Depreciation has its advantages

By Lesley Parker

MANY property owners fail 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.

Property investment adviser Margaret Lomas said: "Depreciation is claimable on, essentially, any property built after 1985."

She said there was a two-year "window" between 1985 and 1987 when an owner could claim building depreciation at the higher rate of 4 per cent for 25 years, but that this had only a couple of years to run.

But you should know certain things about the allowance.

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.

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 said. "But it's about differentiating the cost of the building from the price you paid for the property, which of course includes the land.

"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 you're 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" – that is, how long they're likely to last.

The Tax Office provides guidance on the life expectancy of various assets.

Margaret Lomas, of the 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'," she said.

"That's not true. What happens is that 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.

Ms Lomas defined a repair as the fixing of something that goes wrong.

"Items of a capital nature are those that add to or improve your property," she said.

Garry Addison says that owners can't claim an immediate deduction for initial repairs made to a property in the period after they bought it and before it started producing income.