



A closer look

JAMES HANNAH investigates the effect recent changes to depreciation allowances have on the average investment property.

In my article last issue I commented on the changes to depreciation brought about by the recent “interpretation” by the Administrative Appeals Tribunal sitting as the Small Taxation Claims Tribunal on behalf of the Commissioner of Taxation. In a landmark decision, the tribunal stated that certain items which were depreciated as plant were in actual fact treated as part of the building and therefore were not eligible for depreciation as such, although this appears to be contrary to what the ATO has previously allowed.

The items under review were:

- Electrical switchboards, mains and submains cables, gas and telephone installations.
- Kitchen counter fittings, bathroom

mirror, glass shower screen, wardrobe shelving and mirrored doors.

- Sliding security screens, security floodlights, gates, deadlocks and letterboxes.
- Pools and spas
- Protective bollards or vehicle control equipment.

Most investors that contacted me were disappointed that, once again, the tax system seems to be picking on the “little people.” Before jumping to conclusions and spreading doom and gloom for the property investing group, let us first investigate what effect these changes actually make to the average investment property. What long and short term effect does it have your specific property? In this article I’ll analyse three properties to determine the effect these changes have had, and in what areas.

I’ve selected three properties, as there are three distinct phases of a property’s life. These are:

- A new property
- A secondhand property 1 – 15 years old, post 1985.
- An old property, pre 1985 (building allowance was introduced in 1985.)

The first property is a newly constructed townhouse located in Sunnybank on the Southside of Brisbane approximately 12 kilometers from the CBD. The purchase price was \$185,000 and the townhouse is one of 45 in the development. The property is a two bedroom, two level, brick construction with tiled roof. It’s of medium standard fitout with modern appliances, fixtures and fittings complete with gated security, swimming pool and barbeque area. Table 1 shows that the loss in this type of property due to the changes in legislation is \$2,876 over the first five years, or \$1,216 over the first 104 days!

The second property is a 6 year old house located in Castle Hill, a North Western suburb of Sydney about 26 kilometers from the CBD. The property was purchased for \$455,000 and is a two storey brick veneer house with tile roof. It’s a very well appointed house complete with 4 bedrooms, two bathrooms, ensuite and electronic home surveillance. Most properties that are a few years old have similar traits to new properties but lack plant and articles, basically because when they were built they did not contain as many items of plant. Modern construction methods, especially fitouts, contain a high percentage of plant; e.g. dishwashers, cooktops, exhaust canopies, built-in

vacuum system, air conditioners and expensive lighting systems. (See *Which property is best for you?* API June/July 2001.)

Table 2 shows that the loss in this type of property due to the changes in legislation is \$2,876 over the first five years, or \$1,564 over the first 286 days.

The third property is an older style unit complex built in the 1930's in the inner Sydney suburb of Darling Point. The purchase price was \$330,000 and the unit is one of 12 units in the development. The property is a two bedroom unit, brick constructed with original fixtures and fittings. It can be seen from Table 3 (next page) that the loss in this type of property due to the changes is \$7,333 over its remaining life or \$2,773 over the first five years, or \$114 per month in the first year – a considerable loss.

Before we start jumping up and down at the above losses, and as I explained to a disappointed investor, it's important not to forget the basic principles of property related tax benefits. The simple equation is that to maximise your return

Table 1: New Property

	Pre			Post			Change	
	Plant	Build	Total	Plant	Build	Total	\$ Diff	% Diff
104 Days	4,964	632	5,596	3,703	675	4,380	-1,216	22%
Year 2	4,455	2,218	6,673	3,700	2,371	6,071	-601	9%
Year 3	3,195	2,218	5,417	2,641	2,371	5,012	-400	7%
Year 4	2,349	2,218	4,567	1,926	2,371	4,297	-270	6%
Year 5	2,797	2,218	5,015	2,255	2,371	4,626	-389	8%
Total 40 yrs	28,380	87,134	115,514	21,370	93,144	115,514	Same	0%

Table 2: Second Hand Property

	Pre			Post			Change	
	Plant	Build	Total	Plant	Build	Total	\$ Diff	% Diff
286 Days	7,847	3,970	10,944	6,233	3,148	9,380	-1,564	14%
Year 2	8,759	3,952	12,711	8,194	4,018	12,211	-500	4%
Year 3	5,963	3,952	9,915	5,574	4,018	9,592	-323	3%
Year 4	4,150	3,952	8,103	3,874	4,018	7,892	-211	3%
Year 5	5,654	3,952	9,607	5,270	4,018	9,287	-320	3%
Total 40 yrs	42,546	146,108	188,654	38,149	150,505	188,654	Same	0%

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I BELIEVE THAT THE ASTUTE PROPERTY INVESTOR SHOULD ALWAYS HAVE A WELL-DIVERSIFIED PROPERTY PORTFOLIO COMPRISED OF A CAREFULLY SELECTED MIXTURE OF PROPERTIES. THESE MIGHT INCLUDE UNITS, FREESTANDING HOUSES, STUDENT ACCOMMODATION AND SOME OLDER PROPERTIES AS WELL.

one has to identify the plant and articles and separate them from the building.

The reason for doing this is that the plant and articles are depreciated at higher rates than that of the building allowance, which is either 2.5% or 4% depending on the property.

To explain it simply, I'll use a jug of water as an analogy. The full jug of water represents the purchase price of the property (less land content).

Now take two glasses and fill them each with the water from the jug, one being the building and the other the plant.

If (as in the case above) the plant is rejected as a depreciable asset, then we simply pour some water from the plant glass into the building glass. Over the life of the property, the total claim is the

same – it is only that you've lost some of the higher-percentage depreciable items which of course determines the maximum benefit of those early years.

The problem with old properties is that there is only one glass, a plant glass, as they do not qualify for building allowance. Therefore what you empty from the plant glass is lost forever.

On a summary analysis of the figures we can determine that both the new and near new (second hand) properties there is a 6% – 11% loss in benefits over the first five years of ownership which in both cases result in a loss of almost \$3,000 for the same period.

Old properties are the hardest hit with a loss of 33% over the first five years of ownership, which of course is a benefit that is not picked up in later years or


switched to a building allowance. There is no building allowance because the property does not qualify, as it was constructed prior to 1985.

This is disappointing. If you've read any of my previous articles or heard me speak at conferences you would realise that I always profess the benefits of older properties.

It's my belief that this area of the market is often overlooked by investors building a portfolio of properties. (See *Older Properties in Focus*, API June/July 2002.)

I believe that the astute property investor should always have a well-diversified property portfolio comprised of a carefully selected mixture of properties.

These might include units, freestanding houses, student accommodation and some older properties as well.

Remember the old adage – location, location, location. With older established properties you have the advantage of purchasing in well established areas, close to the CBD, rail, bus, hospitals, schools, restaurants and a variety of services. 

■ The author, James Hannah, has over 15 years experience in the valuation of property and plant and equipment for tax depreciation purposes, he is a member of the Australian Property Institute and is an expert on property allowances.

Table 3: Old Property

	Pre Build			Post Build			Change	
	Plant	Build	Total	Plant	Build	Total	\$ Dif	% Dif
345 days	3,438	0	3,438	2,069	0	2,069	-1,369	40%
Year 2	1,495	0	1,495	1,106	0	1,106	-389	26%
Year 3	1,288	0	1,288	926	0	926	-362	28%
Year 4	1,118	0	1,118	780	0	780	-338	30%
Year 5	976	0	976	661	0	661	-315	32%
Total 40 yrs	17,922	0	17,922	10,589	0	10,589	-7,333	41%

Table 4: Summary Analyses

Property	Change over 5 years		Change over Life	
	Dollars \$	Percentage %	Dollars \$	Percentage %
New	-2,882	-11%	No Change	No Change
Secondhand	-2,918	-6%	No Change	No Change
Old	-2,773	-33%	-7,333	41%