Business Basics

DEPRECIATION

Understanding Depreciation

Fixed assets are long-term assets that a business owns which are expected to be used in the business for longer than one year. They are often used to operate the business, such as machinery, buildings, equipment and vehicles. As you can't deduct the cost of fixed assets from your taxable income as expenses, instead depreciation comes into play. It allows for the cost of the asset to be written off over its useful life, and is claimed as a deduction from your income on your tax return.

You must claim depreciation on all of your business' fixed assets which have a usable lifespan of more than 12 months. These are assets that you own, lease (depending on the type of lease), or buy under a hire-purchase agreement.

Some fixed assets **cannot** be depreciated, such as:

- Land
- Trading stock
- Franchise fees
- Assets you have elected not to depreciate
- Low-cost assets of less than $500 which are claimed as full deductions
- Intangible assets, for example goodwill or trademarks

The reducing value of your fixed assets for tax purposes begins when they are first used (or available to be used) within your business, and continues until they are sold or no longer needed. Once the total cost of the asset has been depreciated, no additional deductions are allowed.

Depreciation deductions vary depending on the cost of the asset, the depreciation method and depreciation rate.

Keeping Records For Depreciation

It is important to keep accurate records on your assets, such as tax invoices for proof of purchase and sale. You must keep these records for a minimum of seven years. It is also recommended to keep a Fixed Assets Register of your depreciable assets which tracks the cost price of the asset, the amount of depreciation claimed each year and the adjusted tax value. The adjusted tax value is the value of your asset at the end of each tax year after annual depreciation has been deducted.

Depreciation Rates

The IRD sets the depreciation rates for different types of assets based on the cost and useful life. Rates also vary depending on the year in which the asset was acquired. The IRD website has a downloadable guide to general and provisional rates, as well as a useful Depreciation Rate Finder tool.

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DEPRECIATION

Depreciation Methods

There are two main methods for calculating depreciation:

1. **Diminishing Value** - each year the amount of depreciation is worked out on the adjusted tax value of the asset. Your depreciation deduction reduces progressively each year.
2. **Straight Line** - depreciation is calculated on the original cost price of the asset and the same amount of depreciation is claimed each year.

You can use different calculation methods for different assets, and you can change methods from year to year. However, if you change methods you must use the adjusted tax value and not the asset's cost price going forward.

Pooling Assets

You can choose to pool low-value assets together and depreciate them collectively as though they are a single asset using the diminishing value method. The pooled assets must have a cost or adjusted tax value less than $5,000 (excluding GST if you are GST-registered). Pooled assets can only be used for business, not private use.

Electing Not To Depreciate An Asset

Although claiming depreciation on your business assets is generally compulsory, it is possible to elect not to depreciate an asset. If you do this you may not claim depreciation on that asset in future years. IRD must be notified of an election not to depreciate an asset in the income year that:

- the asset was purchased; *or*
- the asset use was changed from private to business; *or*
- you elect not to claim depreciation on an asset you have not claimed depreciation on before.

Selling A Depreciated Asset

If you sell or dispose of an asset that you have claimed depreciation on, you must show any loss or gain in your tax return. This also applies if your business ceases operating, or if you have claimed depreciation on a home office and then sell your home. If an asset has been used for both private and business use, any loss or gain must be apportioned accordingly. Selling costs such advertising or commission can be deducted from the sale price before you calculate the loss or gain on sale.

You are not permitted to claim depreciation in the year in which you sell an asset, with the exception of a building.

Mixed Use Assets

If a fixed asset is used for both private and business use, you can only claim depreciation on the percentage used for the business.

If you start using a privately-owned asset within your business, or conversely keep a business asset for private use after your business stops operating, you must confirm that the asset is valued at current market value - which may require an independent valuation.