

Accountants News

INFORMATION FOR PRACTISING ACCOUNTANTS

ATO review of depreciable items



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The review rolls on

Over the past 2 years the ATO has extensively reviewed the eligibility and effective life of depreciable items in a number of industry categories.

To date the most widely discussed element of the review process has been the review of depreciable items in residential rental properties, the results of which were released at the end of June 2004. In this instance the review process was notable both for its comprehensiveness and the fact that the ATO included in its public advice a formal list of those items it considered non-depreciable, along with an explanation of the underlying principles on which their decisions were based.

You can find the list of depreciable and non-depreciable items in the ATO publication 'Guide to Rental Properties 2004-05' and the explanation in TR 2004/16 'Plant in residential rental properties'. It is worth noting that while TR 2004/16 deals specifically with determining whether or not an item is depreciable in a residential rental property setting, the ATO's basic analysis of the legislation and case precedent should be equally applicable in other settings.

In June this year the ATO published the results of an extensive review of items in short-term style accommodation, pubs, taverns and bars, cafes and restaurants, plus other general retail and commercial applications. In addition to these two major use category reviews, over the past two years there have also been numerous other changes affecting individual items or plant systems.

The complete list of changes is far too extensive for us to discuss individually. Indeed, TR 2000/18C9 (the most recent consolidation of the ruling showing all rates effective as

at 1 July 2005) is 20 pages longer than its 1 July 2003 equivalent - and that doesn't even take into account the multitude of existing items that have had an effective life amendment. Instead, in this newsletter we have focused on the impact of all of these review related changes on the general preparation and management of depreciation schedules.

Two styles of change

The ATO's review has resulted in two distinct types of change, each with their own unique system implications.

Review of effective lives

The effective life of many items has either been determined for the first time or amended. A new effective life applies only to items acquired after that effective life becomes 'applicable'. It does not affect existing depreciation schedules. The date each rate becomes applicable is published in TR 2000/18 along with the effective life itself.

The major challenges:

a) The move toward industry based categorisation of items means there are more items with multiple effective lives. For example, carpet in general residential units has an effective life of 10 years, in commercial office buildings 8 years, in 'accommodation provider' facilities (such as hotels / motels) 7 years, and in a pub / bar / cafe or restaurant 5 years. Even the most common furniture items such as beds, chairs, linens and crockery now have multiple effective life listings. [Make sure you check the new Table B listing of items under the heading 'Furniture, freestanding' as it contains effective lives for some furniture items in general use that vary substantially from the previous generic 13.33 years.]

In order to be able to determine the appropriate depreciation rate, you may need to ask a lot more questions. First you will need to establish which (if any) industry category applies to your client's property. Now that there are a number of different commonly applicable categories within both the residential and commercial property sector merely knowing that a property is residential or commercial may not be adequate.

If your client's property contains a mix of category use areas you will need to know in which category area the item is to be used - and hope that it isn't to be relocatable or shared. This will be a common issue for taxpayers with factory, retail or restaurant style facilities, as they frequently have separate service and administrative areas. If you are the accountant for a client who owns one of the large resort style facilities containing serviced apartments, hotel style suites, shops, bars and restaurants, gyms and administrative facilities, you have our sincere sympathy.

b) The rates for many 'grouped items' have been subdivided into individual listings, each with their own potentially different effective lives. For example, in a building's security access system the door opening controllers have a different life than the card readers (and you have to know if they are proximity or swipe card readers). Similar item breakdowns have occurred in most other major multi-component systems including fire protection and air conditioning systems.

Once again these changes mean that it requires more information about items in order to be able to depreciate them appropriately. It also means that the number of items that need

to be entered into the average schedule is likely to increase. Even schedules for simple units and houses are likely to be affected if they include a furniture package. Higher individual item rates now mean that items such as linen, cutlery and crockery, shower screens, free-standing bathroom accessories and ironing boards all have to be separated out of the general 'loose furniture' item.

Review of depreciation eligibility

In conjunction with the review of effective lives, the ATO has reviewed an extensive list of items to determine whether or not they should qualify as depreciable under Division 40.

Unlike changes in effective life, a change in the depreciable status of an item may affect both new and existing schedules. The ATO has announced that they will not normally require a taxpayer to amend previously lodged depreciation claims, provided that at the time their return was lodged there was reasonable grounds for depreciating the schedule items. This does not mean that a taxpayer who acquired or created a depreciation schedule prior to the publication of the review findings can continue making depreciation claims on an item after its non-depreciable status has been announced. Depreciation claims made in a 2004/2005 tax return should reflect current eligibility determinations as at 30 June 2005.

The challenges:

a) All existing schedules need to be reviewed to ensure that they no longer contain non-depreciable items.

b) If a non-depreciable item qualifies for a Division 43 deduction instead, you may not be able to use a value taken from the depreciation schedule as the basis for this claim. Items acquired as part of a previously used property are likely to have been valued based on their market value at purchase. Division 43 requires you to base your deduction calculations on their original construction / installation cost.

To meet the requirements of the law it may be necessary to obtain a construction cost estimate for the item. Obviously this will only be economically viable for larger cost items. You may also need to retrospectively obtain documentation to prove when the item was built / installed - something not always easy if it was not part of the original construction project. For example, installation date documentation is likely to be a particular problem for ductwork associated with central heating and air conditioning added to existing houses by a previous owner. Many such units are purchased second hand, so even a manufacturer's date on the equipment may not be a reliable guide.

c) The ATO has deemed some existing TR 2000/18 items partly depreciable and partly non-depreciable. For example, the ATO has changed the item descriptions for central air conditioning and mechanical ventilation systems to exclude the previously allowable cost of ductwork, piping and vents. In many instances, this

change reduces the item's depreciable value by between 50 to 70 percent. Most taxpayers and accountants will not have the expertise required to determine the proportion of the original schedule value attributable to the components that remain depreciable. Where the item values and resulting deductions are substantial, it would be wise to obtain expert advice.

d) The eligibility of some potentially depreciable items is dependant on specific installation details. For example, carpet is depreciable when laid in the traditional manner but not when glued in place. (A substantial percentage of commercial carpet and an increasing percentage of lower end residential carpet is glued in place. Short of ripping up the edge of the carpet, even we can't always determine with 100% certainty which method has been used.)

e) If the main building structure is too old to qualify for a Division 43 deduction, some high cost, long life items (such as fire sprinklers and ventilation ducting) will not qualify for any alternative form of deduction. This may not be an easy fact to explain to your clients.

What does it all mean?

Whether a taxpayer is better or worse off as a result of the effective life and depreciability review process depends largely on their own individual circumstances. The same may also be true for you as their accountant. What is certain is that the utopian dream of a simple tax system seems more remote then ever.

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