

## September 2010

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## High Wealth Individuals Targeted

The Inland Revenue Department set up a special unit in 2003 to target high wealth individuals. In late 2009 it was reported that more than \$300 million in extra tax has been paid by high wealth individuals since the establishment of the unit.

It was also reported that there were 250 high wealth individuals with 7,500 associated entities for the year to 30 June 2009 and that 161 individuals were selected for review.

There has recently been another round of letters issued by the Unit. A typical letter does not ask for any information to be provided but does contain a list of the individual's associated entities. In some cases this can include brothers and sisters which seems odd.

It is important to review the list of associated entities. The lists appear to have been prepared by simply searching entities that have the individual as a director, shareholder or trustee without actually determining the level of involvement of the individual. The list may also disclose entities you didn't know existed. If this is the case, it is a good opportunity to talk to your client.

The letters are being sent directly to clients and this can in some cases cause concern. Practitioners will receive a copy of the letter so it would be prudent to call the client and explain the background to the unit.

**Phil Walker**

## Depreciation of Residential Buildings Post Budget Changes

The new rules relating to the depreciation of buildings from the 2012 has received much publicity. From the 2011/12 income year, the depreciation rate for buildings with an estimated useful life of 50 years or more will be 0%. Such buildings will still be classified as depreciable property, but with an annual depreciation rate of 0%

This restriction does not apply to items used in the building but which are not part of the building, (e.g. chattels), and the taxpayer will be able to continue to depreciate these items separately from the building. IRD have recently advised that non-building items would include wardrobes & cupboards (which are not built in), carpets, curtains, blinds, water heaters, hot water cylinders, ovens, stoves and fridges etc.

We consider that taxpayers who have traditionally included their chattel depreciation with their residential building depreciation at building rates, are able to adjust their depreciation claims for chattels going forward by claiming depreciation on such chattels at a more favourable rate.

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The applicable provision is section EE 12 of the Income Tax Act 2007. The section prescribes that a taxpayer can make an annual election to apply a depreciation method to each item of depreciable property. Depreciation method is defined in the section to include a method that may be used to calculate depreciation (i.e. diminishing value, straight line or the pool method) as well as an annual depreciation rate as determined by the Commissioner.

Where the DV or SL method is chosen, it cannot be altered during the income year, but can be altered from year to year. The pool method must be used for the income year and later income years. With a change from DV to SL, the item's cost equals its adjusted tax value at end of previous year. If changing from SL to DV, then simply use the adjusted tax value at end of previous year

A taxpayer is therefore free to change depreciation rates on an annual basis. By extension, a taxpayer who has previously depreciated non-building items at the building rate should be able to change to a higher rate for the next income year and continue to depreciate those items in the 2012 and subsequent income years. To do so, it will be necessary for the taxpayer to firstly identify the historical cost of these non-building items. The easiest manner of doing this would be to obtain a valuation of the building and non-building items as at the date of acquisition in order to split out the original purchase price. Depreciation would then be calculated on the adjusted tax value going forward. There are a number of firms that offer such a valuation service.

A similar valuation exercise would also be required when the building is sold in order to calculate any depreciation recovered or loss on sale.

Practitioners need to be mindful of the associated persons rate limitation in section EE 40 which prevents a change to a higher depreciation rate where depreciable property has been disposed of to an associated person. The associated purchaser cannot use a higher rate than the annual rate applied by the associated vendor, e.g. where an individual sells his rental property to an LAQC.

**Tim Chemaly****CV Method Loss Restriction Extended to Super Schemes & Life Policies**

The comparative value ("CV") method in section EX 51 of the Income Tax Act has been amended so that the loss restriction rule under this method applies to foreign superannuation and foreign life insurance interests with effect from the 2009/2010 income year. Before this amendment investors were able to claim a loss under the CV method for these FIF interests.

The effect will be to subject these FIF investments to the same rule that has applied to foreign shares since the FIF rules were amended

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with effect from April 2007. The loss restriction rule ensures that the CV method cannot produce a loss except in circumstances where the use of the CV method is mandatory. This rule applied only to FIF interests that were foreign shares during the 2008 and 2009 income years therefore it was possible to claim a CV loss for superannuation scheme and life insurance policy interests for those years.

This significant amendment may have escaped the attention of some practitioners as it was contained within the voluminous Taxation (International Taxation, Life Insurance, and Remedial Matters) Act 2009 although it was highlighted in a two line item in the November 2009 TIB.

**Tim Chemaly****Seminars**

Our spring series seminars are scheduled to run over October and November. These are being held in Auckland, North Shore, Hamilton and Tauranga. If you wish to attend, please fill out the relevant attached registration form.

**Lara Hartmann**