

Older properties in focus

Depreciation issues can be complex. As JAMES HANNAH explains, a thorough understanding of depreciation allowances – along with some expert advice – can make a big difference to investors' bottom-line returns.

Having attended the Sydney Property and Investment Expo which was held at Darling Harbour in early April of this year it became frighteningly apparent that incorrect advice was being delivered by a number of so called experts in the field of “quantity surveying and tax depreciation.”

One of the most frequently-asked questions was: “My property is old... is it still worth my while getting a depreciation schedule done?”

Firstly the answer is clearly YES! Regardless of how old the property, the tax legislation is clear in its advice that you, as an investor, are entitled to have the plant valued and have its effective life assessed at settlement date.

It was alarming to hear that investors who posed this very same question were typically told, “if the property is older than 5 years it's not worth while doing.” When I heard this, my immediate response was; not worthwhile to whom?

The bottom line is, that in every industry there are so called experts who are not really what they profess to be. Since I started writing articles and educating the investor public to the benefits of tax depreciation it's amazing how many ‘experts’ have suddenly sprung to life. Unfortunately for the general public it's difficult to judge the true professionals from the self-proclaimed ‘experts.’

It also amazes me that investors who pay hundreds of thousands of dollars for properties skimp on the important issues, such as valuations, tax schedules and the professional advice of tax accountants or financial advisors. It's also important to note that being qualified in a profession does not automatically qualify you as an expert in a specific area such as tax depreciation, as this article will point out.

The majority of so called tax depreciation experts take the easy way out. The old terrace house, built back in the early 1900's that's been refurbished

and added to on a number of occasions over time, is rarely marketed to. By contract, the newly constructed high rise or cluster developments with multitudes of apartments are in favour, simply



Table 1: Depreciation Schedule showing first 10 years only.

Year	Depreciation Plant	Low Value Pooling	Capital Allowances	Yearly Total
1	2,635+	1,056+	1,151=	4,842
2	1,956+	1,717+	1,154=	4,827
3	1,677+	1,073+	1,154=	3,904
4	1,447+	671+	1,154=	3,272
5	1,255+	1,118+	1,154=	3,527
6	1,095+	0+	1,154=	2,249
7	961+	0+	1,154=	2,115
8	847+	0+	1,154=	2,001
9	750+	0+	1,154=	1,904
10	667+	0+	1,154=	1,821

because they're easier and less work. Construction costs, dates and land values are readily available, and there's the added bonus of picking up additional clients.

"My property is old... is it still worth my while getting a depreciation schedule done?" If you're lucky enough to speak to a quantity surveyor who is slightly interested, the quote will usually start at \$800, and then all additions are extra. They'll also require you to supply all the additional costs and construction dates. It's therefore easier and quicker in most

cases for them to state that there is no allowance available, or simply that you can only claim plant for the initial 5 years since purchase.

If that were the case then it's no wonder that so many investors are not claiming their legitimate depreciation (see API March 2000 article *Millions Lost.*) It would also seem that approximately 62% of Sydney property investors had no legitimate right to depreciate their property, which isposterous to say the least. It's no

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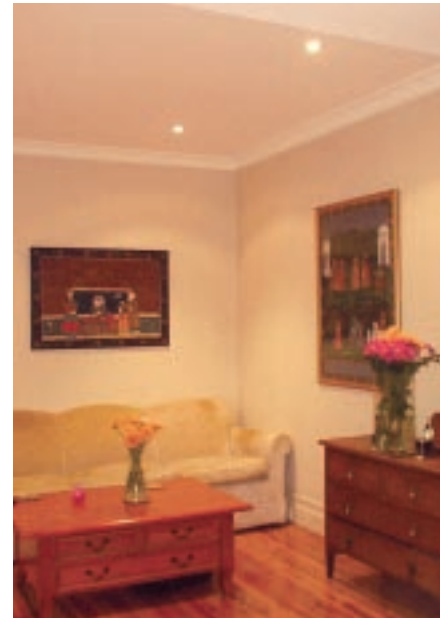
wonder that the property investor public is confused.

To illustrate the depreciation entitlements available on older type properties and as an example, I've selected a property in the Sydney suburb of Paddington close to the CBD which I analyzed only last month. This property is an ideal example of a typical inner city investment property.

The area is very popular and property values have risen accordingly over the past 18 months.

Table 2: Typical Refurbishment Costs (\$)

Description	Cost	Description	Cost
Electrical Wiring	3,860	Toilet Fixtures/ Hardware	630
Plumbing	4,510	Insinkerator	520
Plasterer	3,730	Water Filter	650
Guttering and Down pipes	2,240	Built In Wardrobes	2,200
Drainer	3,300	Security Grills	1,680
Skylight	870	Electronic Security Alarm	650
Insulation	960	Door Locks	395
Outdoor Paving	1,400	Heat/Exhaust Fan	130
Landscaping	1,800	Wall Mirror	80
Floor Treatment	3,890	Smoke Detectors	80
Floor Tiling	820	Clothes Dryer	480
Wall Tiles	1,100	Dishwasher	2,400
Shower Screen and Vanity	1,820	Air Conditioner	2,100
Tap Ware	520	Rangehood/Oven/Stove	3,800
Kitchen Benches	9,800	Hot Water Unit	925
WC	650	Rubbish Removal	300
Painter	4,640		



The property was purchased earlier this year for \$350,000 and renovations were completed prior to purchase. The building itself is pre-1985 and therefore does not qualify for building allowance.

But like most of these inner city properties it's had substantial renovations throughout its life and therefore qualifies for capital works allowance (Building Allowance.)

As can be seen from Table 1, the depreciation schedule showing the analysed property provides \$2,635 Depreciation of Plant in the first year plus \$1,056 of Low Value Pooling* plus \$1,151 in Capital Works Allowance providing a total claim of \$4,842 in the first full year of ownership.

Common refurbishments to these

properties consist of renovations to kitchens and bathrooms, which account for about 60% of the budget, with the remaining 40% being spent on lounge, family and bedrooms, which would include floor coverings and repainting only and of course the obligatory security screens to doors and windows.

A typical amount spent ranges between \$24,000 to \$38,000 for a basic refurbishment which would include minor changes; e.g. shower screen, vanity basin, toilet suite, kitchen benches, carpets, light fittings and painting. This would not cover a refurbishment that included building works, plastering, plumbing and electrical changes which would start at the higher end, between \$45,000 to \$85,000.

A typical refurbishment breakdown would be as in the example shown in Table 2.

The table shows the most popular items and costings for a typical two-bedroom terrace house refurbishment.

As can be seen in this table, the terrace house certainly has far more depreciation than the 5 years which some tax depreciation companies state.

If the property had more than one major refurbishment or addition; for example, one in 1998 and the other in 2000, the Capital Works Allowance for the initial building is nil as stated previously due to the fact that the building was before (pre) 1985, which was the year the government introduced a Building Allowance for residential properties.

We would then analyse the first major refurbishing of \$20,000 in 1998 and the second addition of \$45,000 in 2000. The dates of 1998 and 2000 would be the starting dates for depreciating the Capital Works Allowance (Building



Table 3: Simplified Capital Works Depreciation Report for Illustrative Purposes

Year	1998 Capital Allowances	2000 Capital Allowances	Yearly Total
1998	500+	0=	500
1999	500+	0=	500
2000	500+	1,125=	1,625
2001	500+	1,125=	1,625
2002	500+	1,125=	1,625
2038	500+	1,125=	1,625
2039	0+	1,125=	1,125
2040	0+	1,125=	1,125
Total	\$20,000	\$40,000	\$60,000

Allowance) respectively. Depreciation would be over the life of the asset adopted by the Australian Taxation Office, which is 2.5% over a period of 40 years.

Some investors get confused with the 4% Building Allowance.

This allowance is adopted for either residential properties built between 1985 and 1987, or those that qualify as short-term letting. This mainly applies to resort or holiday letting apartments similar to those that appear on the Gold Coast. Basically, the rules state that there has to be ten or more apartments available in the complex, plus other restrictions.

The report would look like Table 3. This example assumes that the money spent was on capital works only (for illustrative purposes) although this would be highly unlikely as there would always be a percentage of plant.

As I said, the most common question that property investors ask me is, "My property is old... is it still worth my while getting a depreciation schedule done? Well, I'll let you be the judge of that!"



** Low Value Pooling. The government recently introduced an optional low-value pooling arrangement for plant. It applies to plant costing less than \$1,000 or having an undeducted cost of less than \$1,000 at the start of the income year provided it's been depreciated using the diminishing value method. Such low-value plant can be allocated to a low value pool and depreciated at statutory rates as a single item of plant.*

The low-value pool is depreciated using the diminishing value method. Items of plant in the pool have an effective life of 4 years. The pool is depreciated using 2 statutory depreciation rates – for the initially allocated plant in its first year 18.75% (which is 50% of the pool depreciation rate of 37.5%), and for all other plant in the pool (that is, plant that's been introduced to the pool in the previous year) 37.5%. As always, the government has kept the new changes as simple as possible so that the investing public can comprehend and follow the changes!

Prudent investors will make sure their report includes Low Value Pooling!

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The author, James Hannah, has over 15 years experience in Tax Depreciation and the benefits available on investment properties, he is a member of the Australian Property Institute.

