The Benefit of Claiming Depreciation on your Rental Property

Depreciation expense can be claimed on the rental schedule along with other costs for the rental property.

The key difference is that depreciation is **not an additional out of pocket cost** to you each year but still gives you cash back through your return.

How Depreciation Works

When you buy the property, the purchase cost includes the cost of the building and assets within it.

As these items incur wear and tear over time and reduce in value the ATO recognises this and allows a tax deduction each year for it.

How much is claimable depends on whether you have a brand new property or an existing one and the age of an existing property and assets.

The Cash Flow Bonus

Being able to claim a tax deduction without having to spend extra money each year allows for a great cash flow effect over the life of the asset. You will get a refund of tax on the claim at your marginal rate through your return.

For example, if you claim $4000 in depreciation and your marginal tax rate including Medicare Levy is 34.5%

The Effect on End Capital Gain Calculations

When you claim a component of the original building and asset costs over time through your tax return it will affect the final capital gains calculation on sale.

The capital gain calculation on sale of your rental is total sale consideration less the purchase price and associated costs of buying and selling (in summary).

Original building and asset costs are bundled with the purchase price.

When these costs have already been claimed through your tax return as depreciation then they can't be included again in the capital gains calculation as part of your purchase costs. An adjustment needs to be done on sale to reduce the purchase cost by the amount that has already been claimed.

This adjustment will increase the amount of capital gain (or decrease your capital loss) on the property. Although this may lead to more tax payable, the cash flow benefit of having the depreciation claim over time (while the property is held and incurring costs) will generally outweigh any adjustment at the time of sale.

At the time of sale, if the property has been held over 12 months, there is also a 50% discount on the gain which helps to reduce any tax payable and there will likely be other strategies available at that time to reduce the gain.

Another Benefit of Claiming Depreciation During the Life of the Asset

While the discount does allow for a 50% reduction on any gain it also has the effect of reducing the benefit of any cost claimed by 50%. By extracting the cost from the purchase price of building and asset costs and claiming them over the property's holding period it allows for 100% of these costs to be deductible.

Effective tax planning before sale can help minimise any tax payable – which may still be many years off. Depreciation is an expense that can be of advantage now.

How to Get a Depreciation Report

Some property developers will provide a report with the finished property but in most cases, you will need to engage a property surveyor to prepare a depreciation report for your property for tax purposes.

We recommend **BMT Depreciation Specialists** due to the quality of their reports and the ease for them to fit into our software systems (website address below).

If you let them know that you were referred by Callaghans then they will provide you a discount on any report. They will also be able to advise whether it is worth going forwards with the completion of the report depending on the type and age of the property. The cost of their report is tax deductible in the year in which the cost is incurred.

Additional information as to how depreciation works and the difference between claiming building and asset costs can also be found on the BMT website. **www.bmtqs.com.au**