

PKF Poutsma Lemon (Kerikeri) Limited
Building Stronger Futures



A Tax Perspective on Rental Properties

By Alison Lemon



Taxation of Rental Properties

- Common Expenses that can be claimed
- Depreciation
- Repairs & Maintenance
- Healthy Homes
- Bright Line Test
- Loss Ring Fencing
- Structures
- Capital Gains



Common Expenses

- Advertising
- Commission
- Depreciation
- Insurance
- Interest
- Travel (IRD or AA km rate are acceptable)
- Phone
- Power (between tenancies)
- Rates
- Repairs & Maintenance



Depreciation

- Is the item distinct or separate from the building
- Would the building be able to function or would it be incomplete without the item
- Is the item built-in or attached or connected that would make it part of the fabric of the property
- Does it meet the definition of “depreciable property”
- Section EE8:- property that in normal circumstances might reasonably be expected to decline in value while it is used
- IRD website: Depreciation Rate Finder..Asset Category..Building Fit-Out



Repairs & Maintenance

The Must Haves:

- An expense on the repair & maintenance of an asset
- Sufficient relationship between the expense and the earning of income
- Not subject to the Capital Limitation Rule



Repairs & Maintenance – It's a Yes (cont'd)

- Jack owns a rental property. Jack's tenant has just moved out. Although Jack advertised the property he is experiencing difficulty finding a new tenant. He concludes that the reason he cannot find a new tenant is that the property is too run down. Jack decides to tidy up the property to make it more attractive to potential tenants. The property is temporarily unavailable for rental while Jack arranges to have the property repaired, cleaned, and painted. Once this work has been done Jack will look for a new tenant. The expenditure that Jack incurs will have a sufficient nexus to Jack deriving assessable income from his rental activity.



Repairs & Maintenance – It's a No (cont'd)

- Tina owned a residential rental property for several years. Two years ago she decided to move into the house and use it as her home. This year she has undertaken **repairs** on the property and had it fully repainted. Tina seeks to claim a deduction for the cost of the **repairs** to her house on the basis they related to damage sustained when the house was tenanted. However, the **repair** costs are not deductible because the rental activity has ceased and the house is no longer being used to derive assessable income. At the time the expenditure was incurred it did not have the necessary nexus to Tina's assessable income.



Repairs & Maintenance – Capital Limitation Rule

If the nature and extent of the work undertaken means that the work is of a capital nature a deduction will not be allowed.

- A repair that changes the nature of the asset will make the expense capital and not deductible
- Using new materials doesn't necessarily mean the asset is improved unless is better than it was originally
- A change to the asset value, earning capacity, useful life, function or operating capacity will make the expense capital and not deductible



Repairs & Maintenance

- Frank owns a rental property for the past five years. Just recently the roof started to leak badly. The roofer has advised him that the roof has had it and needs to be replaced. The roofer recommends that the old corrugated iron roof is replaced with long line colour steel. The asset in this case is the building, and is physically connected to the larger asset. The roof is integral to the building.
- If long line colour steel is better than corrugated iron, it improves the value of the property, the expected life and/or the income earning capacity then it is capital.



Healthy Homes

- Top-Up Insulation “Top Up” - no change in character or substantial replacement or renewal
- New Insulation – improvement that changes the character
- IRD Interpretation Statement IS12/03



Top Up Insulation

- Peter and Alice own a residential rental property in Wellington that was built 30 years ago. After a cold snap, their tenants complain that the insulation in the house has deteriorated and is no longer effective. Peter and Alice arrange for new insulation to be inserted into the house. The cost of the insulation is revenue in nature on the basis that it is a **repair** to the property and does not change the character of the asset. Nor does it result in a replacement or renewal of substantially the whole of the house. The work done only restores the property to its former condition.



New Insulation

- Ralph and Bridget own a residential rental property that has never been insulated. Their tenants have been asking for years for the walls and floors to be insulated. Finally, Ralph and Bridget agree and insulation is installed. The cost of this new insulation is capital expenditure. It is not a **repair** to the rental property. The addition of insulation to the house improves the house and changes its character.



Brightline Test

- Came to life 1 October 2015 and was for 2 years from date of purchase
- Extended to 5 years from date of purchase from 29th March 2018
- Generally the date of purchase is registration at the Land Transfer Office
- Bright Line date generally earliest of:
 - Date of the agreement to sell or gift
 - Date property is acquired under a compulsory acquisition
 - Date property is sold by a mortgagee



Loss Ring Fencing for Rental Properties

- Takes effect from 1 April 2019 for Financial Year End 2020
- Rental property losses will not be deductible against other income such as salary and wages or business income.
- Losses will be “quarantined” and carried forward and offset against future income.
- It only applies to residential property not commercial property.
- Expected to raise \$325M over five years.



Structures

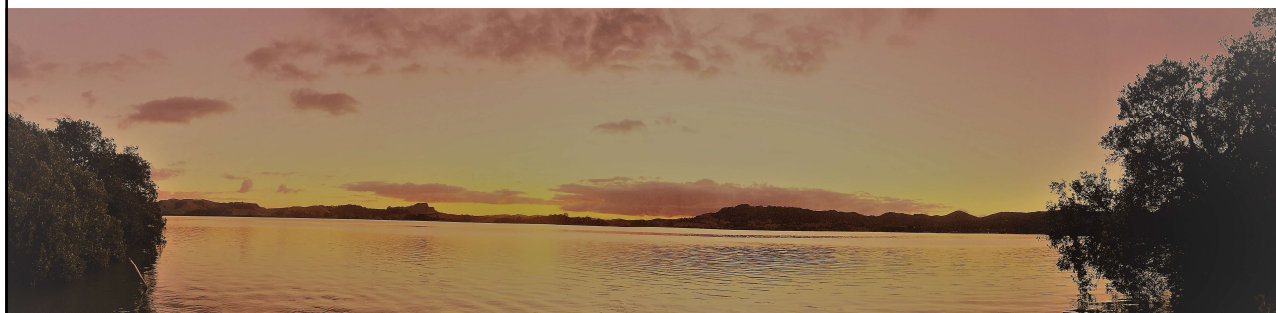
- Sole Trader
- Partnership
- Trust
- Company
 - Ordinary
 - Look Through Company



Capital Gains Tax

- It's off the governments agenda for now

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Thank you.

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