9 ways to cut tax bills through depreciation

Depreciating your investment property can dramatically improve your bottom line. *Tyron Hyde* reveals his top tips on how to maximise your cash flow

Claiming depreciation on your property is one of the most important steps in an investor's journey – plus it's the only deduction that can be subjective. All other expenses – such as interest, strata fees etc, must equal the amount you have paid out exactly.

But having an expert prepare your depreciation report can enhance your claim. Here are some insider tips to help you take full advantage of the return on your investment property.

Tip #1: Maximise the cost of construction

When depreciating an investment property, the original construction cost must be used. Many of our clients are now buying properties at dramatically reduced prices – nearer to the original building cost.

So the tip is to make the most of the current market conditions and search for properties where the actual construction cost is close to the current purchase price.

By way of example, we had a client who bought a property in Sydney's western suburbs for $250,000 last week. It was a two-year old, two-bedroom unit. We were the quantity surveyors on the project – and I know the original construction cost for that unit was $175,000. But its purchase price – brand new – was $335,000.

Guess what? We still use original construction cost as the basis for the incoming property investor. So not only has the new purchaser paid less stamp duty and increased their chance of a capital gain – their depreciation deduction relative to the purchase price has also increased.

So this property would be cash flow neutral at worst – cash flow positive at best.

Tip #2: Old properties depreciate too

Even properties built before 1985 (when the building allowance kicked in) are worth the time in savings through depreciating.

The purchase price of your property includes the land, building and plant and equipment.

Quantity surveyors can help you apportion or break down those categories. In about 99% of cases we find enough plant and equipment items to justify the expense of engaging our firm.

Tip #3: The taller the building, the higher the depreciation

Taller buildings attract higher plant and equipment allowances and the higher the plant and equipment, the higher the depreciation. Plant and equipment refers to necessary services within the building, as well as items within the property itself.

Some of the services required as buildings increase in height are obvious, such as a lift (transport service). Other services are less obvious, with fire hose reels and intercoms all being depreciable under this category.

The other reason tall buildings have a higher ratio of plant and equipment has to do with the amenities the developer provides. For instance, some high-rise buildings have swimming pools, gyms and even mini-cinemas.

Let's look at the numbers. The first thing to do is to look at a rough ratio of plant and equipment relative to construction cost (see Table 1).

Now take a look at how this translates into deductions (see Table 2). These allowances all relate to a $400,000 property in a capital city – and are very approximate to allow for illustrative purposes only.

As you can see, the taller the building, the more you can depreciate. But keep in mind that a tall building doesn't necessarily mean it's a better investment.

It often means there'll be higher levies and additional expenses, and you own less land as well. But at the end of the day, it's up to you to weigh up the pros and cons and make that final decision!

Table 1

Type of dwelling	Percentage
Freestanding house	8–10%
Unit <4 floors	10–12%
Unit 4–8 floors	20–25%
Unit >8 floors	20–25%

Table 2

Type	Year 1	Year 2	Year 3	Year 4	Year 5	Total
House	$7,000	$5,000	$4,000	$3,500	$3,250	$150,000
Unit <4 floors	$8,500	$7,000	$5,500	$4,750	$4,250	$175,000
Unit 4–8 floors	$10,000	$8,000	$7,000	$6,000	$5,000	$200,000
Unit >8 floors	$12,500	$10,000	$8,000	$7,000	$6,000	$225,000

Tip #4: Small items and low value pooling

A dollar today is worth more than a dollar tomorrow, so deduct items as quickly as possible. Individual items under $300 can be written off immediately. An important thing to remember is that provided your portion is under $300, you can still write it off.

For instance, say an electric motor to the garage door cost an apartment block $2,000. If there are 50 units in the block, your portion is $40. You can claim that $40 outright – as your portion is under $300.

You can buy items that depreciate faster. Items priced $300–1000 fall into the low-pool category and attract a higher depreciation rate. So, a $1,200 television attracts a 20% deduction while a $950 TV deducts at 37.5% pa.

Tip #5: Don't bother with DIY depreciation

As an expert in the market I am baffled with the number of companies offering a DIY option. I personally think there are some legal anomalies here, but more importantly – I think you will be missing out on deductions.

Here's one example. The DIY options in the marketplace give you a tick sheet and ask you to take your own measurements. Now let's say you measure from one bedroom wall to the other. If you do that all around the house you would reduce the property by 10% in gross area. At around $1500 per square metre to build, you would have missed out on something like $15,000 worth of tax deductions.

But don't just take it from me. General manager of the Australian Institute of Quantity Surveyors, Terry Sanders says: "The AIQS has produced guidelines for the preparation of property depreciation reports by qualified quantity surveyors, which are aimed at insuring property owners get a comprehensive and professional report that meets the ATO's requirements."

He adds that owners who attempt to estimate their own depreciation, or who use non-quantity surveying qualified people risk submitting an incomplete or poor depreciation report which "could not only cost them in missed deductions but could also possibly attract an audit by the ATO if their report is not up to standard."

Tip #6: Claiming the residual value write off

I believe millions of dollars will be missed over the coming years in tax depreciation claims due to changes in what can be defined as 'plant and equipment'. When I first started preparing depreciation reports, there were several factors in determining what made the list.

These included whether the item was absolutely necessary in order to make the property available to be rented out. For instance, a kitchen is an absolute necessity – but a microwave isn't always.

So the moral of the story is that if you're renovating a kitchen or bathroom on a property built after 1985 – get a quantity surveyor in *before* you demolish so they can assess what the residual values of these items are. That value can still be claimed as an outright deduction and can generate huge savings in the first year. For instance, a rental property with a 20-year-old $10,000 kitchen attracts an immediate deduction of around $5,000.

Tip #7: Furnish your property

This is another way to increase your depreciation deductions. For example, we have calculated that a $20,000 furniture package supplied by a developer can result in an additional $10,000 deduction in the first year alone. In addition to your other depreciation opportunities furniture really can enhance your overall claim.

According to Rob Farmer, CEO of Run Property, a typical furnished apartment in Bondi Beach can attract up to $100 in additional rent per week. But he warns that furnishing your investment isn't necessarily the best option for all properties and locations. It's better suited to smaller one or two-bedroom apartments in transient areas that attract short-term tenants.

Tip #8: Avoid properties with a 4% building allowance

Residential properties built between 18 July, 1985 and 15 September, 1987 attract a 4% building depreciation rate. Anything built since has a 2.5% rate.

So, if you do buy a property built in 1986, that means 23 of its useful 25 years have been eaten away (from 2009 to 1986). You can only depreciate the residual for the next two years at 4%.

However, if you buy a property where construction commenced in 1989, you still have 20 years to depreciate the property, at 2.5%.

That's 50% of the original construction cost left for you – as opposed to only 8%.

Tip #9: Use an experienced quantity surveyor

You just paid hundreds of thousands for a property – do you really want to save a couple of hundred tax-deductible dollars on your only tax break that can be open to interpretation and skill?

Laws have changed frequently over the years and each building is unique, so it pays to get expert advice. The ATO has identified quantity surveyors as qualified to estimate original construction costs where that figure is unknown. Please note – an accountant, real estate agent or property valuer are not qualified to make this assessment, in accordance with the ATO. ■

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 they do on behalf of their clients. All views expressed are his own.