6 Facts

Every Property Investor Should Know About Depreciation

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Fact 1 - Depreciation is typically one of the largest deductions available to property investors

Depreciation is a tax deduction claimable for the ageing and wearing out of your building and assets over time. It is a paper deduction, meaning it is calculated and added to your tax return each year. Below are average deductions claimable for different property types.

Average deductions claimable							
Building Type	1 BR Unit	2 BR Unit	Townhouse	House A	House B	Commercial	Industrial
Purchase Price	$495,000	$592,000	$545,000	$595,000	$697,000	$2.5M	$1M
Year 1 Depreciation	$11,540	$13,250	$11,720	$11,950	$13,250	$107,000	$51,450
Years 1-5 Cumulative	$40,620	$50,150	$47,870	$50,015	$57,245	$468,000	$171,600

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Example

Chad purchased a brand new unit for $625,000 in July, 2018.

Chad earns as salary $75,00 per annum, and he has paid $15,922 tax through his employer.

Chad's rental income is $26,000, making his total income $101,000.

Before Claiming Depreciation

Chad's tax deductions excluding depreciation equal $20,000 (these deductions include interest expenses, property management, maintenance, and other property and personal expenses).

Chad's taxable income is now $81,000 and his tax payable for the year is $17,872.

In this situation, Chad owes the tax office $1,950.

After Claiming Depreciation

In addition to the expenses Chad is already claiming above, he is also eligible to claim depreciation for the ageing and wearing out of his building and assets (rental property depreciation).

The depreciation claimable on Chad's unit for the 2019 financial year totals $12,672.

Chad's tax deductions now equal $20,500 + $12,672 = $33,172 (the depreciation plus the cost of the depreciation schedule).

Chad's new taxable income is now $67,828 and his total annual tax payable is now $13,591.

Chad has already paid $15,922 in tax via his employer and should now expect a refund of $2,331.

Chad's after tax cash situation is improved by $4,281 just by claiming the depreciation on his investment property.

Fact 2 - Brand new properties generate the biggest depreciation deductions

Brand new properties typically generate the most tax deductions as their construction costs are the highest and the building and assets are still at the beginning of their effective lives.

Owners of brand new investment properties have the benefits of claiming depreciation on both the building and all of the included assets in their investment property. Purchasers of second hand properties can claim depreciation on the building but not on the second hand assets.

Even where the construction cost of a new build is known,
a quantity surveyor will be required to separate and itemise the costs and depreciation deductions of the building (Division 43) from the included assets (Division 40) and ensure the deductions are maximised for in the most appropriate years for the owner.

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Fact 3 - Old properties can still generate big deductions

Whilst brand new properties typically 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.

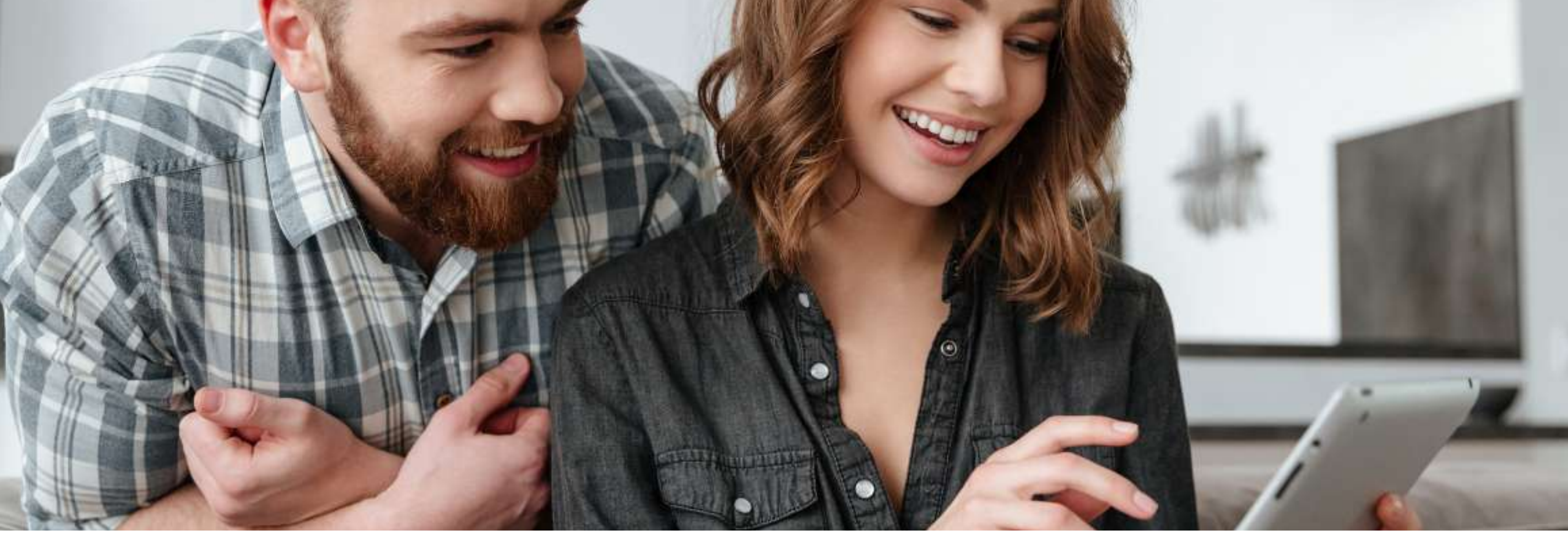
The fact is, most older properties have been improved or extended since original construction. The original building may not have claims left in it, but structural work completed in the last 30 years will qualify.

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. It doesn't matter if you don't know when the work was done or how much it cost. 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. 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 often eligible for depreciation claims.

If the property was purchased prior to 9th May, 2017 assets within the property that have been updated/replaced will qualify for depreciation deductions. Additionally, for these properties the 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 - You can back-claim for missed years

If you have held your investment property for a number of years but didn't realise you could be claiming depreciation on it, you have effectively over-paid your taxes and you are entitled to claim the over-payment back. How many years you can back-claim will depend on your previous tax lodgments, as well as your personal circumstances. Your accountant will be able to provide more detailed advice for your own situation.

A quick case study as an example...

Joe purchased a 2 year old investment property in 2016. Joe was not aware at the time that he could benefit from claiming depreciation. Joe had Capital Claims Tax Depreciation prepare a depreciation schedule for him in May 2019. A Capital Claims Tax Depreciation schedule begins from the time the investment property is available as an investment property, which in Joe's case was as soon as he purchased it in March 2016. Joe holds his investment property as an individual and would like to back-claim depreciation in previous years that he missed out.

See over the page for Joe's total depreciation deductions for each financial year:

Financial Year	ATO Notice of Assessment Date for tax return	Claimable in May 2019	Depreciation deductions reported
2016	December 2016	No	$5,013.00
2017	December 2017	Yes	$10,043.00
2018	December 2018	Yes	$8,223.00
2019	Not yet lodged	Yes	$6,804.00
Total			**$30,083.00**

Based on the above example, Joe is able to request amendments for his 2017 and 2018 tax returns, as well as claim deductions in his 2019 tax return and subsequent years going forward. Total deductions claimable across the 3 years equals $25,070.00. Unfortunately, the $5,013.00 that would have been claimable for the 2016 financial year have been lost. On the upside, Capital Claims Tax Depreciation held off immediate write-off and low-cost and low-value pooling provisions to minimise the first year losses and improve results in subsequent years.

Fact 5 - The benefits of claiming depreciation still far outweigh the impact on CGT

Some investors are concerned that by claiming for depreciation now, they only increase 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 and 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. No claim for Division 40 assets are deducted from the cost base or have the impact of increasing CGT - in fact the the opposite is true;

- 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 2015 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 2018 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 kick-start 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 improve their portfolio!

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Fact 6 - Cheap reports will cost you more in missed deductions

Not all depreciation schedules are created equal and a cheap or DIY report can end up costing you thousands more in lost deductions. A quality schedule will ensure all depreciable assets are identified and accurately valued and will utilise the appropriate legislation to maximise the deductions to the investor.

You also want a quality provider who will still be around in the event of an audit, and whose schedules have been proven to be compliant over many years. Depreciation schedules that generate the best results, like the one prepared by us will include:

40 year forecasts
Making the depreciation schedule a once-off purchase that can be used every year.

Diminishing value and prime cost
Reporting of both methods to allow the investor to tailor their strategy.

Low cost and low value pooling
So investors can claim aggressively in the earlier years of the investment when costs of holding are typically higher.

Pre-purchase renovations
Estimation of any works completed over time, pre and post-purchase to ensure building deductions are maximised.

Inclusion of preliminary and consultant fees
To ensure maximum, legitimate values are attributed to all assets.

Disposal of assets – “scrapping”
To ensure investor claims for renovations are maximised. Scrapped items are valued and written off at 100% in the year of disposal.

Full estimation of construction and asset costs
Where full costs are not available our team are qualified to estimate the full costs.

Lifetime of free updates
We will update reports free of charge when investors replace/install new assets and provide evidence of the costs of those assets.

Contact us to discuss your residential property

We are expert quantity surveyors, depreciation specialsits and registered tax agents. We are not Australia's largest, but we are Australia's leading provider of depreciation schedules for smart investors and proactive property and accounting professionals. Contact us for a free estimate of deductions and quote today.

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