Maximising your building allowance

Many property investors are only aware of the 2.5 per cent building allowance deduction applicable to residential buildings. However, there are some buildings that qualify for a full 4 per cent, as Tyron Hyde explains.

THE BUILDING ALLOWANCE is a deduction that enables property investors to offset the hard construction costs of their investment property against their assessable income.

Hard construction costs may include items such as concrete, brickwork and common property items that are not plant and equipment, and even excavation.

This deduction is allowed under Division 43 of the *Income Tax Assessment Act 1997*, which sets out deductions for capital works.

What's so good about claiming a 4 per cent building allowance? Well obviously the higher the deduction, the less tax you have to pay. The building allowance is one of those "non-cash deductions". This means you don't have to fork out cash to claim it. You already did when you purchased the property.

For example – if your house was built for $250,000 and the plant and equipment was $30,000 – this leaves a Division 43 claim of $220,000. At 2.5 per cent, annually this amounts to a $5500 deduction. At the 4 per cent rate the claim is $8800 per year.

Ways to claim

Here are four ways in which you can claim the 4 per cent building allowance:

1. Purchase a residential property (eg. house, unit or townhouse) where the construction commenced between July 18, 1985 and September 15, 1987.
2. Purchase a property that falls into the category of "short-term traveller accommodation" (eg. serviced apartments) where construction commenced after February 27, 1992.
3. Purchase a manufacturing building where the core activities qualify under Section 43-150 of the *ITAA 1997*.
4. Buy a commercial, industrial, manufacturing or serviced apartment built within the "window of opportunity". This is for any building (not residential) with a construction commencement date between August 22, 1984 and September 15, 1987.

Option 1

Many investors specifically target residential property commenced between July 18, 1985 and September 15, 1987.

Not a bad strategy – but time is running out. Why? Well if you do buy a property built in say 1986, it means that 19 years of its useful 25 years have been eaten away (from 2005 to 1986). This means you can depreciate the residual for the next six years at 4 per cent. This is OK for now but the window is rapidly closing.

However, if you buy a property where construction commenced in 1988, you still have 23 years to depreciate the property, but at 2.5 per cent. So the amount of time you wish to the keep the property is one factor to consider.

Determining the construction commencement date can be tricky. The commencement date is defined as the date the footings were poured. Local councils generally keep records of this inspection, but not always. Remember this is an event that occurred close to 20 years ago.

It's not always practical to go to the local council and retrieve these documents every time you are interested in a property.

Online programs such as RP Data can give useful information about the original settlement date of the property. Some people then work backwards one year as an approximation before approaching the local council.

Option 2

If you purchase a unit that can be defined as "short-term traveller accommodation" you may be able to claim a 4 per cent building allowance.

ATO *ID 2003/513* has provided clearer definition as to what can now be defined as short-term travellers accommodation. Unfortunately, it's not good news for investors, as most serviced apartments fall back into the 2.5 per cent category. If your serviced apartment has a kitchen, you should be claiming 2.5 per cent not the 4 per cent building allowance – unless you own 10 in the same building.

Some investors expect to receive the 4 per cent building allowance because they own a holiday house and have it fully furnished. But this type of accommodation does not fit into the category.

The construction needs to have commenced after February 27, 1992 to be eligible. This type of investment generally has the highest depreciation claim as a proportion of the purchase price. This is due in part to the higher building allowance but also because these types of investments have more plant and equipment in them. They generally have lifts, pools, and also are often fully furnished.

But a high depreciation schedule does not necessarily make a good investment. Many people have been burnt in the past buying these types of investments based upon the available tax deductions.

Option 3

Purchase a building that qualifies under the industrial activities of s43-150 of the *ITAA 1997*. According to s43-150, certain core activities will qualify the industrial building for a 4 per cent write off.

But not all industrial buildings qualify. More than likely, if you have purchased a single factory in a complex of 50 factory units, it's unlikely your building will qualify.

However, if your building is involved in refining petroleum, milling timber, freezing primary products, printing, curing meat, canning or bottling, then it might qualify.

Other operations that qualify include buildings in which items are brought in or maintained in the condition in which they are sold. For instance, recently we were able to claim this allowance for a major car manufacturer on the property where its vehicles were serviced.

Option 4

Option 4 refers to the "window of opportunity" – August 22, 1984 to September 15, 1987.

The building allowance is a tool the Government can use to stimulate growth within the economy. Stimulation must have been high on the agenda during this period, as any non-residential building which commenced construction at this time qualifies. This is the only period where an office building or suite qualifies for the 4 per cent allowance.

Any downside?

Surely there must be some downside in claiming the 4 per cent building allowance?

Well there's no such thing as a free lunch.

There is one downside – any amount claimed under Division 43 will need to be factored in when calculating your capital gains tax liability. This rule applies generally to assets acquired after July 1, 1997.

But under the principal of "a dollar today is a better than a dollar tomorrow", coupled with the CGT relief allowed, it's still worth the exercise, especially to higher income earners. ■

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Does your building qualify?