Top 10 must-know depreciation terms for residential investors

You don't need to be a depreciation expert but understanding some of the key concepts surrounding this complex area of taxation can help your ongoing investment strategy.

1. **Capital works deduction**

This is the depreciation deduction you can claim on the structural component of the building and any fixed assets. Some common examples include walls, doors, roofing, sinks and built-in kitchen cabinetry.

Capital works deductions can be claimed under division 43 at a rate of 2.5 per cent for up to forty years on any residential property where construction commenced after 15 September 1987. But if a property is older than this and has undergone a structural renovation, such as retiling a kitchen, some capital works deductions will be available.

2. **Plant and equipment**

This category of depreciation refers to the easily removable or mechanical fixtures and fittings in a property. Floor coverings, furniture and air-conditioning units are some examples of plant and equipment assets. Plant and equipment assets are depreciated under division 40.

Legislation changes mean that some owners of second-hand properties can't claim depreciation on previously used plant and equipment assets.

3. **Effective life**

Plant and equipment depreciation rates are calculated based on their effective lives. The Australian Taxation Office sets the relevant effective life of an asset.

4. **Diminishing value method**

This is just one of the two methods of calculating depreciation for plant and equipment assets. When this method is chosen, the deduction is calculated as a percentage of the asset's depreciable balance.

5. **Prime cost method**

The second way to calculate plant and equipment depreciation is under this method. The deduction for each year is a percentage of the cost, resulting in a more even claim per financial year.

6. **Low-value pool**

You can place plant and equipment assets that cost or are valued at less than $1,000 in a low-value pool. Once allocated to the pool, the asset is depreciated at an accelerated rate of 18.75 per cent in the first year and 37.5 per cent for each following year.

7. **Quantity surveyor**

This is a professional specialising in building measurement and estimating construction costs. Under Tax Ruling 97/25, they are the few professionals that are qualified to accurately calculate construction costs for depreciation purposes.

8. **Substantial renovation**

A substantial renovation differs from a cosmetic renovation as this is where all, or substantially all, of a building is removed or replaced. When a property is substantially renovated, previously used plant and equipment assets are no longer affected by 2017 legislation changes.

9. **Cosmetic renovation**

Painting internal walls, replacing floor coverings and light fittings are just some examples of cosmetic renovations. They are usually visual in nature and are a more cost-effective option to structural renovations.

10. **Tax depreciation schedule**

This is a schedule that lasts the lifetime of the property and specifies all available depreciation deductions of a building's structure and its assets. The schedule fee is 100 per cent tax deductible.

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