THE AUSTRALIAN

Property investors must be aware of big changes to tax depreciation

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12:00AM JULY 14, 2018 • 1 COMMENT

If you're a property investor preparing your tax returns keep one thing in mind — over the past 12 months the government introduced some of the biggest tax depreciation changes in decades.

However, it is important to remember there are still plenty of valuable depreciation deductions available for property investors.

As a building gets older and items within it wear out, they depreciate in value. The Australian Taxation Office allows owners of income-producing properties to claim certain deductions for the wear, tear and ageing to the structural elements of such a property, and many items within.

There are two categories of depreciation deductions property investors should be aware of: ‘‘capital works allowance’’ for the structure of the building and many fixed items such as walls, windows and doors, and ‘‘plant and equipment’’ depreciation for any of the mechanical or easily removable assets found within the property such as carpets, hot water systems and garbage bins.

On an average residential investment property, an owner can claim between $5000 and $10,000 in depreciation deductions in the first full financial year alone.

With such lucrative deductions available, prudent property investors should look to develop a basic understanding of the new rules as this could help shape investment decisions in the future while also helping to ensure that cash flow is maximised from an investment property.

The new rules only apply to property investors who exchanged contracts on a second-hand residential property after 7.30pm on May 9, 2017. These investors can no longer claim depreciation on previously used plant and equipment assets found in their property.

This means that an item such as a pre-existing smoke alarm can no longer be depreciated and claimed by the new owner of an incoming producing property. Plant and equipment deductions can still be claimed on assets added to the property by the owner at any time. That is, if a new owner decides to add a smoke alarm to a second-hand investment property after it becomes income producing, the owner can claim a deduction of approximately $145 for that unit in the first financial year.

For investors who exchanged contracts prior to this date the rules have been grandfathered. This means that those investors who exchanged contracts prior to 7.30pm on May 9, 2017, can continue to claim depreciation using the older, more generous rules.

The good news for property investors is that all investors can continue to claim capital works deductions for structural items such as walls, roof, windows, kitchen cupboards and doors. These features, which are considered to be permanently fixed to the building, typically make up between 85 to 90 per cent of a total claimable amount.

The other useful information is that buyers of new residential properties, regardless of when they were purchased, are not affected by the changes and can continue to claim depreciation as normal.

Investors who buy properties that have been substantially renovated by a previous owner can also continue to claim deductions for any new plant and equipment assets installed along with relevant capital works deductions.

Each year many property investors choose to self-assess their depreciation claims.

Our in-house research suggests that these investors typically have substantially smaller depreciation claims than those that choose to have their investment property professionally inspected and assessed by a reputable Quantity Surveyor who produces a depreciation schedule.

A depreciation schedule typically only has to be produced once and will pick up on all the common and unusual items that hold legitimate and often lucrative, tax deductions. For example, items such as garbage bins, garden sheds and exhaust fans are easy to overlook but for many investors, can hold over $1200 in combined tax deductions in the first full financial year.

A tax depreciation schedule is 100 per cent tax deductible. It will also ensure that items are depreciated at the correct rate based on current legislation, and can be used as evidence should the ATO audit an investor's claims.

While the new rules add another layer of complexity to tax depreciation, there remain enough lucrative deductions on the table for property investors to justify spending a little bit of time with their advisers to ensure that they are maximising the cash flow from their properties through tax depreciation.

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