What a write-off!

Many investors fail to maximise their tax deductions when renovating their rental property. Here, Tyron Hyde reveals a little-known fact about residual value write-off and how it can boost your tax savings

Over the coming years, I believe millions of dollars in legitimate tax deductions will go unclaimed by property investors. Hopefully this article will help you to avoid missing out!

These lost deductions relate to the residual value write-off I mentioned as one of my top tips in the April edition of *Your Investment Property* magazine.

In summary, the residual write-off allowance relates to deductions on a property you are about to renovate, as long as the property was built after 1985. The key is to get a quantity surveyor to inspect the property before demolition so they can assess the residual value of the items.

This value can still be claimed as an outright deduction and can generate huge savings in the first year.

Many clients contacted us asking for more information about this topic, as it presents a great opportunity for the savvy investor. A better understanding of the topic can yield significant after-tax returns.

Understanding residual value write-off : the background

As quantity surveyors we are often asked to provide depreciation schedules for property investors.

When preparing these reports we separate the building into two categories:

Category A: plant and equipment – ovens, dishwasher, blinds, etc.
Category B: Capital Works Building Allowance – bricks, concrete windows, etc.

In our reports we break down any items that fall into Category A, as these items have different rates of depreciation.

For instance, carpet depreciates faster than a lift, so we separate them and claim the carpet at a higher rate.

But when it comes to Category B, we lump items together as they depreciate at the same rate of 2.5% per annum based upon the original cost.

In the past, all quantity surveyors had their own interpretation of what was considered plant and equipment in a residential building and what was considered capital works.

Eventually the Australian Taxation Office published a definitive list of what can be claimed as plant and equipment, and what can be claimed as capital works.

The Problem

There is nothing wrong with having a definitive list. In fact, I welcome it!

My problem concerns what is included in the list – as investors, we do not have the choice to designate items where we see fit.

You can choose the effective life or depreciation rate of an item that goes into the plant category, but you can't choose the effective life of an item in the capital works category. It must be claimed at 2.5% per annum.

The Tax Office determined which items went into plant and which went into capital works based on factors such as:

- the degree of affixation to the property
- the physical life of the asset
- manufacturing specifications,
- industry standards
- the level of repairs by users of the asset
- whether the asset is leased

While the tax commissioner says out that the manufacturing life does not necessarily have to equal the effective life, that appears to be the case to me.

Here's a list of items I believe won't necessarily last the 40 years the commissioner has determined they will.

I don't know about you, but the light fittings I bought that were made in China don't seem to last a year in my place!

While the Australian Taxation Office can't take into account personal taste, they should have allowed for the fact that investors

> The key is to get a quantity surveyor to inspect the property before demolition so they can assess the residual value of the items

Will these items last 40 years in your property?

- Kitchen cupboards
- Light fittings
- Shower screens
- Built-in wardrobes
- Balcony handrails
- Taps
- Vanities
- Floor & wall tiling to wet areas
- Balcony balustrades
- Wet area ceilings
- Windows
- Paint

> The most important thing is to get a Qualified Quantity Surveyor in before you renovate if the costs of the items you are demolishing are unknown

need to update items (like the light fittings mentioned above) in order to lease the property out.

I believe a 20-year allowance or 5% depreciation rate for the items above would be far more realistic.

So what's the solution?

The most important thing is to get a Qualified Quantity Surveyor in before you renovate if the costs of the items you are demolishing are unknown.

These costs, in residential property, will rarely be passed on at settlement.

As quantity surveyors we cannot break down the cost of every item in a building depreciation schedule, but we can itemise work that is about to be demolished.

Last week, I inspected a property the day before settlement where the owner was planning a small renovation. I depreciated the normal items, yet he was also replacing all 10 light fittings.

I concluded that those 10 light fittings had a residual value of $600 and he could write them off immediately. That deduction alone paid for our fee!

So, how much money can be saved?
Let's crunch the numbers:

Let's say Jackie Investor buys a property built in 1988. Jackie believes the original kitchen and bathroom are now quite passe and in desperate need of a makeover to meet market expectations.

Without an independent estimate by a qualified quantity surveyor, Jackie's tax deduction in regards to this renovation would be zero. Here are the potential deductions she is missing out on.

Original Item Installed 1988	Estimated Original Value when installed	Value left when demolished (20yrs @2.5%) = ½ value left
Kitchen Cupboards	$16,000	$8000
Kitchen Wall Tiles	$2,500	$1250
Kitchen Plumbing	$1,700	$850
Kitchen Electrical	$1,060	$530
Shower Screen	$1,500	$750
Vanity	$1,300	$650
Bathroom Tiling	$4,400	$2,200
Bathroom Ceilings	$2,700	$1350
	Immediate deduction	$15,580

Some key facts about this situation are:

- When Jackie finishes her new kitchen and bathroom she can start claiming those items at 2.5% again.
- Jackie demolished these items voluntarily and was still able to claim the amounts in full.
- This work is very different to repairs in that the work was done straight after settlement, and she was still able to claim the amounts in full.
- The property was built after 1985 – that's the year the ATO allowed investors to claim the building allowance (for bricks, tiles, etc)

So in a nutshell, it pays to know what you're entitled to – and if you don't, find someone who does! ☗

Tyron Hyde is director of quantity surveying firm Washington Brown . For more information visit www.washingtonbrown.com.au where you can estimate the likely tax depreciation deductions on your property before you buy it. It's free of charge, and it allows you to compare apples with oranges and see what works best for you. This calculator uses real life data collated from every inspection we do on behalf of for our clients. So the data gets more accurate with time.

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