MAVERICK™

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1 FEATURED

Maximise deductions after living in an investment

Discover the taxation and depreciation implications of living in an investment property

This time last year, experts were predicting impending doom for the property market. Plunging property values, falling rents and record-breaking high vacancy rates were just some of the disaster scenarios mentioned.

As banks and the government rushed to safeguard Australians' livelihoods and the national economy, The Australian Prudential and Regulation Authority (APRA) found that almost $40 billion in loans were either overdue or had defaulted in the quarter ending June 2020.

Moving along to 2021, we are seeing house prices strengthening, interest rates remaining low, and the property market's path forward beginning to clear.

Investor loans are starting to recover. The Australian Bureau of Statistics' (ABS) Lending Indicators data revealed that loan commitments for investment properties rose 8.2 per cent in December 2020, reaching $6 billion.

The unprecedented times and turbulent market has resulted in many investors reassessing their financial and investment strategies.

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BMT Tax Depreciation
QUANTITY SURVEYORS

One of the more interesting trends that we have seen here at BMT is an uplift in people converting their homes into investment properties. Throughout 2020, more than one in every four schedules BMT prepared were for properties that had been previously owner-occupied. We have also received enquiries from investors looking to do the reverse and make their rental property their main residence.

Whichever side of this story an investor is on, there are several taxation and depreciation implications to be understood.

The first scenario of turning a main residence into an investment property can be an affordable and popular way to enter the investment property scene. It can be a good option if the owner wants to hold onto the property rather than selling in an unpredictable market, while taking advantage of longer-term capital growth.

From a financial standpoint, a lot will change. First and most importantly, is that the owner can now claim their home-ownership losses as tax deductions.

These deductions can climb into the thousands of dollars in just one financial year. The latest Australian Taxation Office (ATO) statistics reported some of the average deductions residential investors claim. The average interest repayment deduction is almost $9,500, body corporate fee deductions hit an average of almost $2,300 while the average land tax deduction is approximately $1,500 over a full financial year.

New costs associated with turning the home into an investment are also valuable deductions. The average property management fee deduction comes to almost $1,300, and the combined sundry and tenant advertising average deductions come to approximately $1,000.

The homeowner can also begin claiming depreciation on the property's natural wear and tear. Depreciation works slightly differently as it's a non-cash deduction, so they don't need to spend any money to claim it.

A plant and equipment asset is defined as mechanical or easily removable from the property. Key examples include hot water systems, smoke alarms, blinds and carpets. For previously owner-occupied properties, any used plant and equipment assets will be ineligible for depreciation, but new assets purchased for the property can be claimed only while it's an investment.

The homeowner will also be able to claim any eligible capital works deductions on the wear and tear of the property's structure and fixed assets such as doors and built-in cupboards. Capital works make up on average 85 to 90 per cent of total depreciation claims.

The average claim for both plant and equipment and capital works reported by the ATO was $3,835, while the average deduction found by BMT in the same period was $8,540.

The table below demonstrates the depreciation deductions a homeowner could expect from turning their home into an investment. These averages have been calculated from an analysis of all BMT schedules prepared in 2020 for investment properties that were previously owner-occupied.

Property type	First full financial year deductions	Cumulative 5-year deductions	Total
House	$6,542	$32,857	$225,560
House with granny flat	$11,853	$60,553	$386,784
Unit	$6,206	$30,828	$212,559
Townhouse	$6,297	$31,362	$215,009
Duplex	$7,153	$35,795	$233,609
Granny flat	$4,084	$20,815	$136,147

The taxation outcome becomes less appealing when an investor does the opposite and decides to move into an investment property. Whether it's for the short term or they plan to make it their 'forever home', it's key to understand how it all works.

From the moment the property is no longer available for rent, the owner won't be able to claim any expenses or depreciation deductions. If they are only planning to live there in the short-term and rent the property out again, claimable losses will stop and then restart when the property begins to produce income.

For each given scenario when a property starts to produce income, a capital gains tax (CGT) liability could be triggered when the property is sold. The CGT outcome will be affected by a variety of circumstances at the time of the CGT event.

When determining any payable CGT, an accountant will need to consider many factors including the purchase price and market value at the time the property started to produce income, cost base, time of sale and previous deductions claimed.

They will also assess if any of the CGT discounts and exemptions apply including the 50 per cent discount, main residence exemption, six-month rule and six-year rule. A key element of determining if any of these apply is the length of time the property was a main residence or used as an investment.

No matter what the situation is, it's always worthwhile to get a depreciation estimate for an investment property. A BMT Tax Depreciation Schedule ensures all legislative requirements are followed and deductions are maximised. Even if the property only produced income for a short period of time, there can be substantial deductions available.

Buying an investment property with an SMSF

Buying an investment property through a self-managed superannuation fund (SMSF) can be a sound financial move. But all too often, it is placed into the 'too hard basket' due to the complex rules and restrictions surrounding superannuation.

It can seem like a minefield of regulatory bombs just waiting to explode. However, getting it right from the beginning can mean reaping the benefits for years to come.

The Superannuation Industry (Supervision) Act 1993 specifies when and how an SMSF can borrow money to invest in property.

A limited recourse borrowing arrangement (LRBA) involves the SMSF taking out a loan from a third-party lender for the investment property, which is then held in a separate trust called a 'bare trust'.

The bare trust must be formed if finance is required and once the SMSF has identified the property it expects to invest in. While the SMSF is still the beneficiary, the bare trust will be the registered holder of the property until the loan is repaid. Only one property can be held under a bare trust at a time.

The LRBA can only be used for a single asset and ensures that, if the SMSF defaults on the loan, no other assets are touched. There are also minimum requirements surrounding the balance and contribution an SMSF must meet to purchase a property.

If an SMSF uses a loan to purchase an investment property (i.e. it doesn't own the property outright) the types of renovations that can be made are restricted. Essentially, the property's 'inherent character' can't be changed, and only slight improvements and repairs can be made. For example, a rusted gutter can be repaired, but carpet can't be replaced with timber floorboards.

An existing residential investment property can't be transferred to a property held under an SMSF. A party involved with the SMSF, directly or indirectly, also can't live in the property. However, this works differently for commercial properties.

All SMSFs can invest in commercial properties. Small business owners have the added benefit of being able to occupy the property if it's their business premises and pay market-rate rent directly to their SMSF.

Whether an SMSF invests in residential or commercial properties, tax benefits are available.

All tax deductions are available, however they can only be deductible to the fund. This means parties of the SMSF can't use the property's losses against their personal income. Deductions can only be used within the SMSF. While this doesn't necessarily result in a negative-gearing arrangement, it still means claiming deductions results in less tax to pay.

BMT has experienced an increase of tax depreciation schedules ordered for properties held in SMSFs. Both capital works and plant and equipment depreciation deductions can be claimed for property held in an SMSF.

The SMSF operates in a 15 per cent tax environment, meaning it only needs to pay 15 per cent tax on rental income from the property. For this same reason, losses are less lucrative, as reduced liabilities are calculated at the same 15 per cent rate.

In the instance where the SMSF decides to sell the property after owning it for 12 months, capital gains tax (CGT) is discounted. The fund receives a one-third discount on any capital gain made from the sale, bringing the CGT liability down to 10 per cent.

An SMSF in the retirement phase receives further tax concessions. When the investment property income is supporting this phase, it is tax exempt. The technical name for this is the 'exempt current pension income' (ECPI). The ECPI can be applied to the annual SMSF return once it begins paying one or more retirement phase income streams and meets the relevant requirements.

SMSFs can ensure they make the most out of their investment properties by claiming depreciation with BMT. Prior to investing in property with an SMSF, it's recommended to consult with an accountant.

BMT Tax Depreciation is a proud member of:

Driving investment and creating jobs through depreciation and taxation incentives

The past twelve months have presented challenges to business owners across the country. As the uncertain times continue, the government is endeavouring to battle a long-term economic downturn with lucrative depreciation and taxation incentives.

Driving investment and creating more jobs are two essential pieces of the puzzle to strengthen the Australian economy to pre-pandemic levels. In the last federal budget, the announcement of the full-expensing and loss carry back incentives showed that the government is ready to do what it can to achieve this.

Full expensing allows businesses to instantly claim the full value of plant and equipment assets purchased after 7.30pm on 6 October 2020 and first used or installed before 1 July 2022. All businesses with an aggregated turnover of up to $5 billion are eligible for the incentive, making it available to over 99 per cent of businesses. The government has essentially amplified the previous instant asset write-off rules by allowing full expensing. However, it's important to note that businesses can opt out of full expensing on an asset-by-asset basis in some circumstances.

This means if the plant and equipment asset is eligible, it can be claimed as an instant expense. With no limit on the number of assets a business can claim in one year, full expensing has the potential to reduce tax liabilities by hundreds of thousands, if not millions, of dollars.

Businesses making a loss is an expected outcome for some industries. Usually, a business would need to return to profit before claiming this loss. But the new loss carry back measure ultimately overturns this arrangement.

Under loss carry back, a business can carry back tax losses from the 2019-20, 2020-21, or 2021-22 financial years to offset taxed profits in 2018-19 or subsequent financial years. Doing so allows the business to receive a healthier tax return now, rather than waiting until they return to profit.

For example, if a business made a tax loss in FY 2020-21, they could offset tax profits from previous financial years. This would result in an instant refund of tax paid. The repayment would require that the amount carried back isn't more than the earlier taxed profits, and that the carry back doesn't generate a franking account deficit.

A business doesn't need to make a hard-hitting fiscal loss with property depreciation. Depreciation is a non-cash deduction, meaning they don't need to spend any money to claim it.

It's possible for a business to make a profit, that could then turn into a loss when depreciation deductions are applied. A loss created by depreciation is treated like any other and can be used as loss carry back to offset profits in previous financial years.

There's no doubting that business owners have a lot to wrap their heads around to claim the most and maximise their cash flows. The below example demonstrates how both incentives can work together.

Ken owns a small farm and purchased $250,000 worth of plant and equipment assets in FY 2020-21 and claimed it under full expensing.

All assets were classed as 'non-primary producing' and included tractors, a work ute, mowers and power tools.

In FY 2020-21 financial year, Ken's farm made a loss of $120,000. This loss was due to the investment in plant and equipment and other depreciation deductions that came to $20,000 from a previously prepared tax depreciation schedule. If Ken didn't purchase the plant and equipment or claim depreciation, he would have made a profit (after other expenses) of $150,000.

Ken's farm business is classed as a base rate entity and is entitled to a lower tax rate of 26 per cent. When applying this to his $120,000 loss, the loss carry back tax outcome is $31,200.

In FY 2019-20 Ken's farm taxable income was $200,000 and had no net exempt income and a franking account balance of $75,000 at the end of the 2020-21 financial year. This entitles Ken to a refundable loss carry back tax offset of the full $31,200.

BMT Tax Depreciation's comprehensive commercial schedules include every incentive on offer to ensure business owners claim the most deductions possible. BMT staff complete physical site inspections that maximise claims and ensure ongoing compliance is maintained.

Full expensing of the simplified general business pool

Australian small businesses entities (SBEs) have access to a variety of simplified depreciation rules. One of the most lucrative is the simplified general small business pool that supercharges depreciation deductions in the early years of ownership. While the temporary full expensing policy is discussed in an earlier article of this Maverick, we also want to delve into how it impacts the operation of this pool.

SBEs are those that have an aggregated turnover of up to $10 million. These businesses have access to the simplified general small business pool and other simplified depreciation rules.

All plant and equipment assets placed in the pool are usually depreciated at an accelerated rate. However, when the entire depreciable value of the pool is less than the current instant asset write-off threshold, it can be written off immediately.

When the instant asset write-off threshold was only $1,000 this was very simple. Since this time, it has been boosted from $20,000, $25,000, $30,000, to $150,000 and now no threshold applies at all while the temporary full expensing policy is in place.

But this raises the question, is it compulsory? If a small business has a pool, can they hold onto it rather than deduct the entire balance?

Some businesses may want to do this instead and take advantage of steady deductions each year. This can be helpful for industries that are currently powering through and experiencing growth. Examples include essential services, online-exclusive retailers and ecommerce suppliers, which may have a greater need for the deductions in later years.

However, Section 328.210(3) of the *Income Tax Assessment Act 1997* instructs that the business must deduct the pool. As it stands, this section of the Act has remained unchanged since the latest thresholds were released. In addition, the Bill presented at the time the full expensing policy was introduced held the same terminology.

Businesses that use division 40 of the *Income Tax Assessment Act 1997* can choose to opt out of temporary full expensing on an asset-by-asset basis. However, this amendment hasn't been applied to Subdivision 328-D, which SBEs using the simplified rules use to calculate depreciation. This means SBEs must apply full expensing to their simplified pools.

However, it is still possible for a business to choose to no longer use the simplified depreciation rules. While their current pool with their used assets will still exist and follow the simplified rules, any new assets can be depreciated with the general depreciation rules under division 40.

The business can't 'pick and choose' which simplified rules it opts out of. If it opts out of the simplified pool, it opts out of all other rules. This includes the exclusive small business capital gains tax discounts and exemptions.

BMT has been specialising in commercial depreciation schedules for businesses for over twenty years and knows what to look for to ensure claims are maximised.

All business owners, large and small, can maximise their cash flows by claiming depreciation deductions. As the environment changes, BMT are keeping up to date with all amendments to taxation legislation to ensure depreciation claims are 100 per cent compliant.

Activate *My*BMT today

If you have ever ordered a BMT Tax Depreciation Schedule, don't forget to activate your MyBMT account today. It makes managing your depreciation and investment property easier than ever before.

Storing your schedule isn't the only thing MyBMT can do. In fact, it helps you do so much more.

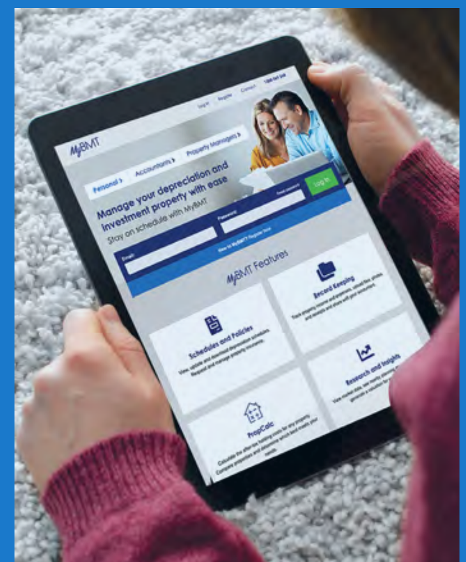
To begin with, MyBMT makes tax time easier. You can track property income and expenses, upload files, photos and receipts to share with your accountant.

If you're looking to buy your next investment property, MyBMT also helps with your market research. With features such as PropCalc and a Research and Insights tool all within the platform, you can save time while consolidating your ongoing investment strategy.

You can calculate the after-tax holding costs of any property, view current market data, see nearby planning applications and generate a valuation for your existing property. And now you can arrange landlord insurance and access property titling information through the portal, too.

So, what's the cost of having all this information at your fingertips? Absolutely nothing. MyBMT is a free tool available online and as an app to ensure that you can manage your investment property and depreciation needs with ease. MyBMT is constantly being updated so you have the best experience possible.

Start managing your investment property with ease through MyBMT. Activate your MyBMT account today at **mybmt.com.au/register.**



Discover the build cost of your next project

The BMT Construction Cost table is a useful guide to the cost of construction for different types of residential and commercial buildings.

To discover the build costs of your next project, adjust costs for various regions by multiplying the construction cost by the regional variations opposite. This will provide an approximate cost for the construction cost per square metre in your area.

Alternatively, you can download and calculate build costs using the BMT Cost Calc app at **bmtqs.com.au/cost-calc**.

Regional variations

Region	Variation
Hobart	95 - 120%
Canberra	92 - 120%
Melbourne	95 - 105%
Adelaide	95 - 108%
Sydney	100%
Perth	98 - 120%
Brisbane	95 - 115%
Cairns	110 - 130%
Darwin	110 - 135%

Construction type		Level of finish (per m²)		
		Low	Medium	High
House	3BR weatherboard project home, level block, single level, shelf design	$1,398	$1,565	$1,935
House	3BR brick veneer project home, level block, single level, shelf design	$1,490	$1,659	$1,981
House	3BR full brick project home, level block, single level, shelf design	$1,484	$1,654	$2,054
House	4BR weatherboard home, level block, single level, unique design	$1,980	$2,096	$2,617
House	4BR brick veneer home, level block, single level, unique design	$2,085	$2,185	$2,749
House	4BR full brick home, level block, single level, unique design	$2,366	$2,703	$2,936
House	3BR brick veneer project home, level block, two level, shelf design	$1,553	$1,716	$2,117
House	3BR full brick project home, level block, two level, shelf design	$1,611	$1,811	$2,222
House	4BR brick veneer home, level block, two level, unique design	$2,180	$2,464	$2,860
House	4BR full brick home, level block, two level, unique design	$2,409	$2,767	$3,020
House	Architecturally designed executive residence	$3,198	$4,093	$5,726
Townhouse	2BR single level brick veneer townhouse including allowance for common property	$2,191	$2,491	$2,808
Townhouse	2BR 2 level brick veneer townhouse including allowance for common property	$2,250	$2,534	$2,945
Townhouse	3BR single level brick veneer townhouse including allowance for common property	$2,171	$2,471	$2,776
Townhouse	3BR 2 level brick veneer townhouse including allowance for common property	$2,228	$2,597	$2,955
Units	3 level walk-up unit complex, concrete structure, ground floor parking	$2,307	$2,476	$3,003
Units	3 level walk-up unit complex, concrete structure, basement parking	$2,260	$2,429	$2,955
Units	4-8 level unit complex, including lift, concrete structure, ground floor parking	$2,635	$2,834	$3,434
Units	4-8 level unit complex, including lift, concrete structure, basement parking	$2,576	$2,776	$3,377
Units	8 or more level unit complex, including lift and basement car parking	$2,734	$3,103	$3,945
Commercial	1-4 level open plan offices, including A/C & lifts, excluding fit out	$2,376	$2,649	$3,113
Commercial	4-8 level open plan offices, including A/C & lifts, excluding fit out	$2,754	$2,955	$3,973
Commercial	8 levels and over, including A/C & lifts, excluding fit out	$3,940	$4,161	$4,351
Industrial	High Bay Warehouse, standard configuration, concrete floor, metal clad	$1,131	$1,278	$1,378
Industrial	High Bay Warehouse, standard configuration, concrete floor, pre-cast concrete wall clad	$1,390	$1,468	$1,636
Retail	Suburban shopping mall area including A/C	$2,967	$3,094	$3,463
Retail	Supermarket, including A/C, excluding fit out	$1,880	$2,007	$2,250
Hotels/motels	Single level boutique motel including A/C, guest facilities	$3,656	$4,183	$5,500
Hotels/motels	Single level tavern/hotel including A/C, excluding loose item fit out	$3,050	$3,630	$4,367

The above rates exclude goods and services tax (GST). Please visit **bmtqs.com.au** for more information.

Disclaimer | The information including the construction costs contained in Maverick is provided for general information only and on the understanding that BMT Tax Depreciation Pty Ltd nor any of its officers or employees are providing professional advice on any particular matter or are liable for any error or omission in the information or any damage or loss suffered from any reliance on that information. Professional advice should be sought for your particular circumstances.

The construction costs are average prices in a metropolitan area and should be adjusted with reference to specific conditions. They are not intended to be relied upon or used for tendering or pricing variations. Construction costs include costs of labour and materials, waste, hoisting, fixing in position and a profit allowance based on prevailing market conditions but exclude any GST, costs of land, demolition and any work outside the footprint of the building.

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