Depreciation of Residential Rental Properties

Is an asset in a residential rental property part of a building or is it a chattel that can be depreciated separately for tax purposes? Interpretation Statement “Residential Rental Properties – Depreciation of Items of Depreciable Property” provides Inland Revenue's answers to this question.

In Inland Revenue's view it is unacceptable for landlords to ‘break up' their properties into smaller components to obtain higher depreciation rates for tax purposes.

In the past, some rental property owners have obtained chattels valuations with the aim of maximising their depreciation claims for tax purposes. A chattels valuation will still be useful in some situations as Inland Revenue accepts that certain assets that are found in rental properties can be depreciated separately.

Inland Revenue has devised the following three-step test to determine whether an item is part of the building or a separately depreciable chattel:

Step 1
Is the item in some way attached to the building?
If the item is completely unattached, it will not form part of the building. An item will not be considered attached for these purposes if its only means of attachment is being plugged or wired into an electrical outlet or attached to a water or gas outlet. If the item is attached to the building, go to step 2.

Step 2
Is the item an integral part of the property such that the property would be considered incomplete or unable to function without the item?
If the item is an integral part of the property, the item will be a part of the building. If the item is not an integral part of the property, go to step 3.

Step 3
Is the item built-in, attached or connected to the building in such a way that it is part of the “fabric” of the building?
Consider factors such as the nature and degree of attachment, the difficulty involved in the item's removal and whether there would be any significant damage to the item or the building if the item were removed. If the item is part of the fabric of the building, it is part of the building for depreciation purposes.

The items in the list below are divided into those that Inland Revenue considers should be treated as part of the building and those that it believes can be depreciated separately.

Building	Separate item
• Bathroom fittings (toilets, baths, showers, basins)	• Wardrobes and cupboards not built into the wall
• Kitchen cupboards	• Freestanding baths
• Internal walls	• Carpet
• Internal and external doors	• Curtains and blinds
Wardrobes and cupboards built into the wall	• Water heaters and hot-water cylinders
• Garage doors (when the garage is attached to the building)	• Ventilation systems with minimal attachment
• Plumbing and piping	
• Electrical wiring	
• Linoleum and tiles	
• Built in ventilation systems	

The list does not cover every asset that can be found in a rental property. We know that, with regard to alarm systems, for example, Inland Revenue expects the answer to depend on the nature of the particular alarm system's attachment to the building. Inland Revenue considers that taxpayers are in a better position to judge how such items are attached to a building and to apply the three-step test.

The Interpretation Statement is limited to residential properties but Inland Revenue is likely to take a similar position in respect of commercial properties.

The Interpretation Statement is available on Inland Revenue's website.