capitalclaims
TAX DEPRECIATION

FOUR FACTS EVERY PROPERTY INVESTOR SHOULD KNOW ABOUT DEPRECIATION

FACT 1 DEPRECIATION IS TYPICALLY ONE OF THE LARGEST DEDUCTIONS AVAILABLE TO PROPERTY INVESTORS

Averaging between $2,500 - $5,000 for an existing house and $10,000 - $13,000 for a brand new house/unit in the first full year for standard residential properties, tax depreciation is often one of the largest deductions claimable for investors.

Average deductions claimable

Building Type	1BR Unit	2 BR Unit	Townhouse	House A	House B	Commercial	Industrial
Purchase Price	$395,000	$492,500	$445,000	$495,000	$597,000	$2.5M	$1M
Year 1 Depreciation	$11,240	$12,750	$11,120	$11,950	$12,730	$107,000	$51,450
Years 1-5 Cumulative	$39,520	$48,550	$45,870	$47,960	$51,220	$468,000	$171,600

Example

Chad is a senior IT officer and purchased a unit in the city for his first investment property. The unit was built 10 years ago and Chad purchased it for $540,000 in April, 2017. Chad earns $75,000 per annum.

Chad is able to claim as tax deductions all of the typical expenses incurred when you own an investment property, such as interest on the investment loan, property management fees, rates and property maintenance.

Chad is also able to claim for depreciation of his unit. Each year Chad's unit ages, and so do all of the common areas in the unit development. Because Chad purchased his property prior to 9th May, 2017 he can claim for depreciation of the building, plus depreciation of all of the included assets as a tax deduction. Chad obtains a Capital Allowance and Tax Depreciation Schedule from Capital Claims Tax Depreciation that reports the dollar value of his depreciation claims in the first year as $9,200. Chad is entitled to deduct $9,200 (along with his other expenses) from his taxable income for that year. Chad's report also includes the deductions he can claim every year for the remaining effective life of the property, meaning Chad never has to buy another schedule to claim his depreciation deductions each year.

Chad's income places him in the tax bracket that pays approximately 32.5% tax. The $9,200 Chad claims as depreciation deductions, gives him an additional $2,990 in his tax return for that year.

Chad will claim $9,200 for depreciation in his first year, and will receive nearly $3,000 more cash in his tax return!

FACT 2 BRAND NEW PROPERTIES GENERATE THE BEST DEPRECIATION DEDUCTIONS FOR INVESTORS

Investment properties purchased brand new will generate the greatest depreciation deductions for investors. This is the case for two key reasons:

1. Constructions costs are at their maximum – it costs more to construct a building today than it has historically. Part of the method for calculating depreciation includes calculating a percentage of the construction cost to deduct each year. Calculating from a higher cost base creates larger deductions for the investor;

2. All plant and equipment assets are brand new – this firstly ensures they are eligible for annual depreciation deductions, plus these assets will also be depreciating also from the highest possible starting value, with no value lost already to previous owners.

FACT 3 AT LEAST 90% OF OLDER PROPERTIES STILL QUALIFY FOR DEPRECIATION DEDUCTIONS

Whilst most people know that brand new properties generate the best depreciation deductions, many investors and their advisers don't realise the value when it comes to claiming for depreciation of older properties. The common myth is that if the property was built at least 40 years ago, there will be no value left to depreciate and claim.

The fact is, most older properties have been improved or extended since original construction. The original building may not have claims left in it, but structural work completed in the last 30 years will qualify.

When you purchase an investment property that is not brand new, any capital improvements or additions completed on the property prior to your purchase will be considered for depreciation purposes. The fact that you don't know when the work was completed or how much it cost doesn't matter. Our experts are qualified to estimate those details and ensure your deductions are maximised.

Not all improvements and additions are obvious to the untrained eye. Re-piering, electrical re-wiring, re-plumbing, roof replacements, window replacements and garages are improvements and additions that are often not recognised by investors, and yet are eligible for depreciation claims.

If the property was purchased prior to 9th May, 2017 assets within the property that have been updated/replaced will also qualify for depreciation deductions. Additionally, for these properties Division 40 (plant and equipment) assets are assigned new values and effective lives at the date of purchase. The depreciation of these assets alone is often enough to make a report worthwhile.

Investors who have purchased established investment properties (properties that are not brand new) since 9th May 2017 are unable to claim annual depreciation on the second-hand assets they acquire (assets like the stove, hot water system etc). All is not lost however, the depreciation of those assets can be claimed as an expense when calculating Capital Gains Tax and help to reduce tax payable in that year.

FACT 4 THE BENEFITS OF CLAIMING TAX DEPRECIATION TYPICALLY OUTWEIGH THE IMPACT ON CGT

Some investors are concerned that by claiming for depreciation now, they only increased the Capital Gains Tax that will be payable if or when they sell their property. It is true that a portion of the depreciation claimed whilst you hold an investment property is deducted from the cost base when calculating a capital gain. However, consider the following:

- When you hold the property more than 12 months you receive a 50% discount on your CGT liability. Combined with the other potential discounts or exemption the impact is minimized even further;

- The value of the dollar you are banking today is greater than the value of the dollar you may save at some time in the future. As Goods as services increase in cost over time, the purchasing power (how much your dollar can buy) of your extra dollars today is far greater than it will be in the future;

- The opportunity cost of delaying those savings could end up costing you greatly. Having the savings tied up in the property, to possibly realise at some time in the future means you are unable to use them to pay down debt, reinvest or manage expenses in the meantime;

- Only the depreciation claimed for Division 43 (building and structure) is deducted from your cost base, not the depreciation claimed on Division 40(assets such as air conditioner, hot water system, blinds, stove etc);

- Properties purchased/becoming a rental after 7.30pm May 2017 are not able to make annual claims for any depreciation on "second-hand" Division 40 assets in their property. Instead, when the property is sold, the cumulative value of that depreciation is also claimable as an expense, reducing profit on the sale as well as potential CGT payable.

Example - Please note these are simplified scenarios to demonstrate the points above only – always seek advice from your accountant.

A - Joe bought an investment property in 2014 for $500,000. It was always an income producing property for him and the accumulative depreciation for the first 5 years of ownership amounts to roughly $34,000: $20,000 of Division 43 (capital works), and $14,000 of Division 40 (plant and equipment). Joe can make annual claims on all of these deductions and on his tax rate, this means an extra $12,750 cash to him over that 5-year period.

Joe decides to sell the investment property and sells at $700,000. Excluding all other variables, Joe makes a $200,000 profit. Taking the depreciation claimed into consideration, the profit becomes $220,000 (purchase price or cost base has been reduced by the depreciation claimed for Division 43 and increased the profit). Joe is entitled to a 50% discount on CGT for holding his property for more than 12 months, so tax is payable on $110,000. At his tax rate he would pay $41,250 in tax.

Had Joe not claimed for depreciation over the 5 years, Joe would pay $37,500. Joe's tax liability at sale has increased by $3,750. However, Joe has had an additional $12,750 over the 5-year ownership. This he used to pay down some debt and do some improvements to the property that increased his rental yield.

B - Jane purchased a similar property in June 2017 for $500,000. It was always an income producing property for her and the accumulative depreciation for the first 5 years of ownership amounts to roughly $34,000: $20,000 of Division 43 (capital works), and $14,000 of Division 40 (plant and equipment). Jane can make annual claims on the Division 43 deductions and on her tax rate, this means an extra $7,500 cash to her over that 5-year period.

Jane decides to sell the investment property and sells at $700,000. Excluding all other variables, Jane makes a $200,000 profit. Taking the depreciation claimed in consideration, the profit becomes $206,000 (purchase price or cost base has been reduced by the depreciation claimed for Division 43 which increased the profit to $220,000, then the Division 40 Depreciation expense of $14,000 was applied).

Jane is then entitled to a 50% discount on CGT for holding her property for more than 12 months, so tax is payable on $103,000. At her tax rate, she would pay $38,625 in tax.

Had Jane not claimed depreciation over the 5 years, Jane would pay $37,500. Jane's tax liability at sale has increased by $1,125. However, Jane has had an addition $7,500 over her 5-year ownership. This, she used to pay down debt and kickstart other investments!

Both Joe and Jane were in better financial positions by making the most of their Capital Allowance and Tax Depreciation Report.

Smart Investors claim depreciation and use the savings to grow their portfolio!

HELPFUL LINKS

Get a FREE estimate of what tax depreciation deductions you are entitled to:
http://capitalclaims.com.au/free-estimate-depreciation-deduction/

Get a FREE quote
http://capitalclaims.com.au/quote-depreciation-schedule/