Partnered by Washington Brown QUANTITY SURVEYORS

DEPRECIATION PART 3 SERIES

OLD HOUSE, NEW TRICKS

Investors buying older properties frequently overlook depreciation benefits – a mistake that could cost them thousands at tax time. In the third instalment of our four part series, Stefanie Garber examines how this policy comes into play with houses and unit that have spanned the decades

Depreciation is a tax deduction that compensates owners for the wear and tear on their properties. Many investors associate this policy with new properties, failing to realise the potential offered by older houses and units, according to Tyron Hyde, director of Washington Brown.

Mr Hyde frequently gets calls from people who had no idea their twenty- or thirty-year-old rental could still attract deductions. Investors who fall into this trap may be missing out on tax rebates year after year, Mr Hyde warns.

Properties built after 1987

Depreciation has two elements: the building allowance and the plant and equipment write-offs.

The building allowance, also known as a capital works deduction, covers loss of value on the structure itself.

"This includes the concrete, bricks, mortar and other construction materials," Mr Hyde says.

According to the Australian Taxation Office (ATO), rental properties built after 18 July 1985 are eligible for this claim. However, if construction started between this date and 15 September 1987, the allowance lasted for 25 years - a timeframe which has now expired.

If construction started after 15 September 1987, investors can look forward to 40 years of deductions. At a rate of 2.5 per cent a year, even 20-year-old properties can return an

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impressive sum. If an investor buys a house in 2014 that was built in 1994 at a cost of $200,000, they can deduct approximately $4,000 a year from their income for the next 20 years.

Properties built pre-1987

If your property was built before the 1987 deadline, don't despair - depreciation benefits may still be in reach. Mr Hyde says wear and tear on the fittings and fixtures can be claimed no matter when the building was completed.

"If a property is built before 1985, there is no building allowance on the property at all, so you can't claim for the structure. But all buildings have plant and equipment in them," Mr Hyde says.

The 'effective life' of an item indicates how long the investor can claim its value. When a piece of plant or equipment is brand new, its effective life is determined by ATO rulings, Mr Hyde says. However, as years pass, this timeframe shortens.

"If you buy a house where the carpet is six years old, the effective life is not ten years any more. It's four," he says.

However, the potential write-offs do not necessarily decrease as time passes, Mr Hyde explains.

"Even though the item's value might have diminished, the rate at which you can claim that item increases," he says.

In the example above, the carpet may originally have cost $1,000. When it is brand new, the owner can claim $100 a year for 10 years. If a new owner buys that carpet six years later, its value may have been reduced to $400 and its life to four years, but the owner can still claim $100 a year, albeit over a shorter period.

The ATO has determined some items have long effective lives - a windfall for owners who buy late in the game. For example, lifts in apartment buildings are deemed to last for 30 years. But even if an item has passed its ATO-determined effective life, a new purchaser may qualify for a rebate, Mr Hyde explains.

If the owner sells the property after the item's effective life has expired, the new owner has still paid money for that item. As such, Mr Hyde says they are eligible for a deduction.

The amount of this deduction is determined by a quantity surveyor's report, according to Mr Hyde. The expert will value the item and put a new lifespan on it. After 15 years, the carpet may now only be valued at $100, meaning the owner can write it off straightaway.

"If the previous purchaser has written the item down to zero, your opening value is what you paid for it," Mr Hyde says.

When the price tag for a house is hundreds of thousands of dollars, how can a quantity surveyor determine how much was paid for each individual item? Mr Hyde says he relies on set formulas and experience to make this judgement.

"Say the property cost $500,000. That means you paid X amount for the land and Y for the house. As part of the house cost, there was an oven included and that oven represents Z amount. Therefore your oven cost is Z," he says.

In his experience, determining the land value is often the most challenging factor.

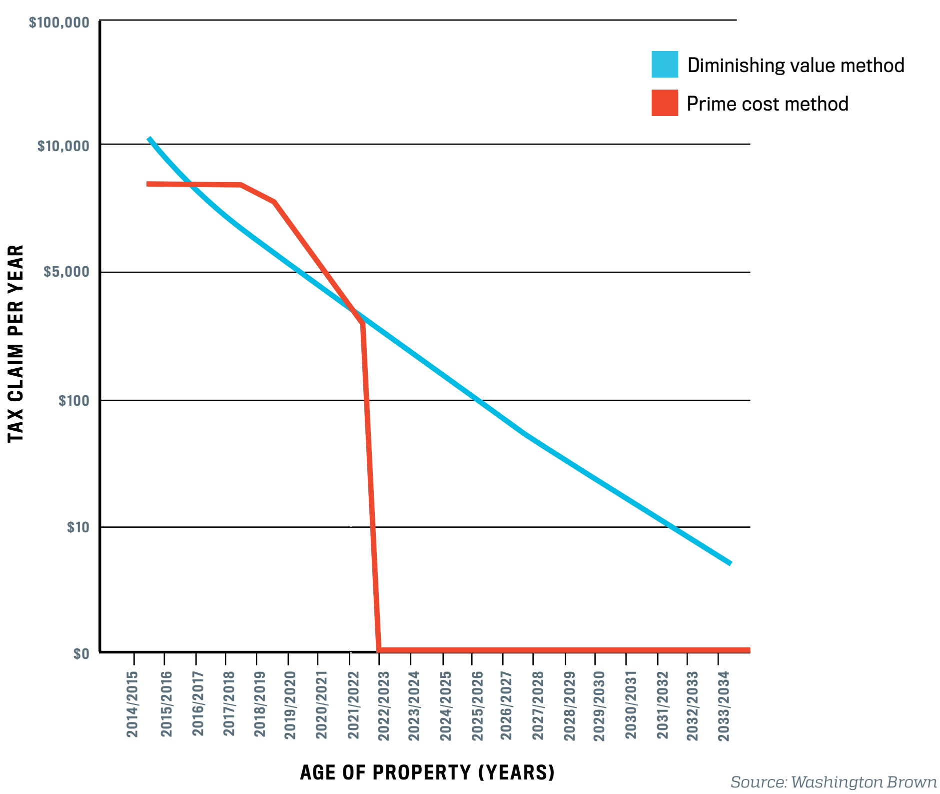
"The Valuer General's department only issues land values every three years so it is not a precise science. As quantity surveyors, we use our estimation of what is reasonable," he says.

In some cases, items may also have been replaced since the building was completed, resetting their lifespan. Quantity surveyors are skilled at recognising renovations and calculating their age.

"That's when our skill comes in. For example, we might look at the type of tile to determine when they were popular or when those kitschy colours were fashionable," says Mr Hyde. ■

EXAMPLE: DEPRECIATION SCHEDULE

Below is an example of a depreciation schedule for a house built prior to 1985. The property cost $654,600 to purchase. While the building allowance is not applicable, plant and equipment deductions worth $25,413 can be claimed over 20 years. Investors can choose to claim using the prime cost method, where the deduction is calculated on the 'original value' each year, or the diminishing value method, where the rate is calculated on the 'remaining value'.

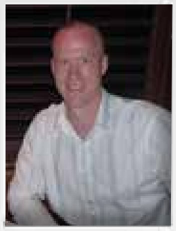


Source: Washington Brown

In the next edition of Smart Property Investment *we will investigate how depreciation applies to renovations – so make sure you don't miss an issue!*

HOW MUCH IS IT WORTH?

Investors may be surprised at how much they can claim on their properties from the 70s, 80s or 90s. Our investors share their experiences with depreciation and the deductions they earned. Collectively, our three investors can write-off almost $8,000 a year – not bad for properties well over 20 years old!



ADAM WIXX

In Adam's experience, getting a depreciation report pays off even when the property has a few years on the clock

Menai, NSW

Purchase price: $615,000

Purchase date: 2010

Year built: 1992

Depreciation:
$4,293 in financial year 2013/2014

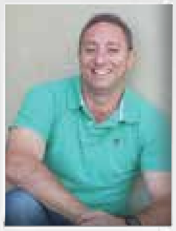
"I think it is absolutely worth getting a depreciation schedule on an older building. For our property in Menai, the light fittings ($415) and split-system air con ($532) will give the biggest amounts in the 'low value pool' category in the 2014/2015 financial year. Out of everything else, the carpets gave the best value, around $500. The rest of the items will return us around the $100 mark each.

In the first year I owned the property, I was able to write-off items straightaway, including the dryer, the rangehood, new automatic garage door, doorbell, smoke detectors and exhaust fans.

There were a few surprises – I did not expect to be able to claim our clothes line and TV antenna as I did not consider them part of the building. Also the doorbell is a portable, wireless one, not hardwired to the building, so I didn't think that would be claimable either.

Many older buildings have had some renovations done. Depending on when they were completed, this alone might give some great depreciation benefits.

Also, most companies offer some sort of guarantee that you will be able to make back at least the cost of the schedule in depreciation. That, along with the fact that the schedule itself is a tax deduction, makes it a no-brainer."



GLEN NEWBERRY

'My 35-year-old property is still depreciating'

Mount Druitt, NSW

Purchase price: $182,500

Purchase date: 2012

Year built: Approx. 1979

Depreciation:
over $2,500 in financial year 2013/2014

"Like most people, I initially thought that depreciation was only suitable for relatively new properties, which is wrong. There is still a considerable amount of depreciation in older properties – obviously not as much as a newer property, but enough to warrant paying to have a depreciation schedule done.

One of the units that I own, which is approximately 35 years old and in original condition, still gives me over $2,500 per year in depreciation.

The carpet, hot water system, and stove gave the biggest benefits. After 35 years, it's highly likely that these are not original items so they still have value which can be depreciated. Also, something that I didn't think about was depreciation of common property, like carpets, intercom systems, garbage bins and TV systems – a share of these can also be claimed.

Things that could be written-off straightaway in the unit were smoke alarms, curtains, bathroom accessories and also the common property items.

There were plenty of things that could be depreciated which were not obvious to me – things like garbage bins, intercom and TV systems, light shades and shower curtains.

For the relatively small cost of having a depreciation report done, and the benefits that it can provide come tax time, there is no reason for not doing it. This is why I have depreciation reports done on all of my properties.

To some people, $2,500 may not seem like a lot, but every little bit counts. It could be the difference that turns a negatively geared property into a positively geared property. When you multiply that by the 14 properties that I have in my portfolio, that's a lot of money to be throwing away every year if I'm not claiming it."

SARAH ROGERS

Claiming depreciation has helped Sarah move towards her goal of owning 10 properties in 10 years

Wodonga, Vic

Purchase price: $220,000

Purchase date: 2012

Year built: 1978

Depreciation:
$1,158 in financial year 2013/2014

"Because this property was built before 16 September 1987, it is ineligible for tax depreciation under the capital works deduction. So why do I think it is still worth paying the money for a tax depreciation schedule?

Simple – I can still claim tax back on renovations to the property and also plant and equipment. This includes items such as cookware, heating and air conditioning, blinds and the hot water service.

For the few hundred dollars you spend to get a tax depreciation schedule made, let's look at the return. Firstly, the tax depreciation schedule costs can be claimed through tax, but the real kicker is the amount you can get back for an old house.

In this year alone I am able to claim $406 for renovations, for things such as a clothes line, a veranda, the fences and the kitchen. I can also claim $752 for plant and equipment, including the cooktop, oven, dishwasher, hot water service, heating/air conditioning, curtains and blinds.

The year before I claimed back $2,208. The total I can claim back for a 10-year period is $9,454. You can claim back up to 34 per cent per year on some items such as the blinds.

This is also perfect if you have just bought the house because you are claiming back expenses you didn't have to pay for in the first place. It's just an extra benefit of being a landlord.

After looking at the figures, I was pleasantly surprised at the deductions and I believe that no matter how old the property is, it is worth having a tax depreciation schedule. Any way we can save on tax is a plus."