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Business Tax Working Group

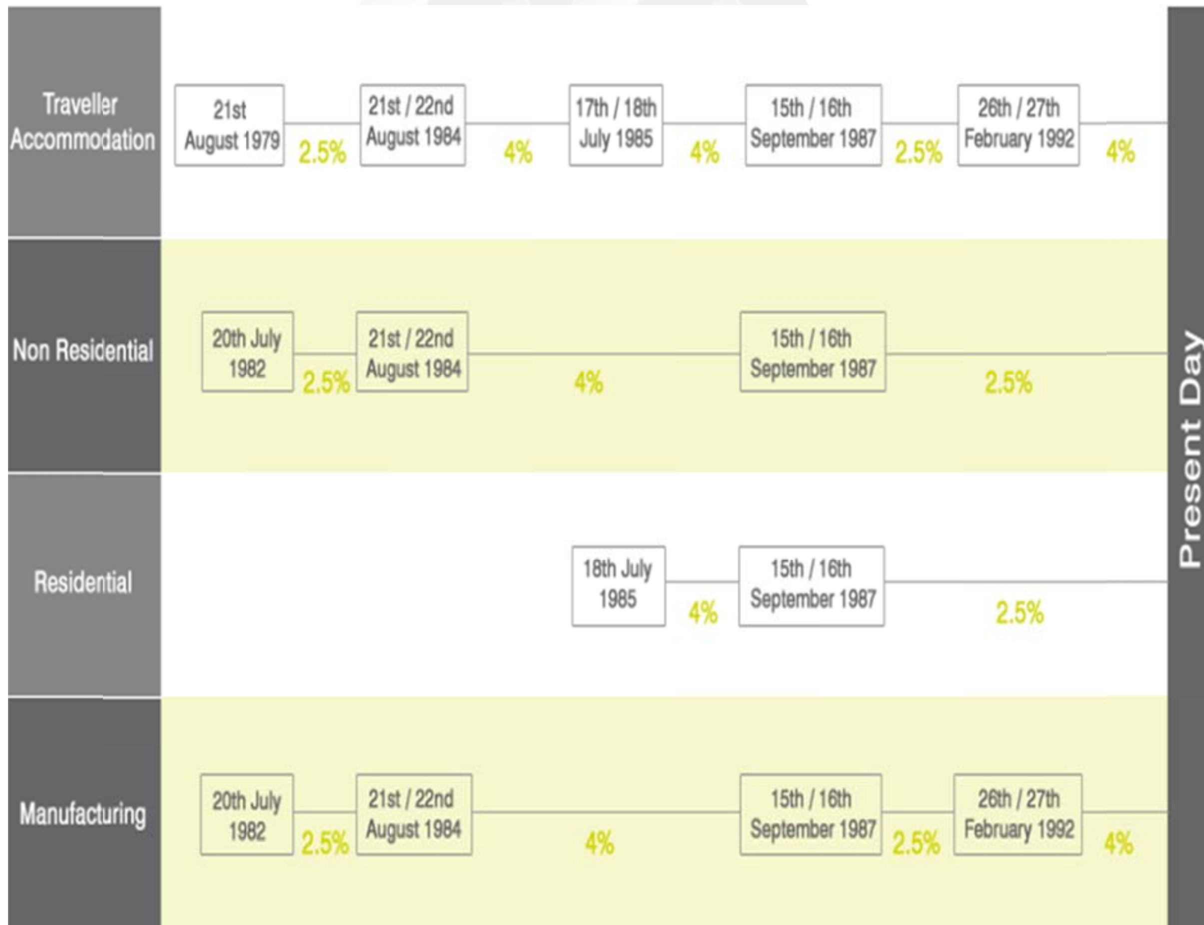
Recommendation

Contracts signed, construction that commences, or assets whose holding commences after the proposed date be subject to a 4% building allowance regime based upon the original construction cost.

Impact: This would result in significant savings for the Government and increase activity in the new construction.

Background:

Property is subject to varying rates of building depreciation as can be seen below:



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By immediately making all purchases and contracts entered into for construction subject to a flat 4% building allowance – significant savings will be made and incentives to buy new property will increase.

Current Building Depreciation Regime

Year Built	Original Construction Cost	Purchased	Residual Building Allowance		
1988	$100,000	2013	15 Yrs	@ 2.5%	= $37,500
1990	$100,000	2013	17 Yrs	@ 2.5%	= $42,500
1995	$125,000	2013	22 Yrs	@ 2.5%	= $82,500
2005	$200,000	2013	32 Yrs	@ 2.5%	= $160,000
2013	$250,000*	2013	40 Yrs	@ 2.5%	= $250,000

*First year deduction based on $250,000 = $6,250 (New property only)

Proposed Building Depreciation Regime

Year Built	Original Construction Cost	Purchased	Residual Building Allowance		
1988	$100,000	2013	0 Yrs	@ 4%	= $0
1990	$100,000	2013	2 Yrs	@ 4%	= $8,000
1995	$125,000	2013	7 Yrs	@ 4%	= $35,000
2005	$200,000	2013	17 Yrs	@ 4%	= $136,000
2013	$250,000*	2013	25 Yrs	@ 4%	= $250,000

*First year deduction based $250,000 = $10,000 (New property only)

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As can been seen above significant savings for the government will made and increase the deductions for newly built construction.

The amount of the overall claim on a property would still be the same and only a timing difference on the deductions going forward would occur.

Under the capital gain regime any building depreciation allowances that are claimed are clawed back upon the sale of the property.

Observations

i. A policy move towards basing the building allowance on the effective life of the structure could have the same impact as our recommended approach.
This approach will have far greater practical challenges, as noted in the working paper.

ii. A move to 25 year effective life of property would more accurately reflect lifespan of certain items currently under the building allowance regime. For instance, kitchen cupboards, shower screens and down lights are considered to last 40 years.

iii. The Ralph Review highlighted that the current law is complex, with varying dates for varying buildings and varying rates applicable. Our recommendation overcomes this complexity.

iv. The Ralph Review, on advice from the property sector, noted that commercial buildings may depreciate faster than the current 40 year write-off. Our recommendation improves this situation.

v. The Ralph Review highlighted that bringing buildings into an effective life regime would be costly exercise. The review further highlighted that subjecting buildings to the normal depreciation provisions will mean a separate valuation of the land and building.

The Ralph Report was written prior to the Global Financial Crisis (GFC). The GFC experience brought home the reality that land values wildly fluctuate.

vi. The original construction always remains the same.

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vii. A move towards a zero building depreciation allowance will have a negative impact on the marketing and selling of development projects. Building depreciation allowances are a key factors in acquiring pre-sales of units, that banks require before construction can commence.
A letter from CBRE Project Marketing and Meriton Apartments are attached and outline their concern for the scrapping of building depreciation allowances.

viii. It is well documented that the construction of new property has a multiplier effect on the economy.

ix. The system of basing the depreciation allowance on the original cost of construction has become more accurate with time. Washington Brown has been preparing reports for close to 20 years now. A large percentage of reports we now prepare we have the original cost as we were either provided them by the developer or we worked on the project on behalf of the lender.

This would be the same for many other quantity surveying firms.

x. Firms preparing depreciation allowance reports are now required to be registered Tax Agents through the Tax Practitioners Board. This will further enhance the accuracy of the reporting in this area.

In summary

Our recommendation is not one of retrospectivity.

Our recommendation simplifies the deprecation regime moving forward in a way that will save the government money and encourage the development of new property.

Tyron Hyde

CEO, AAIQS, B.Build (Const. Econ.)

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19 September 2012

Business Tax Working Group
C/- Washington Brown

Via email: info@washingtonbrown.com.au

Dear Sir/Madam,

Building Depreciation Allowances

CBRE Residential Projects is a national business specialising in the sales and marketing of Residential Projects, with offices in Sydney, Melbourne, Perth, Brisbane and the Gold Coast. The business provides specialist services for developers, including site identification, high and best use studies, market research and strategic sales and marketing campaigns.

When CBRE launches a project to the market a critical part of our strategy is to target property investors.

Property investors, accountant and financial planners carry out financial due diligence on the investment prior to commitment.

Never has there been time a where pre-sales have been a more critical part of a project getting off the ground.

Building depreciation allowances are a vital part of this equation. CBRE does not launch a project without having an estimate of these allowances in order to assist achieving the pre-sale requirement that a funder may insist upon.

Without the financial benefits on depreciation, property investment would be much less appealing resulting in less new development. We feel it is critical that the existing benefits remain in place if new housing supply is to be encouraged.

Yours faithfully

David Milton
Managing Director, CBRE Residential Projects

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Building Depreciation Allowances

For close to half a century Meriton has been building premium apartments across Sydney, Gold Coast and Brisbane. During this time Meriton has become Australia's largest property developer, having received numerous awards and recognition for building excellence.

Meriton undertakes the majority of its operations in-house; from buying land, planning projects, building, selling, property management and financing to strata management. This model ensures quality control at each step.

The Australian economy heavily depends on the residential housing and construction industries which Meriton is a large part of. Meriton produces thousands of apartments each year, providing homes, accommodation and investment opportunities to Australians in serviced apartments and residential properties sold and leased.

A key driver of our business has been to target property investors.

When Meriton launch a project to the market we supply an estimate of the likely depreciation on the property to attract investors.

Property investors, accountants and financial planners carry out due diligence on the investment prior to commitment.

Without building depreciation it would be harder to attract property investors which will reduce how many apartments we build, and this will obviously have a negative inpact on employment and subsequent tax revenues.

Peter Spira

General Manager