The Property Depreciation Experts

Washington Brown

THE PROPERTY DEPRECIATION EXPERTS

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Firstly, thank you for giving Washington Brown the opportunity to provide feedback on the draft legislation, both in written form and in person on Friday the 4th of August.

Whilst the draft legislation will achieve the Integrity Measure as outlined in the Budget - there is a better a solution that we believe will achieve the same result (if not better) and not disrupt the property market.

Concerns with the Draft Bill.

1. **Non-residential property** - If a major concern relates to the constant re-valuation of Plant and Equipment upon successive transfers of property - why does this draft legislation only relate to residential property?

If a major concern is the Integrity of property investors, why is it suggested commercial property owners are more trustworthy?

A system that applies to residential and non-residential property would be more satisfactory.

2. **Two-tiered property market** - Allowing purchasers of brand new property to depreciate the Plant and Equipment - but not the subsequent owner - will create a two-tiered property market.

It will favour developers and project marketers and, in our opinion, will lead to over-inflated property prices for new property.

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Owners of near-new units may struggle to sell their property when they are selling in a market where the new shiny one down the road has 3 times the tax deductions available to them.

3. **Complicated CGT -** The proposed legislation, if enacted, will make the CGT regime more complicated.

This will particularly occur in mixed-use premises such as a property that has a retail premise on the ground floor and residential above. In this scenario, they may be both on one title and you could have a combined Plant and Equipment item, such as Air Conditioning, that runs through both premises and this will require separation for CGT calculations.

Whilst this is not impossible, it will make the calculation very complex for very little reward.

4. **Effective life tables** - An asset should be depreciated based upon its effective life. The draft legislation would create a whole new paradigm for the treatment of depreciating assets.

Take a brand new block of units as an example. The carpet in varying units could end up with completely different effective lives - based on when an individual property investor needs to sell.

5. **Housing affordability -** One of the stated aims of the Budget measure is to reduce pressure on housing affordability. We may indeed see the opposite, those investors who are able to claim depreciation now may simply hold onto their assets thus reducing supply.

6. **Little reward -** The proposed legislation would appear to simply move the benefit of the depreciation from one line of the ledger to another. By disallowing depreciation on previously used assets and then allowing a capital loss on the unclaimed depreciation, it does not truly address the problem at hand.

Based upon the draft legislation we cannot not see what stops a purchaser, for instance, buying a 20-year old property, and apportioning a part of that purchase to assets that are well and truly past their used-by date and then claim a balancing adjustment on those items once removed.

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The Solution

Property investors should claim depreciation on previously used assets based upon the historical cost of the item and have regard to its effective life.

Further, in order to ensure that my proposal meets the Integrity Measures, previously used assets should only be depreciated using the Prime Cost method.

This would ensure that the opening written down value for the incoming purchaser would always be lower than the original cost of the asset. And it should apply across all property classes - be it residential, commercial, retail etc.

Let's put this in perspective using two examples:

Gunther's First Purchase

Gunther buys a 5-year old apartment which includes carpet within. The carpet, with an effective life of 10 years, had an original value of $3000. As the carpet is now 5 years old Gunther acquired the carpet for $1500 and the effective life is 5 years. Gunther can only claim $300 per annum using the Prime Cost method for the next 5 years.

Gunther's Second Purchase

Gunther buys a 12-year old apartment which includes carpet. As the apartment is 12 years old and the carpet had an effective life of 10 years - Gunther cannot claim any depreciation on the carpet.

Key Points

The purchase price of the property has no bearing on what Gunther's opening written down value is for his previously used assets in the same way that the Capital Works deduction currently applies (i.e. Division 43).

The Plant and Equipment valuations could operate in a similar way to the Capital Works deductions, Subsection 262(4AJA) of the 1936 ACT - by way of transfer of information.

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Broadly stated it requires the transferor to provide to transferee with enough information to enable them to calculate the deduction available to them.

Where that information isn't forthcoming an appropriately qualified person could estimate the value having regard to the effective life and historical cost.

This approach would still make effective life tables relevant and could quickly be rolled out to the commercial property market. The impact of a two-tiered property market will be greatly reduced & CGT calculations will be simpler.

But the three most important reasons why this works are:

1. The Government's concern that investors are over claiming on successive valuations of Plant and Equipment are addressed and nullified.

2. It provides a mechanism and methodology on how to value Plant and Equipment of previously used assets which are attached to buildings which are attached to land.

3. The big one - It would reduce the tax deductions available to investors by providing an end point of the deductions (effective life) rather than shifting the deductions from one line of the budget to the other.

Regards

Tyron Hyde

Tyron Hyde
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