Ralph Review Impacts

Rcforming the capital allowances system: its effect on property tax depreciation

PREPARED BY: BMT & ASSOC RESEARCH DIVISION

The release of the Government's response to the Ralph review into business taxation included a substantial change to the method used to calculate depreciation for plant and equipment. The changes focus on the removal of the 'accelerated' component of depreciation provisions and the introduction of a system based on the effective life of an asset. The three major changes included:

1. Abolishing accelerated depreciation rates for plant and equipment which commenced construction or acquired under contract after 11:45 pm AEST 21/9/99.
2. An elective reassessment of effective lives of plant and equipment acquired after 11:45 pm AEST 21/9/99;
3. A proposal to remove immediate deductions for items of plant and equipment costing $300 or less and the introduction of a low-value pool for assets costing less than $1,000 from 1 July 2000. Small business taxpayers will retain access to accelerated depreciation until 1 July 2001.

To facilitate the understanding of the changes resulting from the government's response, BMT & ASSOC have modelled a number of typical property investment types implementing changes 1 & 2 noted above. The third change will require further modelling and will be the subject of a second research paper which will discuss these implications.

The results of the changes to accelerated depreciation are summarised in the percentage difference column. As can be noted in the following tables, alternative property types are affected differently by the removal of accelerated depreciation.

As the tables illustrate, residential investment properties still retain significant depreciation benefits. The impact of removing accelerated depreciation has a more substantial impact upon retail and commercial properties, and is due to the high proportion of plant and equipment contained within the property.

The impact of removing accelerated depreciation declines after the first five years of ownership. The impact this will have on holders of investment properties will depend on their taxation position and the period over which the asset is held. As shown in the residential unit example, the loss of depreciation in year 1 is 19%, however after year five the loss is reduced to 6% and declines further thereafter.

Further changes to legislation effecting depreciation allowances have been proposed to take effect on 1 July 2001. These changes specifically focus on the Division 43 write off allowance with depreciation of a buildings structure to be based on its effective life. Further detail on this new treatment of the construction write off allowances is currently being drafted and BMT will keep clients informed of details as they become available.

THREE BEDROOM UNIT – PURCHASE PRICE $300,000

YEARS	ACQUISITION DATE 27/2/92 - 21/9/99	POST 21/9/99	% DIFFERENCE
1	16,200	13,200	19%
2	10,500	9,250	12%
3	9,600	8,325	13%
4	8,300	7,565	9%
5	7,350	6,930	6%

SMALL RETAIL BUILDING – PURCHASE PRICE $2,500,000

YEARS	ACQUISITION DATE 27/2/92 - 21/9/99	POST 21/9/99	% DIFFERENCE
1	255,000	200,000	22%
2	111,500	87,000	22%
3	82,000	70,000	15%
4	65,000	56,500	13%
5	52,000	48,000	8%

MEDIUM COMMERCIAL BUILDING – PURCHASE PRICE $7,500,000

YEARS	ACQUISITION DATE 27/2/92 - 21/9/99	POST 21/9/99	% DIFFERENCE
1	525,000	368,500	30%
2	370,000	272,500	26%
3	302,500	241,000	20%
4	260,000	220,000	15%
5	220,000	202,000	8%

We note that this document is BMT & ASSOC Pty Ltd interpretation of the Government's response to the Ralph review at 15/10/99. Further changes during the drafting of legislation and the passage of the legislation through both houses of parliament may alter the contents of this page.

BMT & ASSOC
QUANTITY SURVEYORS

SYDNEY
PO Box N314
Grosvenor Place 1220
Level 2, 185 Elizabeth St
Sydney NSW
Ph: 02 9241 6477
Fax: 02 9241 6499

NEWCASTLE
PO Box 340
Level 1, 110 Hunter St
Newcastle NSW 2300
Ph: 02 4927 8195
Fax: 02 4927 8196

Email: bmtassoc@ozemail.com.au

MAVERICK

A BMT & ASSOC PUBLICATION • QUANTITY SURVEYORS ISSUE SIX SUMMER 2000

IN THIS ISSUE:

GST on Property: The Basic Rules

50 York Street Sydney
One of our latest projects.

This article is a summary of the likely GST after 1 July 2000 on the main transactions associated with Australian property that are undertaken by businesses required to obtain GST registration. It also looks at the most common purchases where property industry businesses can claim the input tax credits (ITCs) that are effectively refunds of the GST they have previously paid to suppliers. The suggested GST impact is based on the current GST law and recently proposed amendments. This article deliberately does not address the GST issues associated with property transactions spanning the 1 July 2000 implementation date as these were addressed in the previous edition of "Maverick".

LAND SALES

- Will be subject to GST unless involving government grants or certain supplies of farmland;
- If vendor applies GST to the full land price it will be entitled to ITCs for GST paid on land acquisition; or
- Vendor may instead choose to apply GST only to the margin added since it acquired the land (using the "margin scheme" shown in the table below) provided that acquisition was not subject to full GST. However, the vendor would not be entitled to ITCs for GST paid on the earlier land acquisition if that was taxed under the margin scheme.

COMPARING FULL GST TO MARGIN SCHEME

	FULL GST	MARGIN SCHEME
Sale price at 31/12/2001	$155,000 (a)	$155,000 (a)
Acquisition price at 1/1/2001 (ASSUME GSTFREE LAND GRANT FROM GOVERNMENT)	$100,000 (b)	$100,000 (b)
Value subject to GST	$155,000 (a)	$55,000 (a) - (b)
GST (1/11th)	$14,091	$5,000

HEAD CONSTRUCTION CONTRACT SERVICES

- Will be subject to GST; and
- Head contractor will be entitled to ITCs for GST paid on equipment, materials and sub-contractors' fees.

CONSTRUCTION SUB-CONTRACT SERVICES

- Will be subject to GST; and
- Sub-contractor will be entitled to ITCs for GST paid on equipment and materials.

PROPERTY DEPRECIATION AND CONSTRUCTION COST CONSULTANTS

EQUIPMENT AND MATERIAL SUPPLIES

- Will be subject to GST; and
- Australian suppliers will be entitled to ITCs for GST paid on manufacturing equipment, materials purchased or imported and freight costs.

SALE/LEASE OF COMMERCIAL PROPERTY

- Sale price or lease payments will be subject to GST;
- Developer/Landlord will be entitled to ITCs for GST paid on the full price of property acquisitions and on solicitors', agents', maintenance and management fees;
- If a commercial property purchaser is input taxed eg., banks or other financial suppliers, the developer may instead choose to apply GST only to the margin it has added. This choice is available provided the developer did not pay full GST when it acquired the property. The developer could not claim ITCs for GST paid to the vendor on the preceding property acquisition if the vendor applied GST using the margin scheme; and
- Commercial tenants will be entitled to ITCs for GST paid on lease fees and outgoings unless those tenants are input taxed eg., banks or other financial suppliers.

SALE/LEASE OF RESIDENTIAL PROPERTY

- Sale or long term lease (50 years or more) of new or substantially renovated residential premises will be subject to GST. The vendor can apply GST using the margin scheme thus excluding the value of the land from the property value subject to GST;
- Sale of existing residential premises (unless substantially renovated) will not be subject to GST;
- Leases of existing residential premises for any period, or new or substantially renovated residential premises for less than 50 years, will not be subject to GST;
- If the vendor of new or substantially renovated premises applies GST to the full property price, it will be entitled to ITCs for GST paid on land acquisition and on solicitors' and agents' fees. However, the vendor would not be entitled to ITCs on the land acquisition if that was taxed under the margin scheme;
- ITCs will not be available for GST within certain payments made by the vendor or lessor of existing residential premises or by the lessor of new or substantially renovated residential premises, for example, property acquisition, maintenance and management fees; and
- Residential tenants will not be entitled to ITCs for lease fees and outgoings.

PROPERTY MAINTENANCE AND BUILDING MANAGEMENT SERVICES

- Will be subject to GST; and
- Suppliers of these services will be entitled to ITCs on equipment, materials and administrative costs.

REAL ESTATE AGENCY, VALUATION, ARCHITECTURE AND LEGAL SERVICES

- Will be subject to GST; and
- Suppliers of these services will be entitled to ITCs for various administrative costs.

This article was prepared by Stephen Baxter, Associate Director, Indirect Tax Consulting Group. It does not attempt to exhaustively cover all the GST issues relating to property industry supplies. Stephen can be contacted on (02) 9247 6464 if you wish to discuss the impact of GST on particular property related transactions which you are undertaking.

The Quantity Surveyor's role in perspective

THE QUANTITY SURVEYOR'S (QS) ROLE IN A DEVELOPMENT CAN BE SPLIT INTO THE FOLLOWING BROAD STAGES:-

INITIAL "BROAD ORDER OF COST" ESTIMATE

- Based on minimal information - a concept only
- To indicate whether the project is achievable within the ballpark of the client's budget
- Usually based on a broad square metre (m²) rate for the overall project

"BROAD ORDER OF COST" TO ENSURE FEASIBILITY

- Based upon minimal information
- Usually based on square metre (m²) rates for individual component of the project
- Quality level of elements considered in costing
- A basic costing to commence feasibility analysis

INDICATIVE BUDGET ESTIMATE

- Based upon further information as per initial sketch design
- An elemental estimate of the proposal is prepared providing a more accurate m² rate
- Brief specifications of materials are included to refine costing

BUDGET ESTIMATE AND COST PLAN

- Based upon further information as design develops Services consultants cost estimates are included
- Level of finishes and details confirmed by the design team
- Savings may be implemented to ensure feasibility

CONSTRUCTION PHASE COST CONTROL AND FINAL ACCOUNT

- During the construction phase the QS can be engaged by a number of the developments stakeholders to provide cost advice. The client, contractor or lending institution may engage the QS.
- The main areas of QS role during construction are in cost consultancy and can be identified as follows:
- Measure, estimate and negotiate variations to the contract;
- Prepare certificate valuation recommendations and reports during the construction period;
- Check and negotiate claims for extra costs;
- Prepare a progressive budgetary statement of final cost;
- Prepare and submit certified statement of final cost;
- Check and negotiate costs in relation to extension of time claims;
- Prepare approximate estimates of future increased costs and of the cost of variations, which may or may not subsequently be authorised

TAX DEPRECIATION SERVICES

Specialist Depreciation services can be taken advantage of in the following scenarios:

- As a tax deduction which can be maximised by the investment property owner on their properties, reducing taxable income;
- As a marketing tool for the developer and his real estate agent, illustrating the depreciation potential of a particular property to potential purchasers - the higher the better.

BMT WILL, IN FUTURE EDITIONS OF "MAVERICK", EXPAND UPON EACH OF THE QUANTITY SURVEYOR'S ROLES.