

Increase in Depreciation Deductions

Two methods can be applied when depreciating plant and equipment, the Diminishing Value (DV) and Prime Cost (PC) method. The intentions of the property investor and their individual financial situation will determine which depreciation method will be most suitable for them.

Under the **Prime Cost method** the deduction for each year is calculated as a percentage of the opening cost. The formula for determining the depreciation deduction under the prime cost method is:

Cost	X	Days owned ÷ (365)	X	100% ÷ Plant's effective life (in years)
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The **Diminishing Value method** deduction is calculated as a percentage of the balance you have left to deduct. Until recently the formula for calculating depreciation using the diminishing value method was:

Opening undeducted cost	X	Days owned ÷ (365)	X	150% ÷ Plant's effective life (in years)
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Note: Properties settled prior to 10th May 2006

“On average this change will increase the rate of depreciation by 33%”

Federal Budget Review

The recent Federal Budget announced that for eligible assets acquired on or after May 10th 2006, the diminishing value rate used to calculate depreciation would be increased to 200% of the prime cost rate (previously 150%). The revised calculating formula is:

Opening undeducted cost	X	Days owned ÷ (365)	X	200% ÷ Plant's effective life (in years)
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Note: Properties settled on or after 10th May 2006

How this change may affect an investor

On average this change will increase the rate of depreciation by 33%. Specifically, when BMT & ASSOC reassessed 185 capital allowance and tax depreciation reports and compared the previous legislation calculation to the new legislation, it was determined that the following further benefit existed (on average):

- **First Full Year Claim Increase:** \$933
- **Cumulative (Years 1-5) Increase:** \$2187

Therefore, any property investor whose settlement date is on or after 10th May 2006 should ensure that their depreciation claim has been calculated at the new rate, ensuring the maximum benefit obtainable is achieved.



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Top Ten Tax Depreciation Tips

1. If my property was built before 1985, is it too old?

No. It is worth noting that:

- **Your investment property does not have to be new:** Both new and old properties will attract some depreciation deductions. A common myth is that older properties will attract no claim.
- **You can adjust previous year's tax returns:** When a property owner has not been claiming or maximising tax depreciation deductions, the previous four financial year's tax returns can generally be adjusted and amended. Please note, the adjustment period was recently amended to become a 2 year period.
- **Note:** if the deductions are not high enough to make it feasible to complete a report, we will not proceed.

2. Why is plant and equipment itemised?

The ATO specifies an individual effective life for each plant and equipment item. Consequently, our reports show the estimated cost for each item and its contribution to the depreciation total per financial year. The original building structure and capital improvements, or Division 43, are all written off at the same rate (unless building works have been completed over different legislation periods). Therefore individual costs for these items aren't expressed in the report. If required by the ATO, the estimates for Division 43 can be justified.

3. Why does the depreciation and capital allowance schedule only last 40 years?

From the date of construction completion, the ATO has determined that any building eligible to claim the building write-off allowance has a maximum effective life of 40 years. Therefore, investors can generally claim up to 40 years depreciation on a brand new building, whereas the balance of the 40 year period from construction completion is claimable on an older property.

4. Can I claim renovations completed by the previous owner?

Yes. Anything in the property that is part of a previous renovation will be estimated by our quantity surveyors and deductions calculated accordingly. This includes items that are not obvious e.g. new plumbing, water proofing, electrical wiring etc. For capital improvements to qualify for the Division 43 building write-off allowance, they must have commenced construction within the appropriate Division 43 time periods.

5. What information do I need to provide?

Information BMT & ASSOC require to produce a Tax Depreciation and Capital Allowance report includes the following:

- Date of settlement
- Purchase price
- Access details for inspection
(E.g. property manager or tenant details)

- Any information pertaining to improvements or additions made to the property including dates and actual costs (where available)
- The date the property became available for income producing purposes.

6. What is the difference between plant and equipment and the building write-off allowance?

Plant and equipment items are items that can be 'easily' removed from the property as opposed to items that are permanently fixed to the structure of the building. Plant items also include items that are mechanically or electronically operated, even though they can be fixed to the structure of the building. Plant and equipment items include (but are not limited to):

- Hot Water Systems
- Carpets
- Blinds
- Ovens
- Cooktops
- Rangeshoods
- Garage Door Motors
- Door Closers
- Freestanding Furniture
- Air Conditioning Systems

The building write-off allowance (otherwise known as Division 43) is based on historical building costs and includes things such as the bricks, mortar, walls, flooring and wiring.

7. Who is qualified to estimate construction costs for depreciation purposes?

Quantity Surveyors are one of the few professionals recognised by the ATO to have the appropriate construction costing skills to calculate the construction cost for the purposes of building depreciation. BMT & ASSOC also prepare cost plan estimates for all types of buildings. Construction costs are estimated in today's market and historically adjusted to the year of construction using cost indices.



8. What is pooling?

A low value pool exists providing investors the benefit of pooling items that meet either of the following classifications:

Low Cost Pool - A low cost asset is a depreciable asset that has a cost of less than \$1000 in the year of acquisition.

Low Value Pool - A low value asset is a depreciable asset that has a undeducted value of less than \$1000. That is, the cost of an asset is greater than \$1000 in the year of acquisition but the value remaining after depreciating over time (opening value less deductions in year 1 less deductions in year 2 etc) is now less than \$1000.

Assets meeting both these classifications can be placed in an itemised pool. Pooling is used in conjunction with the diminishing value method to maximise deductions in the initial years of the depreciation schedule.

9. How do you work out how old the building is?

The age of the building can be determined by obtaining council documents with dates pertaining to the original application approval date or the Occupancy Certificate date and final inspection date. Similar methods are used Australia wide, however some properties are privately certified. BMT & ASSOC conduct the relevant searches required to accurately determine the age of a building. These include historical council searches regarding lodged development applications, as well as Occupancy Certificates and certified final inspections.

10. What does a BMT & ASSOC tax report contain?

A detailed 22 page schedule includes the following components:

- A method statement;
- Schedule of Diminishing Value Method of Depreciation;
- Schedule of Prime Cost Method of Depreciation;
- Schedule of pooled items for the property;
- Lists all Division 43 (10C & 10D) allowances available from the property;
- Detailed 40 year forecast table illustrating all depreciable items together with building write off for both Prime Cost and Diminishing Value methods;
- Comparative table of the two methods of depreciation;
- Common property items within strata or community title complexes such as lifts and swimming pools are included in the depreciation report for a unit in a multi-unit development;
- The report is structured to facilitate the client to be able to amend previous years' returns to re-coup unclaimed depreciation benefits; and
- The report is pro-rata calculated for the first year of ownership based on the settlement date so that the accountant has the exact depreciation deductions for each year.

The report will ensure maximum depreciable items are identified and will take into account the pooling of low cost and low value items. It is valid for the life of the property, until capital improvements are undertaken or ownership changes.

Construction Cash Flow - Hidden Expenses

When a developer and the head contractor agree on a contract for a development project, the developer may not realise the impact this decision may have later in the construction phase.

It is quite common for the signed contract between the developer and the head contractor to stipulate that payment for materials will be made to the contractor once materials have arrived onsite. However, this clause may become a financial burden for the developer when they in turn attempt to have funds released from their nominated financial institution.

Most finance agreements between a developer and financier will state that materials must be fixed to site in order to release payment. This can result in materials being delivered to site (but not yet fixed or installed) and the financier not releasing funds to cover these incurred costs.

From a financiers point of view, this clause significantly reduces the risk as they have not paid for materials which are not fixed to site. It also provides the financier with a more accurate indication of the cost to complete the development. Some mechanisms in place that can remove the potential out of pocket expenses for the developer include:

- Completing a Development Check Estimate report at the feasibility stage of the proposed development. This will assess all proposed contracts and highlight the potential clauses that may, in turn, lead to out of pocket expenses. This may lead to an alternative head contract being implemented and signed for the development or the negotiation of prior arrangements being made with the builder in regard to payment/delivery of materials.

- Conducting Progress Claim reports, to ensure funds are released on time or milestone based intervals as appropriate. This process assists in maintaining the cost to complete status and ensures a contingency is in place for unforeseen circumstances.

- Using bank guarantees as security on items not yet delivered, but for which deposits have been paid. For example, a written document outlining the job specification, deposit paid and shipment details for a transportation system (such as a lift) may be considered by a financier and subsequently funds may be released prior to installation.

BMT & ASSOC can provide Development Check Estimate reports and an independent assessment of all contracts relating to a construction project. Obtaining advice in the planning stage of a project may reduce the financial burden caused by contractual obligations once in the construction phase.

“Many developers fail to realise that funds will not be released if materials are not fixed to site”

Construction Costs Per Square Metre - Sydney

Construction Type

Residential

	Low	Medium	High
3br brick veneer project home, level block, shelf design	\$897	\$1,109	\$1,389
Architecturally designed executive residence	\$1,886	\$2,901	\$4,508
3br, 2 level brick veneer townhouse, including allowance for common property.....	\$1,121	\$1,302	\$1,868
3 level walk-up unit complex, concrete structure ground floor parking.....	\$1,265	\$1,521	\$1,975
Multi-level apartment building, including lift and basement car parking	\$1,441	\$1,814	\$2,722

Commercial

1-2 level open plan offices, including A/C, excluding fitout	\$1,036	\$1,336	\$2,000
1-4 level open plan offices, including A/C & lifts, excluding fitout	\$1,154	\$1,357	\$2,059
4-8 level open plan offices, including A/C & lifts, excluding fitout	\$1,458	\$1,802	\$2,129
8 levels and over, including A/C & lifts, excluding fitout	\$1,886	\$2,280	\$2,753

Industrial

High Bay Warehouse, standard config, concrete floor, metal clad (size to 3500sqm)	\$643	\$711	\$823
High Bay Warehouse, standard config, concrete floor, metal clad (size > 3500sqm).....	\$569	\$667	\$785
High Bay Warehouse, standard config, concrete floor, pre-cast concrete wall clad (size to 3500sqm)	\$679	\$786	\$1,087
High Bay Warehouse, standard config, concrete floor, pre-cast concrete wall clad (size > 3500sqm)	\$662	\$744	\$1,016

Retail

Suburban shopping mall area including A/C	\$1,181	\$1,451	\$1,710
Bulky goods centre, concrete tiltup construction, including A/C, excluding fitout	\$937	\$1,165	\$1,297
Supermarket, including A/C, excluding fitout	\$1,024	\$1,121	\$1,303
Specialty shops, including A/C, excluding fitout	\$711	\$831	\$947

Hotels/Motels

Single level boutique motel, including A/C guest facilities.....	\$1,636	\$2,052	\$2,681
Single level tavern/hotel, including A/C, excluding loose item fitout	\$1,433	\$1,800	\$1,964
Licensed club, including A/C, bar, lounge, rec facilities	\$1,373	\$1,762	\$1,893
Multi-level, 3 star hotel including A/C, restaurant, bar, common facilities	\$2,123	\$2,276	\$2,375

Level of Finish

The Calculation of Construction Costs

The above costs are calculated based on a Gross Floor Area (GFA) rate. Typically GFA can be defined as the sum of the fully enclosed covered floor area and the unenclosed covered floor area of a building at all floor levels, measured in a square metre rate. GFA consists of two elements:

- Fully Enclosed Covered Area (FECA) ■ Unenclosed Covered Area (UCA)

FECA:

Includes items such as:

- Basements
- Attics
- Garages
- Penthouses
- Lift shafts
- Staircases
- Columns and piers.

UCA:

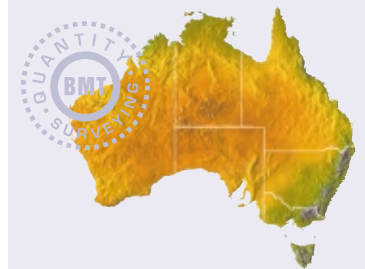
Includes items such as:

- Roofed balconies
- Open verandahs
- Porches and porticos
- Attached covered walkways
- Usable space under buildings.

Costs provided are an average price for typical buildings as at the date of publication, allowing for preliminaries, builders profit and overheads. Costs can provide no more than a rough guide to the probable cost of building, as costs can vary significantly based on site conditions, level of fitout and design.

Regional Variations

Cairns	115 - 130%
Brisbane	105 - 115%
Sydney	100%
Canberra	96 - 104%
Melbourne	98 - 108%
Hobart	87 - 97%
Adelaide	98 - 110%
Perth	100 - 120%



For further construction cost details please refer to our website www.bmtqs.com.au

Disclaimer

The Construction Costs herein are published on and should be read subject to the following conditions:

- Construction costs are published as a matter of interest only and are not intended to be relied upon by readers. In any situations which may be similar to matters herein readers should exercise and rely upon their own judgement.
 - Neither BMT & ASSOC nor any of its officers or employees bear any responsibility for any error in the material published in this publication or in any previous publication, or for any damage or loss resulting from any reliance on any material published in this publication or in any previous publication.
 - Construction costs are not intended for tendering or pricing variations. They are average prices in the Metropolitan Area and should be adjusted with reference to specific conditions. The rates include the cost of labour and material, waste, hoisting, fixing in position and for profit. The profit allowance is based on the prevailing market conditions in each capital city.
 - These Construction Costs were produced prior to publication and due allowance should be made in this regard to the rates shown.
 - The rates exclude any allowance for Goods and Services Tax including compliance cost. Costs exclude land, demolition and any work outside the footprint of the building.
- This newsletter is issued as a helpful guide and is not intended to, and does not cover all aspects of the topics discussed. Professional advice should be sought before any action upon these topics is undertaken.

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