VIEWPOINT

property

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A taxing renovation

Work carried out on investment properties may not necessarily get the tax office's stamp of approval

IF YOU BUY AN INVESTMENT PROPERTY, don't assume you can renovate it and claim an immediate tax deduction for the total cost of the work. "Absolutely not," says Tyron Hyde, a director of Washington Brown, quantity surveyors.

While you can get a deduction for repairs and maintenance, the Australian Taxation Office cracks down hard on investors who actually renovate but try to pretend that its just maintenance, Hyde says. He says many new investors are under the same false impression as *Money* reader Justin.

Justin told us he had just bought an investment unit built in 1995 and planned to redo the kitchen and bathroom to the tune of $40,000 so he could attract better tenants and higher rental. He presumed he could claim this immediately as a deduction, but wanted to check first.

He needs get a quantity surveyor to value what will be demolished

Well lucky he did, because if he goes about it the right way he can recoup a reasonable amount of his expenditure, but certainly not all. Indeed if Justin's unit had been built before 1985, all he would be able to claim on the new building works in the kitchen and bathroom would be 2.5% a year building depreciation.

Any new fixtures and fittings, such as stoves, hot water heaters and exhaust fans, would be able to be depreciated at higher levels, as laid down by the ATO. The cooktop, for example, has an effective life of 12 years (for full details see www.ato.gov.au).

But because Justin's unit was built in 1995, the kitchen and bathroom will have what is called a "residual value", Hyde says. This means the depreciation on them has not run out, as buildings are depreciated over 40 years. So what Justin, and others who have post-1995 properties, needs to do is get in a quantity surveyor to put a value on what is going to be demolished.

Let's say the kitchen had an original value of $10,000. It is now 12 years old, so has only yielded building depreciation claims of $3000, so it has a residual value of $7000.

Let's say Justin spends $20,000 rebuilding his kitchen and a further $5000 on appliances. He will not be able to claim all of that, but he will be able to claim the residual value of $7000 plus 2.5% depreciation on the building each year. And he will be able to claim the relevant depreciation on the new equipment.

When he sells in the future, he will be able to add the $25,000 to his cost base before calculating his profit on sale and therefore his capital gains tax.

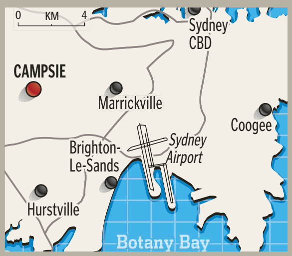
Rebuilding the bathroom would be treated exactly the same. Say it had an original value of $6000; its residual value is $4200 ($6000 – $6000 x 2.5% x 12 = $1800).

So how does an investor know what counts as renovation and what the ATO accepts as repairs and maintenance.

"Take a fence," says Hyde. "If you replace it all, it's a total upgrade and can't be claimed as such, but if you replace a few broken palings you can claim that as a deduction. If you repaint the whole property that is renovating it. But if you repaint a room because it is shabby, that is OK."

It pays new investors to get advice on the work they plan to do so they realise exactly what they can claim.

Property focus



Where: Campsie, NSW
Price Range: Houses $420,000 to $1 million+, units $198,000 to $570,000[1].
Rental value: Houses $250 to $420pw, units $140 to $370pw[1].

[1]Source: www.myhome.com.au

Campsie is the commercial centre of Canterbury City, about 17km from Sydney CBD. It is in the inner south-west region south of Cooks River. The area, which has a very diverse culture, is well served by rail and bus transport with good road links to the Sydney CBD. It is renowned for its Korean flavour and each June it hosts a Korean food festival. It has a vibrant shopping centre, which boasts restaurants and cafes selling food from many countries. House and unit prices have shown consistent growth, with the median house price rising 11% to $510,000 in the six months to June 30, and the median unit price up 10% to $264,000.