Tax Incentives for Replacing Demolished Buildings

Owners of demolished commercial buildings in the Christchurch CBD should take tax relief into account before investing their insurance proceeds elsewhere.

Most building owners will be aware that they will be taxed on any depreciation recovered if they dispose of their building at a gain. The same tax cost will also be triggered if earthquake damage to the building or surrounding land meant their building had to be demolished. This is because a building insured at full replacement value may well have created a gain on this "deemed disposal", causing a tax liability when past depreciation is clawed-back.

Tax relief available

What building owners may not know is that there are tax relief measures available following law changes in August 2011, effective from the date of the first quake on 4 September 2010.

One option deserving attention lets owners elect to defer this tax cost by rolling it into the cost of a replacement building. That way, it is not until the replacement building is ultimately disposed of at a gain that past depreciation would be recovered and taxed. This timing benefit relieves the issue that arises from this unplanned tax cost causing a shortfall of cash available for rebuilding.

Even more interesting is that the replacement building does not have to be located on the original site or even in the Christchurch CBD itself, for depreciation rollover relief to apply. It can be located anywhere in "greater Christchurch". That is, anywhere covered by the Christchurch City, Selwyn District or Waimakariri District Councils.

How to benefit?

To get the benefit of the rollover, notice that the owner plans to invest in a replacement building will need to be given when filing the building owner's income tax return for the year in which their insurance proceeds could be reasonably estimated. That is when the tax on depreciation recovered would otherwise have had to be returned.

The amount of rollover relief that can be claimed depends on the extent the owner replaces affected buildings and the level of insurance cover they had across all affected buildings they owned.

The present deadline requires any replacement building to be ready for occupation by the end of the building owner's 2015/2016 income tax year.

Flexibility for owners

For building owners not yet wanting to commit to rebuilding in the CBD itself, there is some scope to reinvest in greater Christchurch without an immediate, and perhaps unexpected, tax cost. This may provide flexibility for those wanting to delay their decision or even dispose of their current site. For example, obtaining the tax deferral by investing in another existing building in the greater Christchurch area or returning to invest in a greater Christchurch building before the current deadline. For those committed to the rebuild of the Christchurch CBD, it adds further incentive to progress building projects.

If you have any questions about how this or other tax changes may impact property or need assistance on other legal matters involved in your property decisions, please contact us.

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