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## Variables that can effect a tax depreciation claim

**Many variables can effect a tax depreciation claim. Therefore every investment property scenario should be assessed on a case by case basis. The following article outlines two common variables that will effect a tax depreciation claim.**

### 1. Have you ever lived in the property?

For a property to be eligible to claim capital allowance and tax depreciation deductions it must be available for income producing purposes (tenanted or available for tenancy). However, properties available for income producing purposes may also be part private residences, including:

- a holiday letting, where the investor utilises the accommodation for part of the year; and
- a rental property, where the owner resides in one part of the house and another portion is rented (for example: a 3 bedroom house, the investor lives in one room and rent is received from the other 2 rooms).

In some instances a property may have been purchased originally for owner occupation and then become an investment, or has been purchased as an investment and occupied by the owner at some stage. Either way, a depreciation claim can not be made for the period of time that the owner is the sole occupant of the property.

When completing a report for an investor in this situation, BMT & ASSOC will discuss the dates occupied, ensure that depreciation is minimised for these periods and ensure that the maximum claim is obtained for the period the property was available to produce an income.

### 2. Did you build or purchase an existing property?

The process for calculating both the Division 43 (Capital Works Allowance) and Division 40 (Plant & Equipment) varies depending on whether an investor builds or purchases an existing property.

When an investor builds a property, a quantity surveyor may be required to estimate construction costs for the building as complete costs may not be known by the investor. Additionally, the investor will not be able to calculate the element of plant and equipment within the cost to build. Considering plant and equipment items depreciate at a higher rate than the 2.5% capital allowance rate available to new residential properties it is in the best interest of the investor to obtain a professional report that calculates both components of a depreciation claim.

In the situation when an investor purchases an existing property, a quantity surveyor should be employed to determine if the Division 43 allowance is available, and if so, calculate the original construction cost. Whether or not the Division 43 allowance is available, all investment properties are eligible for depreciation claims in respect to plant and equipment items within the property. Therefore a quantity surveyor should be employed to determine the depreciation component on all investment purchases regardless of the age of the property.

### Queensland Growth

As the Queensland property market continues to grow, so does the number of BMT & ASSOC offices. A Cairns office was opened in January and was promptly followed by the opening of a Gold Coast office in February. When combined with the established Brisbane office, BMT & ASSOC now have 3 offices in Queensland servicing all areas regularly.



## Scrapping: investor scenarios

Scrapping is the removal and disposal of any potentially depreciable assets from an investment property. In other words, demolition of any existing structure or fixture onsite that would have been eligible to claim deductions for depreciation (Division 40) or building write off allowance (Division 43).

### How does an investor benefit by scrapping?

Scrapping of existing structures onsite is a very effective method of obtaining deductions within our tax system. It can provide additional tax credits for investors who demolish or dispose of existing buildings or any part of it which were owned as an investment asset and eligible to produce income.

Essentially, if an item is scrapped the amount that is yet to be written off for a particular asset (the residual value) can generally be claimed as a 100% tax deduction at the time of disposal.

### Examples of these potential benefits

#### Example 1:

David purchased an existing house a year ago. The property was approximately 50 years old and was acquired as an investment. The property has been producing income since the purchase. There was no capital allowance deduction available on the building structure due to the age of the property (pre 1985 construction). However, all plant and equipment items in the property were depreciable. This typically includes items like the carpets, blinds, air conditioners and hot water systems.

After BMT & ASSOC conducted a detailed site inspection and noted the eligible plant and equipment, a depreciation report was prepared. This resulted in identifying \$15,000 worth of deductions. Whilst the property was income producing, David claimed a total of \$2,700 in deductions in his first financial year. David decided it was time to build a new investment property on the site. In doing so the existing building was demolished and removed from site and therefore he was happy to find that the residual value of \$12,300 became an immediate 100% deduction in the year of demolition.

#### Example 2:

Mark operates a panel beating workshop. In 1993, he constructed a new service bay. In 2004, due to increased technology and demand, the existing service bay became redundant. Mark decides to build a larger service bay that can accommodate his needs. After completing the additional bay, he demolishes the 1993 extension and replaces it with office space. In his tax return for the income year of 04-05, Mark can deduct an amount in respect of undeducted construction expenditure related to the 1993 extension.

### Clarifying Potential CGT Implications

Many property investors falsely believe that claiming the remaining tax depreciation benefits on a property that is being demolished is not worthwhile. In fact, property investors are generally able to claim the balance of depreciation on any income producing property that is being demolished – for both the eligible Division 43 capital works allowance (building) and the Division 40 plant & equipment items. This assumes nothing is gained from the items that are scrapped.

The following points are provided to clarify the finer details of the process:

- Any financial gain recorded against the disposal of the depreciating asset will add to the assessable income;
- CGT is only applicable to the qualifying Division 43 capital works, not the Division 40 plant and equipment assets;
- Investors have the ability to scrap all Division 40 items and Division 43 works which qualify for a deduction at the time of demolition;
- These deductions will reduce the taxable income (company or individual) by the exact amount of the claim;
- For CGT purposes the deductions for Division 43 may reduce the original cost base;
- If owned by an individual, then generally half the CGT amount will be added to their taxable income and taxed at their marginal rate; and
- If owned by a company, then the full CGT amount will be assessed as income and taxed at the company tax rate.

With every potential investment scenario the deductions that may be obtained vary dramatically. In most cases scrapping will present a benefit.

It is a complex procedure to prepare a report which will give you all the information you need to make the claim. The process involved in determining the amount of potential deductions available from a property requires the engagement of a specialist quantity surveyor.

If you require any further information or clarification on scrapping as it applies to your individual situation, you should contact your accountant.





## Depreciation: an investor profile

As explained on the front page, the tax depreciation benefit available to every property investor will vary. The following example has been provided as an approximate guide, using the diminishing value method of depreciation.

### Property:

- A two bedroom unit purchased for \$400,000

### Income:

- Rented for \$385 per week
- Total income of approximately \$20,000 per year

### Expenses:

- Interest only loan (7%) \$28,000 per year
- Rates and management expenses \$4,000 per year
- Total expenses of \$32,000 per year

### Scenario 1 – No depreciation claim:

#### Pre tax cash flow

- Taxation loss \$12,000 = \$230 per week

#### Post tax cash flow (top tax rate of 45%)

- Tax refund \$5,400

**Net cash outlay \$6,600 = \$126 per week**

### Scenario 2 – With depreciation claim:

#### Pre tax cash flow

- Tax depreciation \$12,000
- Cash flow position -\$12,000
- Total deduction \$24,000

#### Post tax cash flow (top tax rate of 45%)

- Tax refund \$10,800

**Net cash outlay \$1,200 = \$23 per week**

This demonstrates the after tax effect of applying property depreciation. The property investor in this situation has a bottom line benefit of \$5,400 per annum. This benefit is the difference between the \$6,600 cost before depreciation is applied, and the \$1,200 cost once depreciation is applied.

This profile emphasises the benefit of depreciation. The property investor has made this saving from the same property that had moments ago cost \$6,600 for the same period.

**BMT & ASSOC**  
Quantity Surveyors



# Construction Costs Per Square Metre - Sydney

## Construction Type

### Residential

3br brick veneer project home, level block, shelf design .....	\$929
Architecturally designed executive residence .....	\$1,954
3br, 2 level brick veneer townhouse, including allowance for common property.....	\$1,161
3 level walk-up unit complex, concrete structure ground floor parking.....	\$1,310
Multi-level apartment building, including lift and basement car parking .....	\$1,493

### Commercial

1-2 level open plan offices, including A/C, excluding fitout .....	\$1,073
1-4 level open plan offices, including A/C & lifts, excluding fitout .....	\$1,196
4-8 level open plan offices, including A/C & lifts, excluding fitout .....	\$1,440
8 levels and over, including A/C & lifts, excluding fitout .....	\$1,720

### Industrial

High Bay Warehouse, standard config, concrete floor, metal clad (size to 3500sqm) .....	\$720
High Bay Warehouse, standard config, concrete floor, metal clad (size > 3500sqm).....	\$705
High Bay Warehouse, standard config, concrete floor, pre-cast concrete wall clad (size to 3500sqm) .....	\$790
High Bay Warehouse, standard config, concrete floor, pre-cast concrete wall clad (size > 3500sqm) .....	\$750

### Retail

Suburban shopping mall area including A/C .....	\$1,224
Bulky goods centre, concrete tiltup construction, including A/C, excluding fitout .....	\$971
Supermarket, including A/C, excluding fitout .....	\$1,150
Specialty shops, including A/C, excluding fitout .....	\$820

### Hotels/Motels

Single level boutique motel, including A/C guest facilities.....	\$1,695
Single level tavern/hotel, including A/C, excluding loose item fitout .....	\$1,485
Licensed club, including A/C, bar, lounge, rec facilities .....	\$1,422
Multi-level, 3 star hotel including A/C, restaurant, bar, common facilities .....	\$2,200

## Level of Finish

### Low Medium High

\$1,149	\$1,439
\$3,006	\$4,670
\$1,349	\$1,935
\$1,576	\$2,046
\$1,880	\$2,820
\$1,384	\$2,072
\$1,406	\$2,133
\$1,750	\$2,206
\$1,980	\$2,580
\$780	\$900
\$760	\$855
\$875	\$980
\$850	\$950
\$1,503	\$1,772
\$1,207	\$1,343
\$1,250	\$1,350
\$885	\$981
\$2,126	\$2,778
\$1,865	\$2,035
\$1,825	\$2,450
\$2,845	\$3,250

## 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](http://www.bmtqs.com.au)

## BMT & ASSOC

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### Disclaimer

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- 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.