

## Purchase Price Allocation and Depreciation in Commercial Property Transactions

**At the end of 2023, the Government announced its intention to remove tax depreciation on commercial buildings. This was legislated and became law from 1 April 2024. This change, combined with the mandatory requirement for the inclusion of a purchase price allocation in a sale and purchase agreement of property with a purchase price above a certain threshold, is an important change for lawyers and clients alike.**

### When is a purchase price allocation required?

Since 1 July 2021 a purchase price allocation to separate out "depreciable" and "non-depreciable" assets (PPA) is required in the following scenarios:

- the sale and purchase of commercial property (or property that is not wholly residential) with a purchase price of \$1,000,000.00 (including GST) or higher; and
- the sale and purchase of residential land and chattels with a purchase price of \$7,500,000.00 (including GST) or higher (noting sales of residential land by one owner-occupier to another are not affected by the PPA rules since the sale and purchase is not taxable for either party).

Should the parties to an above agreement fail to agree on a PPA, the vendor will have the right within three months of the settlement date to decide the allocation unilaterally. This allocation must then be notified to both

the purchaser and to the Inland Revenue Department (IRD). If a purchaser disagrees with such allocation, the purchaser could try and request the IRD commissioner review it, but in usual circumstances the allocation is unlikely to be adjusted.

Should the vendor fail to make an allocation within the three-month timeframe, the right passes to the purchaser. If the purchaser then also fails to notify the vendor and the IRD of an allocation within an additional three-months, the IRD has the right to make the allocation itself which will bind both vendor and purchaser. Even if the PPA is in an agreement, or is determined by the vendor or purchaser post settlement unilaterally, the IRD can still challenge such allocation.

Should a unilateral allocation be made by the purchaser or IRD, the key implications are as follows:

- there is no right on the vendor to contest the allocation;
- the vendor loses the opportunity to claim a loss on disposal of assets that are worth less than their book value at the time of settlement; and
- that party may allocate a higher value to the vendor's depreciable assets than that recorded on the vendor's books. The vendor will therefore have to account for depreciation recovered on those items when its tax return is completed.

### What does the 1 April 2024 change mean practically in the context of commercial transactions?

Previously the PPA would be addressed by accountants, often at the first tax return. At that time most PPAs would list land (as the non-depreciable asset) and improvements / buildings (as the depreciable asset). Accountants would then request the improvements / buildings be further split to provide value for the fit-out (being "depreciable property other than buildings"). Prior to the removal of building

## Purchase Price Allocation and Depreciation in Commercial Property Transactions (Continued)

depreciation this was not a problem, as both buildings and fit-out were depreciable assets.

This is no longer possible. Buildings are now a non-depreciable asset and now a value for fit out (being "depreciable property other than buildings") must be included in a sale and purchase agreement where the purchase price is over the relevant threshold (GC20(1)(a) and GC21(1)(a) of the Income Tax Act 2007).

It is recommended that an apportionment (such as set out below) be included in the sale and purchase agreement, with the corresponding values recorded as either a percentage of total value or a dollar value:

*LAND (non- depreciable)*

*BUILDING STRUCTURE (non-depreciable)*

*[FIT-OUT] (depreciable property other than buildings)*

Where a PPA is not agreed or for urgent or unconditional transactions, it is recommended that provision is made within the agreement for the parties to agree on the PPA within a certain timeframe following settlement. If there is no mechanic for the PPA to be determined, then the default settings (as noted above) will apply.

If no value is placed on the fit-out, then the impact on a commercial property owner could be \$10,000s - \$100,000s in unnecessary tax.

Common issues that arise with PPAs is when chattels are listed with a value, but no value is included for fit-out or other depreciable property. Note that the chattels listed in schedule 2 of the standard Auckland District Society sale and purchase agreement are not always reflective of all (or even any) building fit-out.

Another common issue is that often vendors include the "book value" of the assets, whereas the assessed / market value can often be much higher.

### What are depreciable assets vs non-depreciable assets?

- Land (non-depreciable).
- Building structure (non-depreciable) = floor, walls roof.
- Depreciable assets = everything else (suspended ceilings, light fittings, smoke alarms, partitions (non-load bearing), electrical reticulation, plumbing, lifts, fire alarms, fitted furniture, floor coverings, fences, retaining walls, driveways, air conditioning and so on).

You do not have to agree on a list of assets within the PPA, just the overall value, but it is always useful to know the different assets the vendor is including.

Note that in an average new build industrial warehouse with office, approximately 67.4% would be building structure, and 32.6% would be depreciable property other than the building. In an average office building (high rise), approximately 47.9% would be building structure, and 52.1% would be depreciable property other than the building. This is much higher than parties usually consider.

### Final tips and tricks

- The best approach when purchasing or selling property with a purchase price above the relevant threshold is to seek advice on the PPA and the value of the assets – even a PPA that looks to be complete, with values that include chattels/fit-out or other items, can be misleading.
- The values in a PPA should represent market value (and not book value).
- If you are purchasing property by way of an auction, ensure that the auction agreement includes a further term allowing a breakdown of depreciable assets post auction.

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## **Purchase Price Allocation and Depreciation in Commercial Property Transactions** (Continued)

- Properties purchased between 1 April 2020 to 31 March 2024 (being the period during which tax depreciation was reinstated as part of the Government's COVID-19 stimulus package) can possibly be reviewed if the parties did not separate out depreciable assets as part of the sale. We suggest you seek advice from your accountant in these circumstances.

### **Want to know more?**

If you have any questions about price purchase allocations or the removal of tax depreciation, or sale or purchase of property in general, please contact our specialist [PPC team](#).