended recovery income by the amount calculated under the formula. *Repeat steps 2–4,* if more than one replacement item is purchased. *Step 5:* Return any unallocated suspended recovery income.

SECTION VIII: CANTERBURY EARTHQUAKE RELIEF DEPRECIATION RECOVERY RULES (continued)

(10) Inland Revenue QWBA on how s. EZ 23B operates (continued)	**Inland Revenue QWBA on how the formula in s. EZ 23B works for property that is not depreciated in a pool (continued)** **Example 1: Acquisition of a replacement building costing more than the destroyed building** Tom receives insurance proceeds of $10 million for a building destroyed in a Canterbury earthquake. The original cost of the building was $10 million and its adjusted tax value was $9 million. Tom plans to acquire a replacement building costing $12 million. Because the cost of the replacement building is equal to or greater than the cost of the affected property, the whole excess recovery amount should be available to be rolled-over against the cost of the replacement building. ***Step 1: Calculate the excess recovery*** The insurance proceeds exceed the building's adjusted tax value by $1 million. Therefore, Tom has an **excess recovery of $1 million**. ***Step 2: Calculate the suspended recovery income*** Tom now has to calculate the suspended recovery income by applying the following formula: $$\frac{\textbf{limited replacement cost} \times \textbf{excess recovery}}{\textbf{affected cost}}$$ The limited replacement cost is the lesser of: (i) The amount by which the cost of the affected property exceeds the total expenditure in acquiring other replacement property, with or before the replacement item; as no other replacement property has been acquired with or before the $12 million replacement building, the amount is: $10 million – $0 = $10 million; or (ii) The amount spent on the replacement item, which in this case is $12 million. The limited replacement cost is the lesser of the above two amounts, which is $10 million. The affected cost is the total cost of the affected property, which is $10 million. The suspended recovery income can now be calculated using the following amounts in the above formula: $$\frac{\textbf{\$10million} \times \textbf{\$1million}}{\textbf{\$10million}} = \textbf{\$1million}$$ ***Step 3: Reduce the adjusted tax value of the replacement item by the amount calculated under the formula*** The suspended recovery income of $1 million is now available to roll-over into the adjusted tax value of the replacement building as follows: $12 million (cost of replacement property) – $1 million (suspended recovery income) = $11 million (adjusted tax value) ***Step 4: Reduce the suspended recovery income by the amount calculated under the formula*** The suspended recovery income of $1 million is now also available to reduce the starting suspended recovery income: $1 million (excess recovery) – $1 million (suspended recovery income) = $0 ***Step 5: Return any unallocated suspended recovery income*** Since the suspended recovery income has been reduced to zero, Tom has no liability to return any unallocated suspended recovery income.

SECTION VIII: CANTERBURY EARTHQUAKE RELIEF DEPRECIATION RECOVERY RULES (continued)

(10) Inland Revenue QWBA on how s. EZ 23B operates (continued)	**Example 2: Acquisition of a replacement building costing less than the destroyed building** Kiwico Ltd receives insurance proceeds of $20 million for a building destroyed in a Canterbury earthquake. The original cost of the building was $20 million and its adjusted tax value was $18 million. Kiwico Ltd plans to acquire a replacement building costing $15 million. Because the cost of the replacement building is less than the cost of the affected property, only some of the excess recovery amount can be allocated against the cost of the replacement building. ***Step 1: Calculate the excess recovery*** The insurance proceeds exceed the building's adjusted tax value by $2 million. Therefore, Kiwico Ltd has an excess recovery of $2 million. ***Step 2: Calculate the suspended recovery income*** Kiwico Ltd now has to calculate the suspended recovery income by applying the following formula: $$\frac{\textbf{limited replacement cost} \times \textbf{excess recovery}}{\textbf{affected cost}}$$ The limited replacement cost is $15 million, which is the lesser of: (i) The amount by which the cost of the damaged asset exceeds the total expenditure in acquiring other replacement property, with or before the replacement item; no other replacement property has been acquired with or before the $15 million replacement building; therefore, the amount is: $20 million – $0 = $20 million; or (ii) The amount spent on the replacement item, which is $15 million. The affected cost is the total cost of the affected property, which is $20 million. The suspended recovery income can now be calculated using the following amounts in the above formula: $$\frac{\textbf{\$15million} \times \textbf{\$2million}}{\textbf{\$20million}} = \textbf{\$1.5million}$$ ***Step 3: Reduce the adjusted tax value of the replacement item by the amount calculated under the formula*** The suspended recovery income of $1.5 million is now available to roll-over into the cost of the replacement building: $15 million (cost of replacement property) – $1.5 million (suspended recovery income) = $13.5 million (adjusted tax value) ***Step 4: Reduce the suspended recovery income by the amount calculated under the formula*** The suspended recovery income of $1.5 million is now also available to reduce the suspended recovery income: $2 million (excess recovery) – $1.5 million (suspended recovery income) = $500,000 ***Step 5: Return any unallocated suspended recovery income*** The unallocated suspended recovery income of $500,000 must be returned as depreciation recovery income in the income year in which Kiwico decides not to acquire any more replacement property in this class or at the end of the 2015–16 income year (whichever comes first).

SECTION VIII: CANTERBURY EARTHQUAKE RELIEF DEPRECIATION RECOVERY RULES (continued)

(10) Inland Revenue QWBA on how s. EZ 23B operates (continued)	**Example 3: Multiple replacement items** The following example demonstrates how the formula works where more than one item of replacement property is acquired. Linda receives insurance proceeds of $1 million for plant and equipment (not previously depreciated under the pool method) destroyed in a Canterbury earthquake. The original cost of the plant and equipment was $1 million and its adjusted tax value was $700,000. Linda acquires a replacement item in each of years 1, 2 and 3, at a cost of $400,000 each, and a final replacement item costing $10,000 in year 4. ***Step 1: Calculate the excess recovery*** The insurance proceeds exceed the adjusted tax value of the plant and equipment by $300,000. Therefore, Linda has an excess recovery of $300,000. ***Year 1 – Step 2: Calculate the suspended recovery income*** Linda now has to calculate the suspended recovery income for year 1 by applying the following formula: $$\frac{\textbf{limited replacement cost x excess recovery}}{\textbf{affected cost}}$$ The limited replacement cost is $400,000, which is the lesser of: (i) The amount by which the cost of the affected property exceeds the total expenditure in acquiring other replacement property, with or before the replacement item; no other replacement property has been acquired with or before the first replacement item of $400,000; therefore, the amount is: $1 million – $0 = $1 million; or (ii) The amount spent on the replacement item, which is $400,000. The affected cost is the total cost of the affected property, which is $1 million. The suspended recovery income for year 1 can now be calculated using the following amounts in the above formula: $$\frac{\textbf{\$400,000 x \$300,000}}{\textbf{\$1million}} = \textbf{\$120,000}$$ ***Year 1 – Step 3: Reduce the adjusted tax value of the replacement item by the amount calculated under the formula*** The suspended recovery income of $120,000 is now available to roll-over into the adjusted tax value of the replacement item: $400,000 (cost of replacement property) – $120,000 (suspended recovery income) = $280,000 (adjusted tax value) ***Year 1 – Step 4: Reduce the suspended recovery income by the amount calculated under the formula*** The suspended recovery income of $120,000 is now also available to reduce the suspended recovery income: $300,000 (excess recovery) – $120,000 (suspended recovery income) = $180,000

SECTION VIII: CANTERBURY EARTHQUAKE RELIEF DEPRECIATION RECOVERY RULES (continued)

(10) Inland Revenue QWBA on how s. EZ 23B operates (continued)	**Example 3: Multiple replacement items** The following example demonstrates how the formula works where more than one item of replacement property is acquired. Linda receives insurance proceeds of $1 million for plant and equipment (not previously depreciated under the pool method) destroyed in a Canterbury earthquake. The original cost of the plant and equipment was $1 million and its adjusted tax value was $700,000. Linda acquires a replacement item in each of years 1, 2 and 3, at a cost of $400,000 each, and a final replacement item costing $10,000 in year 4. ***Step 1: Calculate the excess recovery*** The insurance proceeds exceed the adjusted tax value of the plant and equipment by $300,000. Therefore, Linda has an excess recovery of $300,000. ***Year 1 – Step 2: Calculate the suspended recovery income*** Linda now has to calculate the suspended recovery income for year 1 by applying the following formula: $$\frac{\textbf{limited replacement cost x excess recovery}}{\textbf{affected cost}}$$ The limited replacement cost is $400,000, which is the lesser of: (iii) The amount by which the cost of the affected property exceeds the total expenditure in acquiring other replacement property, with or before the replacement item; no other replacement property has been acquired with or before the first replacement item of $400,000; therefore, the amount is: $1 million – $0 = $1 million; or (iv) The amount spent on the replacement item, which is $400,000. The affected cost is the total cost of the affected property, which is $1 million. The suspended recovery income for year 1 can now be calculated using the following amounts in the above formula: $$\frac{\textbf{\$400,000 x \$300,000}}{\textbf{\$1million}} = \textbf{\$120,000}$$ ***Year 1 – Step 3: Reduce the adjusted tax value of the replacement item by the amount calculated under the formula*** The suspended recovery income of $120,000 is now available to roll-over into the adjusted tax value of the replacement item: $400,000 (cost of replacement property) – $120,000 (suspended recovery income) = $280,000 (adjusted tax value) ***Year 1 – Step 4: Reduce the suspended recovery income by the amount calculated under the formula*** The suspended recovery income of $120,000 is now also available to reduce the suspended recovery income: $300,000 (excess recovery) – $120,000 (suspended recovery income) = $180,000

SECTION VIII: CANTERBURY EARTHQUAKE RELIEF DEPRECIATION RECOVERY RULES (continued)

(10) Inland Revenue QWBA on how s. EZ 23B operates (continued)	**Example 3: Multiple replacement items (continued)** ***The Year 3 calculation is as follows:*** As previously stated, Linda receives insurance proceeds of $1 million for plant and equipment (not previously depreciated under the pool method) destroyed in a Canterbury earthquake. The original cost of the plant and equipment was $1 million and its adjusted tax value was $700,000. Linda acquires a replacement item in each of years 1, 2 and 3, at a cost of $400,000 each, and a final replacement item costing $10,000 in year 4. ***Step 1: Calculate the excess recovery*** The insurance proceeds exceed the adjusted tax value of the plant and equipment by $300,000. Therefore, Linda has an excess recovery of $300,000. ***Year 3 – Step 2: Calculate the suspended recovery income*** Linda now has to calculate the suspended recovery income for year 1 by applying the following formula: $$\frac{\textbf{limited replacement cost x excess recovery}}{\textbf{affected cost}}$$ The limited replacement cost is $200,000, which is the lesser of: (i) The amount by which the cost of the affected property exceeds the total expenditure in acquiring other replacement property, with or before the second replacement item; the total expenditure in acquiring other replacement property with or before the third replacement item is $800,000 (being the cost of the first replacement item); therefore, the amount is: $1 m – $800,000 = $200,000; or (ii) The amount spent on the replacement item, which is $400,000. The affected cost is the total cost of the affected property, which is $1 million. The suspended recovery income for year 1 can now be calculated using the following amounts in the above formula: $$\frac{\textbf{\$200,000 x \$300,000}}{\textbf{\$1million}} = \textbf{\$60,000}$$ ***Year 3 – Step 3: Reduce the adjusted tax value of the replacement item by the amount calculated under the formula*** The suspended recovery income of $60,000 is now available to roll-over into the adjusted tax value of the replacement item: $400,000 (cost of replacement property) – $60,000 (suspended recovery income) = $340,000 (adjusted tax value) ***Year 3 – Step 4: Reduce the suspended recovery income by the amount calculated under the formula*** The suspended recovery income of $60,000 is now also available to reduce the suspended recovery income: $60,000 (excess recovery as reduced in year 2) – $60,000 (suspended recovery income) = $0 At the end of year 3, the combined cost of the replacement items is reduced by a total of $300,000 from $1.2 million to $900,000. The depreciation recovery income of $300,000 is fully rolled into the adjusted tax value of the replacement property, as expected, because the cost of the replacements exceeds the cost of the affected items.

SECTION VIII: CANTERBURY EARTHQUAKE RELIEF DEPRECIATION RECOVERY RULES (continued)

(10) Inland Revenue QWBA on how s. EZ 23B operates (continued)	**Example 3: Multiple replacement items (continued)** ***The Year 3 calculation is as follows:*** As previously stated, Linda receives insurance proceeds of $1 million for plant and equipment (not previously depreciated under the pool method) destroyed in a Canterbury earthquake. The original cost of the plant and equipment was $1 million and its adjusted tax value was $700,000. Linda acquires a replacement item in each of years 1, 2 and 3, at a cost of $400,000 each, and a final replacement item costing $10,000 in year 4. ***Step 1: Calculate the excess recovery*** The insurance proceeds exceed the adjusted tax value of the plant and equipment by $300,000. Therefore, Linda has an excess recovery of $300,000. ***Year 3 – Step 2: Calculate the suspended recovery income*** Linda now has to calculate the suspended recovery income for year 1 by applying the following formula: $$\frac{\textbf{limited replacement cost x excess recovery}}{\textbf{affected cost}}$$ The limited replacement cost is $200,000, which is the lesser of: (iii) The amount by which the cost of the affected property exceeds the total expenditure in acquiring other replacement property, with or before the second replacement item; the total expenditure in acquiring other replacement property with or before the third replacement item is $800,000 (being the cost of the first replacement item); therefore, the amount is: $1 m – $800,000 = $200,000; or (iv) The amount spent on the replacement item, which is $400,000. The affected cost is the total cost of the affected property, which is $1 million. The suspended recovery income for year 1 can now be calculated using the following amounts in the above formula: $$\frac{\textbf{\$200,000 x \$300,000}}{\textbf{\$1million}} = \textbf{\$60,000}$$ ***Year 3 – Step 3: Reduce the adjusted tax value of the replacement item by the amount calculated under the formula*** The suspended recovery income of $60,000 is now available to roll-over into the adjusted tax value of the replacement item: $400,000 (cost of replacement property) – $60,000 (suspended recovery income) = $340,000 (adjusted tax value) ***Year 3 – Step 4: Reduce the suspended recovery income by the amount calculated under the formula*** The suspended recovery income of $60,000 is now also available to reduce the suspended recovery income: $60,000 (excess recovery as reduced in year 2) – $60,000 (suspended recovery income) = $0 At the end of year 3, the combined cost of the replacement items is reduced by a total of $300,000 from $1.2 million to $900,000. The depreciation recovery income of $300,000 is fully rolled into the adjusted tax value of the replacement property, as expected, because the cost of the replacements exceeds the cost of the affected items.

SECTION VIII: CANTERBURY EARTHQUAKE RELIEF DEPRECIATION RECOVERY RULES (continued)

(11) Depreciation rollover relief when an interest in a company is acquired: s. EZ 23BB **(As inserted by s. 65 of the Foreign Superannuation Tax Act 2014)**	**The requirements for depreciation recovery income rollover relief** for a replacement interest in an owning company effective from 4 September 2010 are: 1. **There must be an excess recovery:** Depreciation recovery income must exceed depreciation loss in total for the items in each of **3 classes of affected property**: (a) A building or grandparented structure; (b) Commercial fit-out; (c) Other depreciable property; [**s. EZ 23BB(1)(c) & (d)** and **(11)(b)** as inserted by **s. 65** of 2014 No. 4] 2. **Basis for earthquake compensation:** Insurance receipts or compensation must be received in an income year before the **2019-20** income year, in relation to: **affected property**, other than depreciable intangible property or pool depreciated property, in **1 of the (above) 3 classes,** that is not a class that is linked with a replacement property under **s. EZ 23B**, that is: (a) If not a building or a grandparented structure, irreparably damaged. (b) If a building or grandparented structure, rendered useless for the purpose of deriving income, and demolished, or abandoned for later demolition, as a result of damage to itself or to its neighbourhood. (c) If not irreparably damaged, assessed as uneconomic to repair so that the property is deemed to be disposed of & reacquired under s. EZ 23C or EZ 65. **[s. EZ 23BB(1)(a) & (b)** as inserted by **s. 65** of the *Foreign Superannuation Tax Act 2014* applying for the 2010–11 to the 2019-20 income years.] 3. **There must be a replacement interest in a voting interest in a company** that: (a) The person holds the voting interest in or is the settlor of a trust of which the trustee holds the voting interest; and (b) Has a purpose of acquiring replacement depreciable property; and **(c)** If the affected class is a building, grandparented structure or commercial fitout, the replacement property for the person or the owning company is in the same affected class and is located in greater Christchurch. [**s. EZ 23BB(1)(e) & (f)** and **EZ 23BB(6)** as inserted by **s. 65** of 2014 No. 4**]** 4. **A written election notice must be given to the Commissioner every year:** beginning with the first year in which an excess recovery is realised (the estimate year), by the later of 31 January 2012 or the date on which the return of income is filed for the estimate year: (a) Describing the affected property; (b) Indicating which of the affected classes the affected property is in; (see 1.) (c) Giving details of each item of replacement property in which a replacement interest is held in the year & the affected class to which the interest is linked; (d) Giving, for each replacement interest held in the year, the expenditure of the owning company on the replacement property, the shareholding of the person's holding interest in the owning company, and the shareholding of the person in, or the fraction of the trust corpus settled by the person on, the person's holding entity; and (e) Giving, for each category of replacement property, the suspended recovery income and the depreciation recovery income at the end of the year. [**s. EZ 23BB(1)(g), EZ 23BB(10) & (11)** as inserted by **s. 65** of The *Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Act 2014* – 2014 No. 4]

SECTION VIII: CANTERBURY EARTHQUAKE RELIEF DEPRECIATION RECOVERY RULES (continued)

(11) Depreciation rollover relief when an interest in a company is acquired: s. EZ 23BB (continued)	**The method for allocating depreciation recovery income against the depreciable cost of replacement assets acquired through a replacement interest, and for returning any remaining depreciation recovery income**, is: (a) Determine the net depreciation recovery income (the excess recovery). (b) Calculate suspended recovery income and reduce depreciation recovery income for replacement assets acquired through a replacement interest. (c) Return remaining depreciation recovery income in the current year. (d) Return suspended recovery income in a later year. **Excess recovery:** For each affected class of depreciable property (see **(14)** above) for which insurance or other compensation is received, the amount by which total depreciation recovered exceeds total depreciation loss is the excess recovery: **[Total depreciation recovery income] – [total depreciation loss] = [excess recovery]** The excess recovery is the starting depreciation recovery income if no assets in the affected class are replaced through the replacement interest). **Depreciation recovery reduction = suspended recovery income:** The opening depreciation recovery income for an affected class of depreciable property is progressively reduced by suspended recovery income as replacement assets that are linked with the affected class are acquired through replacement interests. **[Opening depreciation recovery income] - [suspended recovery income] = [Recovery income]** When a person acquires a replacement interest and links the replacement interest with an affected class, the amount given below is the suspended recovery income for the replacement interest ("SRI") and the reduction in depreciation recovery income for the affected class ("RDRI"): ***Step 1:*** Determine the person's fractional interest in the replacement property - the "**fractional interest value**": $$\left[\begin{array}{l}\text{Voting interest in the owning company held by the person} \\ \text{or} \\ \left(\begin{array}{l}\text{Person's} \\ \text{Settlement fraction} \\ \text{of trust corpus}\end{array}\right) \text{ x } \left(\begin{array}{l}\text{Voting interest in} \\ \text{the owning company} \\ \text{held by the trustee}\end{array}\right)\end{array}\right] \text{ x } \left[\begin{array}{l}\text{Expenditure by the owning} \\ \text{company on the} \\ \text{replacement property}\end{array}\right]$$ ***Step 2:*** Calculate the SRI and the RDRI as zero, if the original cost of the property replaced equals or is less than the total of the fractional interest values for other replacement interests the person acquired with or before the replacement interest. ***Step 3:*** Calculate the SRI and the RDRI using the following formula if the cost exceeds the fractional interest values: $$\frac{\text{Limited replacement cost}}{\text{Original cost of affected property}} \text{ x Excess recovery}$$ Limited replacement cost is the lesser of (see the IRD example on **pages 17 - 23**): (a) The fractional interest value of the replacement interest; and (b) The amount by which the cost exceeds the cumulative fractional interest values. [**s. EZ 23BB(2) to (5) & EZ 23BB(12)-(13)** inserted by **s. 65**]

SECTION VIII: CANTERBURY EARTHQUAKE RELIEF DEPRECIATION RECOVERY RULES (continued)

(11) Depreciation rollover relief when an interest in a company is acquired: s. EZ 23BB (continued)	**Suspended recovery income** for a person's replacement interest is not depreciation recovery income for the person arising from the replacement interest unless it is attributed to an income year by s. EZ 23BB(8). **However, a person will have depreciation recovery income in the following circumstances**: 1. If the owning company in which a person has a replacement interest disposes of the replacement property in an income year, the person will have depreciation recovery income equal to the "**fractional interest value**" of the replacement interest (see **page 25** above) and the suspended recovery income will be correspondingly reduced. (**Wrong: Should be "suspended recovery income" ?)** 2. A person has, in an income year, an amount of depreciation recovery income equal to the suspended recovery income for a replacement interest and affected property at the earliest of: (a) The 2018-19 income year if the owning company has not acquired the replacement property relating to the replacement interest and the affected property by the end of that year; or (b) The income year in which the person disposes of the replacement interest; or (c) The income year in which the person goes into liquidation or becomes bankrupt. [**s. EZ 23BB(8) & (9)** as inserted by **s. 65** the *Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Act 2014*]
(11) Depreciation rollover relief when an interest in a company is acquired: s. EZ 23BB (continued)	**Annual written notice to Commissioner of suspended recovery income:** An annual written notice of election to the Commissioner (see **4. on page 24** above) specifying the information **listed in 4. on page 24** above, must be filed with the tax return beginning from the estimate year (see **4. on page 24** above) and ending with: (a) The year in which there is no more suspended recovery income because the excess recovery has been completely allocated to replacement property; or (b) The year in which the person disposes of the replacement interest; or (c) The year in which the person making the election goes into liquidation or becomes bankrupt while there is suspended recovery income because the excess recovery has not been completely allocated to replacement assets; or (d) The 2018-19 income year if any suspended recovery income remains at that time: there will be depreciation recovery income at the end of the 2018-19 income year equal to any remaining suspended recovery income. [**s. EZ 23BB(11)** as inserted by **s. 65** of *Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Act 2014*]
(11) Depreciation rollover relief when an interest in a company is acquired: s. EZ 23BB (continued	**Order of acquisition for items acquired at the same time** When items of replacement property are acquired at the same time, and the effect of s. EZ 23BB depends on the order in which the items are acquired, the items are acquired in the order chosen by the person in the first tax return in which the order of acquisition is taken into account. [**s. EZ 23B(14)** as inserted by **s. 65** of the *Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Act 2014*]

SECTION VIII: CANTERBURY EARTHQUAKE RELIEF DEPRECIATION RECOVERY RULES (continued)

(12) Optional timing rule for depreciation recovery income and depreciation loss upon a deemed disposal: s. EZ 23F **(Changing to s. EZ 73 effective 1 April 2016)**	**New s. EZ 23F (from 1 April 2016: s. EZ 73): Optional deferral of depreciation recovery income and disposal costs, upon a deemed disposal, to 2018-19 if disposal costs not incurred or able to be estimated until then** The calculation and allocation rules in s. EE 48 for depreciation recovery income and depreciation loss will not apply, and the income from insurance and disposal, and the deductions for disposal costs and depreciation loss are allocated to income years according to this s. EZ 23F (from 1 April 2016: s. EZ 73) if: (a) An item of depreciable property is damaged by a Canterbury earthquake as that term is defined in s. 4 of the Canterbury Earthquake Recovery Act 2011; and (b) The damage: (i) Results in a deemed disposal and reacquisition under s. EZ 23C (from 1 April 2016: s. EZ 70) because of property being uneconomic to repair; or (ii) Results in a deemed disposal under s. EE 47(4) due to irreparable damage to non-building property or a building being rendered useless and demolished or abandoned; and (c) The person is entitled to insurance or compensation for damage to the item; and (d) The person chooses to apply this section for all items of depreciable property meeting the above requirements of paragraphs (a) to (c). **Attribution of income and deductions from insurance and disposal** 1. If the insurance or compensation for the damage (the insurance receipt) is derived or able to be reasonably estimated before the end of the 2018–19 income year, the person's income from the insurance receipt and the consideration derived from the disposal of the item is attributed as set out below. 2. If the disposal cost is incurred or able to be reasonably estimated before the end of the 2018–19 income year, the person's deductions for the disposal cost and for depreciation loss under s. EE 48 are attributed as set out below. The person's income and/or disposal cost and depreciation loss is attributed to the earlier of: (a) The 2018–19 income year; or (b) The first income year in which: (i) The cost of disposing of the item (the disposal cost) is or has been incurred or able to be reasonably estimated; and (ii) The insurance receipt is or has been derived or able to be reasonably estimated; and (iii) The consideration from the disposal of the item is or has been derived or able to be reasonably estimated. This section overrides sections EE 1, EE 22, and EE 52 in relation to the timing of the person's income from the insurance receipt and consideration from the disposal of the item, and deductions for the disposal cost and depreciation loss. [**S. EZ 23F** repealed 1 April 2016, and **s. EZ 73** effective 1 April 2016 as substituted by **s. 68** of 2014 No. 4, applying for the 2010–11 to the 2019–19 income years.]

SECTION VIII: CANTERBURY EARTHQUAKE RELIEF DEPRECIATION RECOVERY RULES (continued)

(13) Inland Revenue explanation of the operation of s. EZ 23F **(Changing to s. EZ 73 effective 1 April 2016)**	**Inland Revenue explanation of the operation of s. EZ 23F** 1. New s. EZ 23F provides an optional rule to smooth the timing of income and deductions when insurance proceeds have been received for: (a) Depreciable property that has been irreparably damaged or rendered useless for earning income as a result of the Canterbury earthquakes; or (b) Depreciable assets that are uneconomic to repair to which s. EZ 23C applies. 2. This rule applies to individual items of depreciable property, in line with the general approach under the depreciation rules. 3. The policy intent is that the matching rule allows to be brought to account for tax purposes, the net amount, as determined under s. EE 48, of: (a) Insurance payments and disposal proceeds; ***less*** (b) The write-off of the tax book value and expenditure on disposing of the asset. 4. The timing rule provides that any income or deductions are recognized at the earlier of: (a) When insurance proceeds, and the cost of disposal and proceeds from disposing of the asset , have been derived or incurred or are able to be reasonably estimated; or (b) The 2015-16 income year. 5. Whether insurance proceeds and other amounts can be reasonably estimated is essentially a question of fact, which will depend on the individual circumstances of each case. However, it is envisaged that some form of documentation would be required, for example, a written quote from an insurer. 6. Section EZ 23F overrides the timing rules in sections EE 1, EE 22 and EE 48. The section can also be applied to assets depreciated in a pool. 7. A person who opts to use the matching rule must use it for all their items of depreciable property that meet the criteria for applying the rule. This is to prevent taxpayers "cherry-picking" the assets to which they apply the rule. 8. A taxpayer's decision to elect into the matching rule will be reflected in the tax position they take in their return of income for each tax year – no prior notice of election is required. 9. This Canterbury earthquakes-specific amendment applies for the 2010–11 to 2015–16 income years. The Commissioner may exercise the discretion under section 113 of the Tax Administration Act 1994 to amend an assessment. **Example** Equipment originally costing $10,000 is irreparably damaged in a Canterbury earthquake. The asset's tax book value is $7,000, with $3,000 of accumulated depreciation deductions. The disposal costs are reasonably estimated to be $1,000 in 2012–13. The insurance proceeds received for the asset are reasonably estimated in 2013–14 as being $9,000. The equipment has a scrap value of $100, which is reasonably estimated in 2012–13. Applying the matching rule, any income or deductions are recognised in the 2013–14 income year, as this is when the insurance proceeds, disposal costs and disposal proceeds can be reasonably estimated. Accordingly, in the 2013–14 income year, section EE 48 applies to determine the amount of depreciation recovery income or depreciation loss. [*Tax Information Bulletin Vol. 24 No. 10 (December 2012)* pages 25-26]

SECTION IX: EARTHQUAKE RELIEF: DEPRECIATION RECOVERY INCOME FROM COMPENSATION

(1) General rule: Depreciation recovery when compensation received for property (other than irreparably damaged property): s. EE 52 **(Including s. EE 52(4) inserted by s. 49 of 2014 No. 4)**	**Depreciation recovery when compensation received: s. EE 52** When a person receives insurance, indemnity, or compensation, (other than for an item that is lost, stolen or irreparably damaged), for property described in s. EE 46, being: (a) A depreciable asset (other than one accounted for in a pool); and/or (b) Fixed life intangible property for which a deduction for (1/legal life) was available under s. EE 33; and/or (c) Software acquired pre-1993 for which deductions were available on acquisition and the consideration on disposal is income under s. CZ 11. 1. An amount must be subtracted from the item's adjusted tax value. The amount is the amount by which the insurance, indemnity, or compensation that the person receives is more than the expenditure that the person incurs because of the event for which the person receives the insurance, indemnity, or compensation. 2. If the item's adjusted tax value becomes negative in an income year because of the amount subtracted from the adjusted tax value, the negative amount is an amount of depreciation recovery income derived by the person in the income year. 3. If in the absence of subsection EE 52(4), the person would derive the amount of insurance, indemnity, or compensation after ceasing to own the item, the person is treated as deriving the amount immediately before the person ceases to own the item. [**S. EE 52** including new **s. EE 52(4)** as inserted by **s. 49** of the *Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Act 2014*]
(2) General rule overridden: Deemed disposal of Canterbury property assessed as uneconomic to repair: s. EZ 23C **(Becoming s. EZ 70 from the 2016-17 income year)**	**New s. EZ 23C: Deemed disposal of Canterbury property assessed as uneconomic to repair** A person is treated as, on the date of the Canterbury earthquake, disposing of an item of depreciable property for the amount of insurance or compensation, and reacquiring the item for zero consideration, if: (a) The income year (the current year) is before the 2019–20 income year; and (b) The item is damaged by a Canterbury earthquake as that term is defined in section 4 of the Canterbury Earthquake Recovery Act 2011; and (c) The person is entitled to an amount of insurance or compensation for the damage to the item; and (d) The item is assessed by the payer of the insurance or compensation (the insurer) as uneconomic to repair; and (e) The damage does not meet the requirements of section EE 47(4) (i.e. the property is not a building and is not irreparably damaged, and if it is a building, it is not useless and abandoned for later demolition). This section overrides sections EE 52 (i.e. the compensation is not subtracted from the item's adjusted tax value – there is instead a deemed disposal). [**s. EZ 23C** to become **s. EZ 70** from the 2016-17 income year under **s. 68** of the *Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Act 2014*]

SECTION IX: EARTHQUAKE RELIEF: DEPRECIATION RECOVERY INCOME FROM COMPENSATION (continued)

(3) Inland Revenue explanation of the operation of s. EZ 23C **(Becoming s. EZ 70 from the 2016-17 income year)**	**Inland Revenue explanation of the operation of s. EZ 23C** New section EZ 23C provides for the deemed disposal and reacquisition of assets which are damaged in a Canterbury earthquake and uneconomic to repair. The tax depreciation rules do not provide an appropriate outcome when an asset has been damaged in a Canterbury earthquake and the insurer considers it to be uneconomic to repair (and requiring replacement), even though the asset may be physically repairable. This is because the current rules make a distinction between assets that are repairable and those that are irreparably damaged or rendered useless for earning income. Assets that are uneconomic to repair are generally included in the former category. The consequence is that a taxpayer may face a significant unexpected tax liability when an insurance amount is received, as a result of the application of section EE 52. Section EE 52 treats as taxable any insurance proceeds in excess of an asset's adjusted tax value and expenditure on repairing the asset. This means that an amount greater than the depreciation deductions previously claimed for the asset may be treated as taxable. By contrast, for an asset that is irreparably damaged or rendered useless for earning income, the depreciation rules cap depreciation recovery income at the amount of previous depreciation deductions. In addition, the depreciation "roll-over relief" rule in section EZ 23B, which was developed last year as a response to the Canterbury earthquakes to give taxpayers the ability to defer any depreciation recovery income, applies only to irreparably damaged assets or buildings that are rendered useless for the purpose of deriving income. Accordingly, amendments have been made to align the treatment of assets that are uneconomic to repair with the existing treatment under the depreciation rules of assets that are irreparably damaged or rendered useless for earning income. This recognises that assets that are uneconomic to repair in the context of the Canterbury earthquakes are, in substance, very similar to assets that are physically irreparable and therefore should receive similar treatment under the depreciation rules. This objective is achieved through new section EZ 23C which treats assets that are uneconomic to repair as being disposed of for the amount of insurance received for the asset, on the date of the Canterbury earthquake that caused the asset to be uneconomic to repair. This deemed disposal ensures that section EE 48 in the depreciation rules (which applies to irreparably damaged assets) also applies to assets that are uneconomic to repair. The term "Canterbury earthquakes" is defined broadly in section 4 of the Canterbury Earthquake Recovery Act 2011 as "any earthquake in Canterbury on or after 4 September 2010, and includes any aftershock". Accordingly, when assets have sustained cumulative damage through multiple earthquakes and aftershocks, taxpayers can use the date of the earthquake which caused the asset to be damaged to the extent that it is uneconomic to repair as the relevant date of the deemed disposal and reacquisition under section EZ 23C. [*Tax Information Bulletin Vol. 24 No. 10 (December 2012)* pages 23 - 24]

SECTION IX: EARTHQUAKE RELIEF: DEPRECIATION RECOVERY INCOME FROM COMPENSATION (CONTINUED)

(3) Inland Revenue explanation of the operation of s. EZ 23C (continued) **(Becoming s. EZ 70 from the 2016-17 income year)**	**Inland Revenue explanation of the operation of s. EZ 23C** The asset is treated as being reacquired on the same date as the deemed disposal for nil consideration. This is to ensure that post-earthquake repairs are correctly capitalised (and not treated as deductible expenditure). Roll-over relief for income tax liabilities arising from the receipt of insurance for earthquake-damaged assets has been extended to assets that are subject to a deemed disposal and reacquisition under section EZ 23C by an amendment to section EZ 23B. Section EZ 23C overrides section EE 52, which means that for an asset meeting the criteria for section EZ 23C to apply, section EE 52 will not apply. The deemed disposal and reacquisition under section EZ 23C is not treated as a disposal or reacquisition for the purposes of the land provisions (sections CB 6 to 23). This Canterbury earthquakes-specific amendment applies for the 2010–11 to 2015–16 income years. The Commissioner may exercise the discretion under section 113 of the Tax Administration Act 1994 to amend an assessment. **Example** A building has a cost of $5 million, accumulated depreciation deductions of $4 million and an adjusted tax value (ATV) of $1 million. It is damaged in a Canterbury earthquake and the insurance company decides it has an obligation under the insurance policy to replace it at a cost of $10 million because it is no longer fit for purpose and is uneconomic to repair. The damaged building is retained by the insured party and put to another, less productive, use. The building meets the criteria for section EZ 23C to apply. Therefore, the building is treated as being disposed of and reacquired for nil consideration on the date of the earthquake which caused the asset to be uneconomic to repair. As the building is treated as having been disposed of, the owner of the asset can apply the matching rule in section EZ 23F to smooth the timing of income calculated under section EE 48. Under section EE 48, the result is: Original cost $5,000,000 Depreciation deductions $4,000,000 ATV $1,000,000 Amount item disposed for $10,000,000 Depreciation recovery income $4,000,000 Capital gain $5,000,000 Roll-over relief (under section EZ 23B) is available to the building owner for the $4 million of depreciation recovery income. [*Tax Information Bulletin Vol. 24 No. 10 (December 2012)* pages 23 - 24]

SECTION IX: EARTHQUAKE RELIEF: DEPRECIATION RECOVERY INCOME FROM COMPENSATION (CONTINUED)

(4) General rule overridden: Depreciation recovery limited to depreciation loss for Canterbury property damaged but not assessed as uneconomic to repair: s. EZ 23D **(Becoming s. EZ 71 from the 2016-17 income year)**	**New s. EZ 23D: Depreciation recovery limited to depreciation loss for Canterbury property damaged but not assessed as uneconomic to repair** A person who would, for an item in an income year, ordinarily derive depreciation recovery income under s. EE 52, derives as depreciation recovery income the lesser of: (i) The s. EE 52 depreciation recovery income; and (ii) The total depreciation loss allowed for the item If the following conditions are met: (a) The income year (the current year) is before the 2019–20 income year; and (b) The item is damaged by a Canterbury earthquake as that term is defined in section 4 of the Canterbury Earthquake Recovery Act 2011; and (c) The person is entitled to an amount of insurance or compensation for the damage to the item; and (d) S. EZ 23C does not apply (i.e. the item is not assessed by the payer of the insurance or compensation (the insurer) as uneconomic to repair); and (e) The damage does not meet the requirements of section EE 47(4) (i.e. the property is not a building and is not irreparably damaged, and if it is a building, it is not useless and abandoned for later demolition). This section overrides sections EE 52 (i.e. the compensation is not subtracted from the item's adjusted tax value – there is instead a deemed disposal). [**s. EZ 23D** to become **s. EZ 71** from the 2016-17 income year under **s. 68** of the *Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Act 2014*]

SECTION IX: EARTHQUAKE RELIEF: DEPRECIATION RECOVERY INCOME FROM COMPENSATION (CONTINUED)

(5) Inland Revenue explanation of the operation of s. EZ 23D **(Becoming s. EZ 71 from the 2016-17 income year)**	**Inland Revenue explanation of the operation of s. EZ 23D** ***Cap on depreciation recovery income*** New section EZ 23D limits depreciation recovery income calculated under section EE 52 to the amount of depreciation deductions previously taken, when insurance proceeds are received for a repairable damaged asset. Section EE 52 provides that when insurance proceeds are received for damage to a repairable depreciable asset, the proceeds are taxable to the extent they exceed the cost of any repairs and the asset's adjusted tax value. As noted above, this means that the tax rules may end up taxing more than the amount of earlier depreciation deductions allowed for the asset. In the context of the Canterbury earthquakes, this means that taxpayers may face significant unanticipated income tax liabilities in relation to damaged (but repairable) assets. The cap on depreciation recovery income determined under section EE 52 is confined to depreciable assets damaged by a Canterbury earthquake (as defined in section 4 of the Canterbury Earthquake Recovery Act 2011), the damage does not cause the asset to be irreparably damaged or rendered useless for earning income, and section EZ 23C does not apply to the asset. This Canterbury earthquakes-specific amendment applies for the 2010–11 to 2015–16 income years. The Commissioner may exercise the discretion under section 113 of the Tax Administration Act 1994 to amend an assessment. **Example** A building costing $5 million was damaged in a Canterbury earthquake but is repairable. The building has an adjusted tax value of $1 million, with depreciation deductions of $4 million taken. Insurance proceeds of $7 million are received, with $1 million of the proceeds being spent on repairing the asset. Section EZ 23C does not apply because the asset is not uneconomic to repair. Under section EE 52, the depreciation recovery income would be $5 million. However, section EZ 23D caps the amount of depreciation recovery income at $4 million. The remaining $1 million is treated as a capital gain. [*Tax Information Bulletin Vol. 24 No. 10 (December 2012)* pages 24 - 25]

SECTION X: EARTHQUAKE RELIEF: DEPRECIATION RECOVERIES FOR ITEMS DEPRECIATED IN A POOL

(1) Earthquake relief: Treatment of insurance recoveries relating to items depreciated in a pool	**Earthquake relief: Treatment of insurance recoveries relating to items depreciated in a pool** 1. An excess recovery is subtracted from a pool's adjusted tax value at the end of an income year if: (a) An item that has been damaged is in a pool at the end of an income year; and (b) A person in the income year derives an amount of insurance, indemnity, or compensation (the **compensation amount**) for damage to that item; and (c) The compensation amount exceeds the expenditure or loss that the person incurs because of the damage. [New **s. EE 22(2B)** inserted by **s. 35(1)** of the *Taxation (Annual Rates, Returns Filing, and Remedial Matters) Act 2012,* effective from the 2011-12 income year onwards, except if a return has not been filed for 2010-11 under a Canterbury Earthquake extension of time.] 2. Excess recovery relating to a pool depreciated item that is disposed of is deducted from a pool's adjusted tax value on the date of disposal if: (a) The damaged item that is disposed of was depreciated in a pool; and (b) A person derives an amount of insurance, indemnity, or compensation to which s. EE 22(2B) does not apply for damage to the item occurring before the disposal. (c) Any excess of insurance, indemnity or compensation over expenditure or loss incurred in deriving the insurance or compensation, is deducted from the pool's adjusted tax value on the date of disposal. [**Section EE 22(3)** as amended by **s. 35(2)** of the *Taxation (Annual Rates, Returns Filing, and Remedial Matters) Act 2012,* effective from the 2011-12 income year onwards, except if a return has not been filed for 2010-11 under a Canterbury Earthquake extension of time.]

SECTION X: EARTHQUAKE RELIEF: DEPRECIATION RECOVERIES FOR ITEMS DEPRECIATED IN A POOL (continued)

(2) Optional timing rule for insurance income from disposal of pool depreciated items and insurance income and repair costs when there is no deemed disposal of non-pool items: s. EZ 23G **(Becoming s. EZ 74 from the 2016-17 income year)**	**New s. EZ 23G: Optional deferral to 2018-19 of insurance income upon disposal of pool depreciated items, and insurance income and repair costs of non-pool items when there is no deemed disposal and repair expenditure is not incurred or able to be estimated until then** The calculation and allocation rules in ss. CG 4, EE 22 and EE 52 for insurance receipts in excess of repair expenditure will not apply, and the income from insurance, and the deductions for repair costs are allocated to income years according to this s. EZ 23G if: (a) An item of depreciable property is damaged by a Canterbury earthquake as that term is defined in s. 4 of the Canterbury Earthquake Recovery Act 2011; and (b) The damage: (i) Does not result in a deemed disposal and reacquisition under s. EZ 23C (s. EZ 70 from the 2016-17 income year) because property is not uneconomic to repair; or (ii) Does not result in a deemed disposal under s. EE 47(4) due to non-building property being repairable or a building not being rendered useless and demolished or abandoned; and (c) The person is entitled to insurance or compensation for damage to the item; and (d) The person chooses to apply this section for all items of depreciable property meeting the above requirements of paragraphs (a) to (c). **Attribution of income and deductions from insurance and disposal** 1. If the insurance or compensation for the damage (the insurance receipt) is derived or able to be reasonably estimated before the end of the **2018–19** income year, the person's income from the insurance receipt and the consideration derived from the disposal of the item is attributed as set out below. 2. If the repair cost is incurred or able to be reasonably estimated before the end of the **2018–19** income year, the person's deductions for the repair cost are attributed as set out below. The person's insurance income and/or repair cost is attributed to the earlier of: (a) The **2018–19** income year; or (b) The first income year in which: (i) The repair cost is or has been incurred or able to be reasonably estimated; and (ii) The insurance receipt is or has been derived or able to be reasonably estimated; and This section overrides sections CG 4, EE 22, and EE 52 in relation to the timing of the person's income from the insurance receipt and deductions for the repair cost. [**s. EZ 23G** to become **s. EZ 74** from the 2016-17 income year under **s. 68** of the *Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Act 2014*]

SECTION X: EARTHQUAKE RELIEF: DEPRECIATION RECOVERIES FOR ITEMS DEPRECIATED IN A POOL (continued)

(3) Inland Revenue explanation of the operation of s. EZ 23G **(Becoming s. EZ 74 from the 2016-17 income year)**	**Inland Revenue explanation of the operation of s. EZ 23G** 1. New section EZ 23G introduces an optional rule to smooth the timing of income and deductions when insurance proceeds have been received for a depreciable asset that has been damaged in a Canterbury earthquake but is repairable. The rule is broadly similar to section EZ 23F in design. 2. The timing rule may be used for a depreciable asset when: (a) The asset is damaged by a Canterbury earthquake as that term is defined in section 4 of the *Canterbury Earthquake Recovery Act 2011*. (b) The asset is not irreparably damaged or rendered useless for earning income and therefore does not meet the requirements of section EE 47(4) and the asset is not subject to a deemed disposal and reacquisition under s. EZ 23C. (c) The owner is entitled to insurance or compensation for the damage. (d) The owner chooses to apply the timing rule to all their depreciable assets meeting the above requirements. 3. The timing rule provides that any income or deductions are recognised at the earlier of: (a) When insurance proceeds and the cost of repairing the asset have been derived or incurred or are able to be reasonably estimated; or (b) The 2015–16 income year. 4. Section EZ 23G overrides the timing rules in sections CG 4, EE 22 and EE 52. The section is also applicable to assets depreciated in a pool. 5. This Canterbury earthquakes-specific amendment applies for the 2010–11 to 2015–16 income years. The Commissioner may exercise the discretion under section 113 of the *Tax Administration Act 1994* to amend an assessment. **Example** Machinery originally costing $100,000 is damaged in a Canterbury earthquake. The asset's adjusted tax value (ATV) is $60,000, with $40,000 of accumulated depreciation deductions. The insurance proceeds are estimated in 2011–12 as being $110,000. Repair costs are estimated in 2012–13 to be $20,000 and $10,000 is actually incurred in each of 2012–13 and 2013–14. Applying the matching rule, any income or deductions are recognised in the 2012–13 income year, as this is when the insurance proceeds and total repair costs can reasonably be estimated. Accordingly, in the 2012–13 income year, s. CG 4 and EE 52 apply. (a) The repair costs are deductible under the general deductibility rules. (b) Section CG 4 treats $20,000 of the insurance proceeds as taxable, as this is the amount of insurance proceeds which recovers deductible expenditure. (c) Section EE 52 applies to the insurance proceeds as follows: (d) ATV of $60,000 less ($110,000 – $20,000) = ($30,000) (e) Accordingly, the ATV is reduced to nil and depreciation recovery income under section EE 52 is $30,000. [*Tax Information Bulletin Vol. 24 No. 10 (December 2012)* page 26]

SECTION XI: EARTHQUAKE RELIEF: INCOME FROM INSURANCE RECEIPTS

(1) Recovered expenditure or loss: **s. CG 4**	**The new s. CG 4 deals with "Receipts for expenditure or loss, from insurance, indemnity, or otherwise".** [The (old) replaced s. CG 4 dealt with "Recovered expenditure or loss"] 1. Under the new s. CG 4, an amount that a person derives, to the extent of the deduction allowed for any expenditure or loss, is income of the person, where: (a) The person is allowed a deduction for expenditure or loss; and (b) The person derives an amount relating to the expenditure or loss, whether through insurance, indemnity, or otherwise; and (c) The amount, to the extent of the deduction, is not income of the person under any other provision in the Income Tax Act 2007. 2. Under new s. CG 4, the income is allocated to the later of: (a) The income year in which the expenditure or loss is incurred; or (b) The income year in which the amount is derived. 3. New s. CG 4 applies for: (a) The 2011-12 and later income years; or (b) 2010-11 and later income years for a person who is granted an extension of time for filing a return for the 2010-11 income year under the Canterbury Earthquake (Inland Revenue Acts) Order 2011. 4. Replaced s. CG 4 differs from the previous s. CG 4 in 2 important respects: (a) New s. CG 4 refers to an "amount derived" relating to an expenditure or loss, whereas the previous reference was to a "recovery" of some or all of any expenditure or loss. (b) New s. CG 4 provides for income to be allocated to the later of the year of derivation or the year the expenditure was incurred, whereas the previously the income was allocated to the income year in which "the amount was recovered". [**s. CG 4** as replaced by **s. 12** of the *Taxation (Annual Rates, Returns Filing, and Remedial Matters) Act 2012*, effective from the 2011-12 income year onwards, except if a return has not been filed for 2010-11 under a Canterbury Earthquake extension of time.]

SECTION XI: EARTHQUAKE RELIEF: INCOME FROM INSURANCE RECEIPTS (continued)

(2) Inland Revenue explanation of the replaced s. CG 4	**Inland Revenue explanation of the replaced s. CG 4: Timing of insurance receipts for expenditure or loss** Previous legislation was developed on the assumption that expenditure incurred on, for example, repairing a damaged asset, would be incurred (and the expense taken as a deduction) before insurance proceeds were received. It was therefore not clear how the legislation would operate if an insurance payout was made before expenditure had been incurred on repairing a damaged asset. **Key feature** An insurance receipt which recovers deductible expenditure will be taxable irrespective of whether the insurance is received before or after the expenditure has been incurred. **Detailed analysis** Previous legislation was based on the assumption that expenditure incurred on, for example, repairing a damaged asset, would be incurred (and the expense taken as a deduction) before insurance proceeds were received. This was consistent with the normal insurance model, where the insurer either undertakes the repairs or reimburses the policyholder after they have undertaken repairs on the affected property. However, in the context of the Canterbury earthquakes, it has been common for insurers to make insurance payouts before the policyholder undertakes the relevant repairs. The problem with the previous wording of section CG 4 was that it was not clear if it operated when insurance payouts were made before expenditure is incurred on repairing a damaged asset. If the section did not operate in these situations, it could mean there would be a reduction in the damaged asset's adjusted tax value instead, under section EE 52 of the tax depreciation rules. Furthermore, if an amount of insurance was received that was greater than the adjusted tax value, section EE 52 would treat the excess as taxable income upfront, without taking into account repairs undertaken at a later time. In other words, the compensation payment would be treated as depreciation recovered rather than a recovery of the future expenditure on repairs. Accordingly, the wording of section CG 4 has been amended to resolve this problem. Section CG now provides that an insurance receipt which relates to deductible expenditure is taxable irrespective of whether the insurance is received before or after the repair expenditure is incurred. In cases when insurance proceeds are received before repair costs are incurred, and those costs are incurred in more than one income year, any income from insurance proceeds must be recognised in each income year that the repair costs are incurred. **Application date** This generic amendment applies for the 2011–12 and later income years. However, for a person who is granted an extension of time for filing an income tax return for the 2010–11 income year under the Canterbury Earthquake (Inland Revenue Acts) Order 2011, the amendment applies for the 2010–11 and later income years. [*Tax Information Bulletin Vol. 24 No. 10 (December 2012)* pages 27-28]

SECTION XI: EARTHQUAKE RELIEF: INCOME FROM INSURANCE RECEIPTS (continued)

(3) Allocation of income received for business interruption: s. CG 5B	**Receipts from insurance, indemnity, or compensation for interruption or impairment of business activities** 1. Section CG 5B applies from the date of the first Canterbury Earthquake, 4 September 2010, when a person receives an amount of insurance, indemnity, or compensation for an interruption or impairment of business activities resulting from an event. 2. An amendment contained in the *Annual Rates Tax Act 2012* is aimed at ensuring that any replacement income is not allocated to an income year earlier than the year in which the income that is replaced would have been derived. 3. Under s. CG 5B(2): The part of the insurance, indemnity, or compensation attributable to income that the person would have derived if not for the event is income of the person. In the amendment, the "income that the person would have derived if not for the event" is referred to as "the replaced income". 4. Under new s. CG 5B(3): The income under s. CG 5B(2) is allocated to the later of: (a) The income year to which the replaced income relates; or (b) The earlier of: (i) The income year in which the amount is received; or (ii) The income year in which the amount is reasonable able to be estimated. 5. The amended s. CG 5B applies for: (a) The 2011-12 and later income years; or (b) 2010-11 and later income years for a person who is granted an extension of time for filing a return for the 2010-11 income year under the Canterbury Earthquake (Inland Revenue Acts) Order 2011. [**s. CG 5B** as amended by **s. 13** of the *Taxation (Annual Rates, Returns Filing, and Remedial Matters) Act 2012,* effective from the 2011-12 income year onwards, except if a return has not been filed for 2010-11 under a Canterbury Earthquake extension of time.]

SECTION XI: EARTHQUAKE RELIEF: INCOME FROM INSURANCE RECEIPTS (continued)

(4) Inland Revenue explanation of s. CG 5B	**Inland Revenue explanation of s. CG 5B: Business interruption insurance – timing of derivation** Under the previous legislation, if a person received an amount of insurance, indemnity, or compensation for an interruption or impairment of business activities following an event, any income arising was allocated to the earlier of the income year in which the amount was reasonably estimated or, in case of interim payments, when they were received. On this basis, if an insurer estimated in an earlier income year a loss of income for a number of future income years, the entire estimated amount would be allocated to that earlier income year. This result is inconsistent with the general tax and accounting practice of allocating income on an accrual basis. **Key feature** Income derived under a business interruption insurance policy is now allocated to the later of the income year to which the replaced income relates or the income year the amount is reasonably estimated (or, in case of interim payments, when they are received). **Detailed analysis** Section CG 5B(3) of the Income Tax Act 2007 has been amended so that income derived under a business interruption insurance policy is allocated to the later of: (a) The income year to which the replaced income relates; or (b) The earlier of – (i) The income year in which the amount is received; or (ii) The income year in which the amount is reasonably able to be estimated. The amendment ensures an entire estimated income amount for a number of future years is not allocated to an earlier income year. The income derived under a business interruption insurance policy is allocated to the period the income relates to if the income relates to future income years only. If the income relates to past income years, it will continue to be allocated to the income year in which the amount is either received or reasonably estimated. This is to avoid complex compliance and administrative costs involved in amending past years' income tax returns. **Application date** This generic amendment applies for the 2011–12 and later income years. However, for a person who is granted an extension of time for filing a return of income for the 2010–11 income year under the Canterbury Earthquake (Inland Revenue Acts) Order 2011, the amendment applies for the 2010–11 and later income years. [*Tax Information Bulletin Vol. 24 No. 10 (December 2012)* page 28]

SECTION XI: EARTHQUAKE RELIEF: INCOME FROM INSURANCE RECEIPTS (continued)

(5) General rule: Receipts from insurance, indemnity, or compensation for trading stock	**s. CG 6: Receipts from insurance, indemnity, or compensation for trading stock** 1. Section CG 6 applies when a person receives an amount of insurance, indemnity, or compensation for the loss or destruction of, or damage to: (a) Trading stock; or (b) Anything acquired, manufactured, or produced for a purpose ancillary to a business of manufacturing or producing goods for sale or exchange. 2. The part of the insurance, indemnity, or compensation that is attributable to the asset is income if: (a) The person is allowed a deduction in an income year for the cost of the asset; and (b) The deduction is not for an amount of depreciation loss. 3. The deduction for the cost of the assets (the revenue account property) is allowed under s. DB 23. 4. The income is allocated to the income year in which the amount is received.

SECTION XI: EARTHQUAKE RELIEF: INCOME FROM INSURANCE RECEIPTS (continued)

(6) Business interruption insurance for a replacement property and capital contribution: Inland Revenue explanation	**Business interruption insurance for a replacement property and capital contribution: Inland Revenue explanation** Previously, if a person received a business interruption insurance payment for a replacement property to restart or continue their business operations, the payment was not recognised in the person's taxable income as it is of a capital nature. Also the person could claim full depreciation deductions for the cost of the replacement property even though they had not paid for the replacement property. Allowing the person to capitalise and claim full depreciation deductions for the total cost of the new replacement property was not consistent with the policy to only allow depreciation deductions for the cost of the property which is actually borne by the person. **Key feature** A business interruption insurance payment that relates to a purchase of a replacement property is now a capital contribution for the purposes of sections CG 8, DB 64 and EE 48. **Detailed analysis** The definition of "capital contribution" in section YA 1 of the Income Tax Act 2007, for the purposes of sections CG 8, DB 64 and EE 48, has been amended to include a business interruption insurance payment that relates to a purchase of a replacement property. An amount will now be treated as a capital contribution if the amount: (a) Is paid by a person (other than in their capacity of settlor, partner or shareholder of the recipient) to a recipient under an agreement between them; (b) Is not income of the recipient, ignoring section CG 8; (c) Is paid, under the express terms and conditions of the agreement, as a contribution for depreciable property owned or to be acquired by the recipient; and (d) If the agreement is a contract of insurance, indemnity or compensation, is paid in relation to an interruption or impairment of business activities. A capital contribution, including the business interruption insurance payment that relates to a replacement property, is treated as income of the recipient under section CG 8 unless the recipient chooses to reduce the cost base of the replacement property under section DB 64. **Application date** This generic amendment applies for the 2011–12 and later income years. There is a "savings" provision for people who filed returns before 28 August 2012, which is the date on which the *Taxation (Annual Rates, Returns Filing, and Remedial Matters) Bill* was first considered by a Committee of the whole House. [**Section YA 1** and *Tax Information Bulletin Vol. 24 No. 10 (December 2012)* Pages 28-29]

SECTION XI: EARTHQUAKE RELIEF: INCOME FROM INSURANCE RECEIPTS (continued)

(7) Suspended recovery income from Christchurch revenue account property: Circumstances in which excess recoveries can be suspended: s. CZ 25	**When excess recoveries for Christchurch revenue account property can be suspended** Section CZ 23 that previously dealt with the suspension of excess recoveries has been repealed by s. 18 of the *Taxation (Annual Rates, Returns Filing, and Remedial Matters) Act 2012*, effective from 2 November 2012, the date of assent. (Another s. CZ 23 already existed, dealing with employee benefits.) It has been replaced by s. CZ 25 which is identical to the previous s. CZ 23. New s. CZ 25 overrides s. CG 6 and provides for excess insurance or compensation recoveries from Christchurch revenue account property to be suspended in specified circumstances. Under new s. CZ 25, excess recoveries received by a person that would normally be taxable under s. CG 6, may be suspended (the **suspended recovery income**) in an income year (the current year) before the **2019–20**- income year when the person: (a) In or before the current year, derives for buildings or land (the **affected property**), all of which is revenue account property: (i) Insurance or compensation, if a Canterbury earthquake (as that term is defined in s. 4 of the Canterbury Earthquake Recovery Act 2011) damages the land and damages each building, or the neighbourhood of the building, causing the building to be useless for the purpose of deriving income and consequently to be demolished or abandoned for later demolition; or (ii) An amount from a purchase by the Crown from the person (under s. 53(1), 54 or 55 of the Canterbury Earthquake Recovery Act 2011); and (b) In the absence of this section, would have in or before the current year a total amount of income under sections CB 6, CB 7, CB 12, CB 13, and CG 6 (which relate to income from certain disposals of land and from compensation for trading stock) from the consideration, compensation or insurance for the affected property that exceeds the total amount of deductions under sections DB 23 and DB 27 (which relate to deductions for the cost or value of land) for the affected property; and (c) Plans in the current year to acquire property (the **replacement property**) replacing affected property, meeting the requirements of s. CZ 25(4), and having a cost exceeding total deductions under ss DB 23 and DB 27 for the affected property; and (d) Gives written notice to the Commissioner under s. CZ 25(6) – see **Section VII (7)** below - in relation to the affected property. The requirements of s. CZ 25(4) for an item of affected property are that replacement property must be a building or land that is revenue account property: (a) Acquired in or before the person's **2018–19** income year; and (b) Located in greater Christchurch (as that term is defined in section 4 of the Canterbury Earthquake Recovery Act 2011). [**S. CZ 25(1) & (4) & (8)** as **amended** by **s. 28** of the *Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Act 2014* effective from 4 September 2010.]

SECTION XI: EARTHQUAKE RELIEF: INCOME FROM INSURANCE RECEIPTS (continued)

(8) Suspended recovery income from revenue account property: How much of any excess recovery can be suspended	**Net income under s. CG 6 is eliminated to the extent of the cost reduction of replacement property** Under new s. CZ 25(2), the suspended recovery income is not income except to the extent there is any remainder after the cost reduction adjustment (the "rollover" adjustment) under s. CZ 25(3) that is attributed to an income year by s. CZ 25(5). **Adjustment under s. CZ 25(3): Effect of purchase of replacement property** If the person incurs expenditure (the replacement cost) to acquire replacement property: (a) For the purposes of determining the value of the replacement property for section EA 2 (Other revenue account property), the amount of the person's expenditure on the replacement property is reduced by: (i) If the insurance income exceeds the replacement cost, and the amount calculated as follows does not exceed the insurance income, the expenditure on replacement property is reduced by the amount calculated as follows: $$\frac{\textbf{Replacement cost}}{\textbf{Original cost}} \textbf{ x Excess recovery}$$ Where: • "replacement cost" is the actual replacement cost ; and • "original cost" is the deduction under s. DB 23 and DB 27 for the original property. (ii) If the insurance income does not exceed the replacement cost, or is less than the amount calculated in (i) above, the amount of the excess recovery. (b) The amount of the suspended recovery income immediately before the expenditure is reduced by an amount equal to the reduction of expenditure under paragraph (a) for the purposes of section EA 2. **Explanation of the adjustment** The adjustment reduces the portion of the replacement cost that is less than or equal to the net insurance income that would otherwise be derived, for the purposes of s. EA 2 (i.e. it reduces the deduction in the income year that the property is disposed of, up to a maximum of the income from the insurance recoveries). [**s. CZ 25(2) & (3)** as amended by **s. 28** of the *Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Act 2014* effective from 4 September 2010.]

SECTION XI: EARTHQUAKE RELIEF: INCOME FROM INSURANCE RECEIPTS (continued)

(9) Suspended recovery income from revenue account property: Amount remaining at the end of the 2018-19 income year	**Amount remaining at end of 2018–19 income year or when person changes intentions, is liquidated, or becomes bankrupt** The person has an amount of income for the affected property in the current year equal to the amount of suspended recovery income when: (a) The current year ends, if the current year is the 2018–19 income year: (b) In the current year, the person decides not to replace the affected property: (c) In the current year, the person goes into liquidation or becomes bankrupt. [**s. CZ 25(5)** as amended by **s. 28** of the *Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Act 2014* effective from 4 September 2010.]
(10) Suspended recovery income from revenue account property: Notice of election to the Commissioner for affected property	**Notice of election to the Commissioner for affected property** 1. A person choosing to rely on s. CZ 25 to suspend in a current year the recognition of suspended recovery income from the insurance for affected property must give written notice to the Commissioner: (a) Describing the affected property; and (b) Giving details of replacement property acquired in the current year to replace, in full or in part, the affected property; and (c) Giving the cost of the replacement property and the reduction under s. CZ 25(3) of that cost for the purposes of section EA 2; and (d) Giving the amount, for the affected property, of the income from insurance or compensation remaining suspended under this section at the end of the current year. 2. The notice must be filed: (a) By the later of 31 January 2012 and the date on which the return of income is filed for the earliest income year (the estimate year) in which the amount of the insurance for the affected property can be reasonably estimated; and (b) If the current year is after the estimate year: (i) For each income year between the estimate year and the current year, by the date on which the return of income is filed for that income year; and (ii) For the current year, by the date on which the return of income is filed for the current year. [**s. CZ 25(6) & (7)**]

SECTION XI: EARTHQUAKE RELIEF: INCOME FROM INSURANCE RECEIPTS (continued)

(11) Inland Revenue example of s. CZ 23 (now s. CZ 25)	**Inland Revenue has provided the following example, on its website, of how this section is meant to operate:** In February 2011, a 31 March balance date firm's revenue account building is destroyed in the earthquake. The building originally cost $3 million. The replacement insurance proceeds are $6 million and the insurance company "delivers" the replacement building on 15 June 2014. In the absence of any rollover relief the building owner will have taxable income of $3 million under section CG 6. New section CZ 23 allows the owner to defer the CG 6 income tax liability by allocating an amount of the $3 million suspended income to the replacement building - provided the replacement building is located in greater Christchurch. As a result of negotiations between the building owner and the insurance company, the insurance proceeds are capable of being reasonably estimated on 30 June 2011. In the tax return for the tax year ending on 31 March 2012 the building owner files a written election to defer the $3 million of income - pending the acquisition of a replacement building. Provided the taxpayer continues to elect to defer the income the income remains suspended for the tax years ending on 31 March 2013 and 2014. The replacement building is delivered on 15 June 2014. The tax return for the tax year ending on 31 March 2015 will include this new building at a cost of $3 million (being the $6 million cost of the new building less the $3 million of rollover relief). A notice will have to be filed with the tax return for the tax year ending on 31 March 2015 advising that the deferred income has been rolled into the tax base for the replacement asset. The person must also give notice that the amount of unallocated suspended income has been reduced by $3 million to $0. When the replacement asset is eventually sold, the difference between the $3 million cost and the sales proceeds will be taxable provided it is sold for at least $3 million. http://www.ird.govt.nz/technical-tax/legislation/2011/2011-63/2011-63-canterbury-earthquake-relief-measures/

SECTION XI: EARTHQUAKE RELIEF: INCOME FROM INSURANCE RECEIPTS (continued)

(12) Additional Inland Revenue TIB explanation of s. CZ 25	**Additional Inland Revenue TIB explanation prior to the amendments in the Foreign Superannuation Tax Bill that extended the relief to 2018-19:** Section CZ 25 was introduced in 2011 to provide special roll-over relief for profits arising from compensation payments received in relation to buildings held on revenue account that were destroyed due to a Canterbury earthquake. The relief did not apply to land, or to buildings that were not demolished, or abandoned for later demolition. If the roll-over relief provision applies, the cost of any replacement building for tax purposes is reduced by [up to] the amount of profit made on the destroyed building. The effect is that, in most cases, a tax liability arising from the profit from compensation or insurance received in relation to the destroyed building is deferred until the replacement building is eventually sold. **Key features** The roll-over relief now also applies to: (a) Land held on revenue account that is damaged as a result of the Canterbury earthquake; and (b) Crown purchases of buildings held on revenue account. This is intended to address purchases being made under the Government's "red zone compensation package", and applies even in situations when the building is not demolished. **Detailed analysis** New section CZ 25(1)(a)(i) applies the roll-over relief provisions to land held on revenue account that is damaged as a result of a Canterbury earthquake. New section CZ 25(1)(a)(ii) applies the roll-over relief provisions to both land and buildings, if the owner accepts the compensation provided by the Crown's offer of purchase made in accordance with section 53(1) of the Canterbury Earthquake Recovery Act 2011. In this situation only, the roll-over relief can be claimed regardless of whether the building is destroyed or abandoned for later destruction. The remaining conditions of the roll-over relief, which relate to the replacement building or (now) replacement land, remain unchanged. In summary these are: (a) The owner must incur, or intend to incur expenditure on replacement building(s) or land in or before their 2015–16 income year. (b) The owner must hold the replacement building(s) or land on revenue account. (c) The replacement building(s) or land must be located in the greater Christchurch area (as defined by section 4 of the Canterbury Earthquake recovery Act 2011.) Amounts received under a Crown offer of purchase for a building may be used to acquire replacement land and vice versa, as long as the remaining conditions are met. **Application date** The amendments apply from 4 September 2010, being the same date as the roll-over became effective.

SECTION XI: EARTHQUAKE RELIEF: INCOME FROM INSURANCE RECEIPTS (continued)

(13) Optional timing rule for insurance income from disposal of pool depreciated items and insurance income and repair costs when there is no deemed disposal of non-pool items: s. EZ 23G **(Becoming s. EZ 74 from the 2016-17 income year)**	**New s. EZ 23G: Optional deferral to 2018-19 of insurance income upon disposal of pool depreciated items, and insurance income and repair costs of non-pool items when there is no deemed disposal and repair expenditure is not incurred or able to be estimated until then** The calculation and allocation rules in ss. CG 4, EE 22 and EE 52 for insurance receipts in excess of repair expenditure will not apply, and the income from insurance, and the deductions for repair costs are allocated to income years according to this s. EZ 23G if: (a) An item of depreciable property is damaged by a Canterbury earthquake as that term is defined in s. 4 of the Canterbury Earthquake Recovery Act 2011; and (b) The damage: (i) Does not result in a deemed disposal and reacquisition under s. EZ 23C (s. EZ 65 from the 2016-17 income year) because property is not uneconomic to repair; or (ii) Does not result in a deemed disposal under s. EE 47(4) due to non-building property being repairable or a building not being rendered useless and demolished or abandoned; and (c) The person is entitled to insurance or compensation for damage to the item; and (d) The person chooses to apply this section for all items of depreciable property meeting the above requirements of paragraphs (a) to (c). **Attribution of income and deductions from insurance and disposal** 1. If the insurance or compensation for the damage (the insurance receipt) is derived or able to be reasonably estimated before the end of the **2018–19** income year, the person's income from the insurance receipt and the consideration derived from the disposal of the item is attributed as set out below. 2. If the repair cost is incurred or able to be reasonably estimated before the end of the **2018–19** income year, the person's deductions for the repair cost are attributed as set out below. The person's insurance income and/or repair cost is attributed to the earlier of: (a) The **2018–19** income year; or (b) The first income year in which: (i) The repair cost is or has been incurred or able to be reasonably estimated; and (ii) The insurance receipt is or has been derived or able to be reasonably estimated; and This section overrides sections CG 4, EE 22, and EE 52 in relation to the timing of the person's income from the insurance receipt and deductions for the repair cost. [**s. EZ 23G** to become **s. EZ 74** from the 2016-17 income year under **s. 68** of the *Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Act 2014*.]

SECTION XI: EARTHQUAKE RELIEF: INCOME FROM INSURANCE RECEIPTS (continued)

(14) Inland Revenue explanation of the operation of s. EZ 23G **(Becoming s. EZ 74 from the 2016-17 income year)**	**Inland Revenue explanation of the operation of s. EZ 23G** 1. New section EZ 23G introduces an optional rule to smooth the timing of income and deductions when insurance proceeds have been received for a depreciable asset that has been damaged in a Canterbury earthquake but is repairable. The rule is broadly similar to section EZ 23F in design. 2. The timing rule may be used for a depreciable asset when: (a) The asset is damaged by a Canterbury earthquake as that term is defined in section 4 of the Canterbury Earthquake Recovery Act 2011. (b) The asset is not irreparably damaged or rendered useless for earning income and therefore does not meet the requirements of section EE 47(4) and the asset is not subject to a deemed disposal and reacquisition under s. EZ 23C. (c) The owner is entitled to insurance or compensation for the damage. (d) The owner chooses to apply the timing rule to all their depreciable assets meeting the above requirements. 3. The timing rule provides that any income or deductions are recognised at the earlier of: (a) When insurance proceeds and the cost of repairing the asset have been derived or incurred or are able to be reasonably estimated; or (b) The 2015–16 income year. 4. Section EZ 23G overrides the timing rules in sections CG 4, EE 22 and EE 52. The section is also applicable to assets depreciated in a pool. 5. This Canterbury earthquakes-specific amendment applies for the 2010–11 to 2015–16 income years. The Commissioner may exercise the discretion under section 113 of the Tax Administration Act 1994 to amend an assessment. **Example** Machinery originally costing $100,000 is damaged in a Canterbury earthquake. The asset's adjusted tax value (ATV) is $60,000, with $40,000 of accumulated depreciation deductions. The insurance proceeds are estimated in 2011–12 as being $110,000. Repair costs are estimated in 2012–13 to be $20,000 and $10,000 is actually incurred in each of 2012–13 and 2013–14. Applying the matching rule, any income or deductions are recognised in the 2012–13 income year, as this is when the insurance proceeds and total repair costs can reasonably be estimated. Accordingly, in the 2012–13 income year, s. CG 4 and EE 52 apply. (a) The repair costs are deductible under the general deductibility rules. (b) Section CG 4 treats $20,000 of the insurance proceeds as taxable, as this is the amount of insurance proceeds which recovers deductible expenditure. (c) Section EE 52 applies to the insurance proceeds as follows: (d) ATV of $60,000 less ($110,000 – $20,000) = ($30,000) (e) Accordingly, the ATV is reduced to nil and depreciation recovery income under section EE 52 is $30,000. [*Tax Information Bulletin Vol. 24 No. 10 (December 2012)* page 26]

SECTION XII: EARTHQUAKE RELIEF: THIN CAPITALISATION CHANGES

(1) Inclusion of insurance relating to Canterbury earthquake impaired asset for thin capitalisation purposes: New s. FZ 7	**New s. FZ 7: Inclusion of insurance relating to Canterbury earthquake impaired asset for thin capitalisation purposes** For the purposes of sections FE 16 (Total group assets) and FE 18 (Measurement of debts and assets of worldwide group) the person may, if the requirements below are met, choose to include an amount of the insurance, corresponding to the amount of the impairment or the derecognised value of an asset, in the value of the total group assets of the person's New Zealand group during the period: (a) Beginning with the impairment or derecognition of the asset; and (b) Ending before the earlier of: (i) The recognition of the amount of insurance; or (ii) The beginning of the **2019–20** income year. If a person includes an amount of insurance in the value of the total group assets of the person's New Zealand group for a period, the person must include the amount in the value of the total group assets of the person's worldwide group for the period. **Requirements** (a) An asset of the person's New Zealand group is damaged as a result of a Canterbury earthquake, as that term is defined in section 4 of the Canterbury Earthquake Recovery Act 2011; and (b) The asset is impaired, or derecognised, under generally accepted accounting practice as a result of the damage; and (c) Insurance for the damage is recognised at a later date under generally accepted accounting practice; and (d) Notice is given to the Commissioner, in the form and by the means prescribed by the Commissioner, no later than the later of 30 November 2012 and the day by which the person is required to make a return of income for the corresponding tax year, that the person has applied this s. FZ 7 for the income year, specifying: (i) The amount of income that would arise under section CH 9 (Interest apportionment: excess debt entity) for the income year before application of this section; and (ii) The amount of income that arises under section CH 9 for the income year after the application of this section; and (iii) Further information required by the Commissioner. [New **s. FZ 7** inserted by **s. 73** of the *Taxation (Annual Rates, Returns Filing, and Remedial Matters) Act 2012,* applying for income years ending after 4 September 2010 and before the 2019-20 income year as replaced by **s. 76** of the *Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Act 2014*.]

SECTION XII: EARTHQUAKE RELIEF: THIN CAPITALISATION CHANGES (continued)

(2) Inland Revenue explanation of s. FZ 7	**Inland Revenue explanation of s. FZ 7: Optional adjustment to assets under thin-cap rules** For New section FZ 7 provides an optional adjustment to how group assets are measured for the purposes of the thin-capitalisation rules. The adjustment mitigates a timing problem that arises because insurance proceeds are recognised at a later date than damage caused by the Canterbury earthquakes. **Background** The thin-capitalisation rules are based on accounting measures of assets. For accounting purposes, damaged assets are immediately impaired or derecognised. In contrast, insurance proceeds cannot be recognised until they are reasonably expected (for example, can be given a confirmed value). Section FZ 7 is designed to mitigate this timing difference by allowing certain taxpayers to carry-back known insurance proceeds to the date on which an asset was impaired or derecognised as a result of damage caused by the Canterbury earthquakes. The amount that can be carried back is limited to the lesser of the amount of damage or the related insurance proceeds. **Key features** Before a person can choose to use the optional adjustment, they must first satisfy the conditions in section FZ 7(1). These conditions are that: (a) An asset of the person's New Zealand group has been damaged as a result of the Canterbury Earthquakes; (b) The asset has been impaired or derecognised under generally accepted accounting practice as a result of that damage; and (c) Insurance for the damage has been recognised at a later date under generally accepted accounting practice. In such cases, the New Zealand group is able to choose to carry-back the insurance amount and regard this as an asset. The amount that can be carried back is limited to the lesser of the amount of damage or the related insurance proceeds. For impaired assets the damage is measured as the amount the asset has been impaired (as long as the impairment was a result of the earthquake damage rather than other reasons). For derecognised assets the damage is the amount of the derecognised asset (again, as long as the asset has been derecognised as a result of earthquake damage). Section FZ 7(2) provides for this additional asset to exist for a temporary period beginning on the day that the relevant asset is impaired or derecognised and ending on the day that the corresponding amount of insurance is recognised for accounting purposes. Section FZ 7(3) requires that if a person chooses to use section FZ 7(2) to increase the assets of their New Zealand group they must also increase the assets of their worldwide group by the same amount for a corresponding period. This ensures the worldwide group test continues to operate on a consistent basis. A person could receive insurance pay-outs for several different events. In such cases, each insurance pay-out is treated separately and can only be carried back to the date of the related damage. [*Tax Information Bulletin Vol. 24 No. 10 (December 2012)* pages 31 - 32]

SECTION XII: EARTHQUAKE RELIEF: THIN CAPITALISATION CHANGES (continued)

(2) Inland Revenue explanation of s. FZ 7 **(continued)**	**Inland Revenue explanation of s. FZ 7: Optional adjustment to assets under thin-cap rules (continued)** **Example** A company has $1 million of impairment as a result of an earthquake that occurred during its 2010–11 income year. In its 2011–12 income year there is a further $500k of impairment relating to a different earthquake. It receives $1.5 million of insurance pay-outs for both events in the 2011–12 income year. The company would only be able to claim an asset of $1 million in the 2010–11 income year. Under generally accepted accounting practice the insurance may be recognised all at once if it is for a certain amount. Alternatively, if the person is entitled to reimbursement of costs actually incurred in repairing an asset, then the insurance revenue could be recognised gradually as the repair costs are incurred. In cases when the insurance is recognised gradually, the amount that is available under the provision should also be reduced gradually, at the same time that the insurance is recognised. **Example** A company has $2 million of impairment, $500k of which is repaired and reimbursed by insurance in 2011–12 and the remaining $1.5 million is repaired and reimbursed in 2012–13. In 2011–12 the company can claim $1.5 million of additional assets under section FZ 7 ($2 million – $500,000 = $1.5 million) and in 2012–13 all the impairment has been met by insurance so section FZ 7 no longer applies ($2 million – $2 million = 0). *Notification requirement* Section FZ 7(4) requires a person who chooses to use section FZ 7(2) to inform the Commissioner that they are applying this rule and to provide some information on its effect, including: (a) Notice to the Commissioner that section FZ 7 of the Income Tax Act 2007 has been applied; (b) The amount of income that would arise under section CH 9 of the Income Tax Act 2007 in the absence of section FZ 7; and (c) The amount of income that arises under section CH 9 by applying section FZ 7. This information should be e-mailed to **competent.authority@ird.govt.nz** by the later of 30 November 2012 or the day that the person is required to make a return of income for the corresponding tax year. **Application date** Section FZ 7 applies for income years ending after 4 September 2010 and before the 2016–17 income year [*Tax Information Bulletin Vol. 24 No. 10 (December 2012)* pages 31 - 32]

SECTION XIII: DISPOSAL OF MOTHBALLED ASSETS

(1) When a mothballed asset is disposed of the atv does not have to reflect (unclaimed) depreciation after it was mothballed	An amendment has been inserted to clarify that unclaimed depreciation after an asset was mothballed does not affect the asset's adjusted tax value. **No adjustment to atv:** If an item has been withdrawn from use, depreciation that would have been allowed if the asset had still been in use does *not* have to be deducted from the asset's adjusted tax value. **Deduction for asset no longer used affects atv:** However, if a deduction has been claimed under **section EE 39** for an asset no longer used, the adjusted tax value must be reduced by that deduction. **Retrospective application:** The change is retrospectively effective from 1 April 2008. **[ss. EE 60(3B), EE 60(3)(b) & EE 39]**

SECTION XIV: GST ADJUSTMENTS WHEN CALCULATING DEPRECIATION RECOVERY INCOME AND DEPRECIATION LOSS

(1) Tax depreciation treatment of the new GST adjustments (under the new apportionment rules)	Amendments have been made to allow GST adjustments to be taken into account when calculating depreciation loss and depreciation recovery income. **Input tax deduction reduces cost:** An item's cost is reduced by the amount of any adjustment made under **s. 20(3)(e) of the GST Act** (which concerns adjustments under the new GST apportionment rules that result in deductions from output tax). **[s. EE 54(3)]** **Output tax increases cost:** An item's cost is increased by any *deductible output tax* (See below) for the year. **[s. EE 54(4)]** **Deductible output tax:** There is a new definition of "*deductible output tax*": it is the sum of the following, as applicable: (a) Output tax payable by a recipient of a supply that includes land, when that supply has been incorrectly zero-rated. (b) Output tax paid by recipients of imported services when they have no corresponding input tax deduction. (c) Output tax payable under the old apportionment rules. (d) The extent to which input tax cannot be claimed in full under the new apportionment rules. (e) Output tax payable on any non-taxable use, by a recipient of a zero-rated supply that includes land. (f) Output tax adjustments under the new apportionment rules. (g) Output tax payable on fringe benefits (included by **s. 154(6)** of the *Taxation (Annual Rates, Returns Filing and Remedial Matters) Act 2012* applying from 1 April 2011). **[s. YA 1 definition of "deductible output tax"]** **Application date:** The changes are effective from 1 April 2011.