

Accountants News

INFORMATION FOR PRACTISING ACCOUNTANTS

Division 43 - Points To Ponder

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Division 43 - Is the End Nigh?

You've checked if a building's construction qualifies for a deduction by looking up the Division 43 deduction period commencement dates, but have you ever checked a building's deduction period end date?

It's one of the first and simplest questions we ask clients who are contemplating the purchase of an investment property. "Have you checked that the construction date qualifies it for a Division 43 deduction?" If their answer for a commercial building is "Yes, construction commenced post 19th July 1982" or, for a residential building, "Yes, construction commenced post 17th July 1985", we automatically assume that we can factor in an ongoing 2.5% or 4% deduction. However, that assumption is rapidly becoming hazardous.

It is a self evident, but apparently little considered fact that buildings constructed during the short window of time when 4% was the standard rate are rapidly approaching the end of their deductible life.

In simple terms, the Division 43 deduction runs for a set time period from when the building was first used by any entity (for any purpose) after completion of construction. The length of

the period is determined by the deduction rate applicable to the building. A 4.0% rate means a 25 year claim period and a 2.5% rate a 40 year claim period. (For post 26th February 1992 buildings, the time period must be individually calculated if, over time, the deduction rate for the building has changed.)

As the table above shows, the deduction cut-off date for many 4.0% buildings is rapidly approaching.

Purchasers acquiring a 4.0% property as a long term investment could be in for an unwelcome shock if they are unaware of the downside to that attractive 4% rate. As could real estate agents, investment marketers and even accountants, if they give investment advice based on the long-term availability of what may, within as little as 4 to 5 years, be a non-existent deduction.

It's still an issue worth noting. It's amazing how quickly time passes.

Division 43 & GST Credits

It is usually easy to determine whether GST should be included in an item's Division 40 depreciable cost. The depreciable cost is the amount the taxpayer is actually out of pocket. If the taxpayer is entitled to a GST credit the depreciable value is the GST exclusive cost. If not, it is the GST inclusive amount.

For Division 43 the test is the same, but determining how to apply it can be anything but simple. Division 43 deductions are always based on the original construction cost incurred by "the owner, lessee or quasi-owner of the capital works at the time the works were undertaken" (ATO ID 2003/553). This means the 'out of

Commercial

earliest eligible construction date:	22 Aug 1984
deduction end date	21 Aug 2009
latest eligible construction date:	15 Sept 1987
deduction end date	14 Sept 2012

Residential

earliest eligible construction date:	18 July 1985
deduction end date	17 July 2010
latest eligible construction date:	15 Sept 1987
deduction end date	14 Sept 2012

'pocket' test is applied to the entity that owned the construction works during the construction process. Subsequent owners merely inherit the original owner's Division 43 cost base. The GST status of their purchase is irrelevant.

Directly Commissioned Construction

When an entity directly commissions the construction of a structure, whether or not the GST component of their cost is included in the Division 43 cost base is dependant on their own ability to claim a GST credit.

For example, if a GST registered entity commissions a builder to construct a new office building, they will claim any GST payments they make as a tax credit and claim Division 43 based on the GST exclusive contract price. Conversely, if a taxpayer commissions a builder to construct a new house (for their own use or as a rental property) they will not be entitled to a GST credit on the contract and will claim Division 43 on the full contract amount.

Spec Built Construction

Almost all unit buildings and a substantial percentage of houses are not commissioned by what we would generally refer to as the property's 'first owners'. They are built 'on spec' by developers who sell the completed properties. As the construction works are trading stock, the developers will always be entitled to claim GST credits. Consequently, the Division 43 cost base will exclude the GST component of the developer's expenditure.

This legislative interpretation remains applicable even if the property is purchased

off-the-plan. An off-the-plan contract is simply an agreement to purchase a property once the developer has completed its construction. No title in the property passes to the purchaser until settlement.

The greatest potential for confusion lies with what are broadly referred to as 'house and land packages'. If the contract is a simple agreement to purchase a specified block of land with a specific design of house built on it, the developer remains the house's legal owner until settlement on completion. The Division 43 deduction is based on the developer's GST exclusive costs.

If however, the contract documentation contains two clearly separate contract sections, one for the purchase of the land and a second for the commissioning of the house's construction, then it is more likely that the house is the property of the purchaser during the construction process. It will be important to check the contract details carefully, as there are many different variations on the house and land package concept, and a relatively small technical variation could have a significant tax consequence.

As a matter of note, even before the introduction of GST it was important to check the fine print of these contracts. The directly commissioned contract cost will always exceed the eligible expenditure of the house if it had been 'spec built'. The contract will contain allowances for things like the builder's profit, legals and finance, all of which are not allowable in the cost base of a 'spec built' property. (See TR 97/25.)



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