

Property claims

Investors should check the rules on depreciation.

By Lesley Parker

Many property owners are neglecting to take advantage of a valuable building depreciation allowance available on rental properties built or renovated from 1985 onwards.

Under the allowance, the cost of a building or the renovations can be claimed as an expense at the rate of 2.5 per cent a year over 40 years.

“Depreciation is claimable on, essentially, any property built after 1985,” says property investment adviser and author Margaret Lomas.

There’s a two-year window between 1985 and 1987 where you can claim building depreciation at the more generous rate of 4 per cent for 25 years, she says, but this has only a couple of years to run.

There are a few things to know about the allowance, however. First, you can claim only the balance that hasn’t been claimed already. If you buy a property that’s 10 years old, you can claim only the remaining 30 years.

And don’t think that if the previous owner didn’t claim the first 10 years of depreciation you can claim that unused amount – you can’t, Lomas says.

Also, the allowance is based on the original construction cost of the building. If you didn’t build the house and don’t know the cost, a quantity surveyor can work it out for you.

CPA Australia’s senior tax counsel, Garry Addison, says a common mistake is for people to confuse the value of a property with its construction cost.

“They just assume they can claim the value of the whole property” including the land, he says. “But it’s about differentiating the cost of the building from the price you paid for the property, which of course includes the land,” he says. “Land doesn’t depreciate – it appreciates, as we all know. It’s only the building that depreciates.”

The cost of the land is relevant only when working out any capital gains tax on the sale of the property. You can also claim depreciation on fixtures, fittings and furniture over their “effective life”

– how long they’re likely to last. The Tax Office provides guidance on the life expectancy of various assets.

Lomas, of property investment advice firm Destiny Financial Solutions, says investors should be aware that when they buy a property the fixtures and fittings take on a new effective life.

“People might think, ‘I’ve bought a property that’s five years old, there’s carpet in there and carpet has a 10-year life, so I only have five years to claim.’ That’s not true,” she says. “What happens is you get 10 years – but only on the carpet’s value from the day you buy it, and clearly that’s going to be a second-hand value.”

Rental property owners also need to know the difference between repairs, the cost of which can be claimed immediately, and capital works, which must be claimed over time.

Remodelling a bathroom or building a deck, for instance, isn’t a repair.

“A repair is when something goes wrong that has to be fixed,” Lomas says. “Items of a capital nature are those that add to or improve your property.”

Addison notes, however, that you can’t claim an immediate deduction for initial repairs made to a property in the period after you buy it and before it starts producing income.

People not sure how to treat a particular item – as an asset to be depreciated over its effective life or as capital works to be spread over 25 or 40 years – can turn to the Tax Office’s rental properties guide (see www.ato.gov.au/content/downloads/00117625_NAT1729.pdf). The guide explains how to treat more than 230 residential rental property items.

With the \$24 billion in claims for tax deductions in 2005-06 outweighing \$19 billion in gross rental income reported by landlords, the Tax Office has pinpointed several other areas where there are “common mistakes”.

Claims for interest expenses are among the areas in the Tax Office’s sights. Interest is the single largest

claim made by landlords, at \$14 billion in 2005-06.

Lomas says problems arise in this regard when people mix their investment and personal affairs. “Somebody might be borrowing money to purchase a property but they might include \$10,000 extra to buy a car,” she says. “They have to know that only [the interest on] the amount used to purchase the property is claimable.”

Borrowing expenses – costs other than interest, such as legal expenses and valuation fees – are treated differently again. Rather than being claimed immediately, these must be spread over the loan term or five years, whichever period is shorter.

Lomas notes that if you borrow money to meet those expenses, the interest on that debt is claimable.

Mixing business and pleasure also causes problems when property owners combine a rental property inspection with a holiday.

The Tax Office says a claim can be made only “for the portion of the travel that directly relates to the property inspection”.

“Someone might have a house on the Gold Coast, for example, and they might think if they travel up there they can write off all the costs,” Addison says. “But if you stayed for three weeks on holiday, you’d have to apportion your costs.”

Holiday homes themselves can cause headaches. The Tax Office has made it plain you can’t claim deductions for a “rental property” that is really a family retreat and not really available for others to hire.

Similarly, if a property is available for rent only part of the year, you must scale back your claims.

“You’d have to apportion your interest and other expenses,” Addison says. “If the house is rented six months of the year, you can claim only half of your interest and other expenses. And if you rent it out to friends at a non-commercial rental – at mate’s rates – you then have to adjust your interest

and other claims appropriately.”

Owners who are selling a property close to the end of the financial year should think about the timing of the transaction, says Peter Bembrick, a tax partner with HLB Mann Judd Sydney.

“Be aware that CGT is triggered on exchange of contracts, not settlement. So when you exchange before June 30, the whole amount of any taxable gain is

included in your 2007-08 return,” he says.

Addison agrees: “Capital gains can be quite significant and from a tax point of view it might be wise to have them in one particular year rather than another.”

If you’re looking to buy, be aware that you can’t claim a tax deduction for the costs you incur in finding an investment property.

“If you bear in mind the rule that you

can’t claim any cost that isn’t related to an income-producing asset, then you can understand that if you fly somewhere to look at a property, or you consult an adviser about a property you might want to buy, you can’t make any claim for those expenses – because you haven’t got the property yet,” Lomas says.



Big bites ... be careful with claiming those deductions.

You can claim depreciation on fixtures, fittings and furniture over their 'effective life'.