CARISMA SOLUTIONS

DEPRECIATION

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Depreciation - Introduction

Depreciation represents the estimated reduction in value of a fixed assets within a financial year.

Tangible assets, such as buildings, equipment, vehicles and so on, are purchased in large lump sums. The value of these assets decreases over time after their purchase because of wear and tear (i.e. use of the asset) and obsolescence. Depreciation represents the estimate for how much this value has declined in each financial period.

Depreciating assets include such items as computers, electric tools, furniture and motor vehicles.

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Is depreciation an expense?

Yes, depreciation is considered an expense.

Depreciation is a non-cash expense, which means that it does not require a cash outflow, but it does reduce the asset's value. Therefore, since the expense has already been incurred, the depreciation does not affect the company's liquidity.

SMSF Depreciation

There are two main types of depreciation deductions that an SMSF can claim:

- Division 40
- Division 43

For division 43 and 40 as well as the low value pool it doesn't matter whether the property is used in a business (active asset) or just to collect rent (passive income). The only requirement is that the asset is used to generate income. So, a SMSF can claim Div 43 and 40 and the low value pool irrespective of whether they run a business or not.

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Division 40 & 43 Overview

Division 40

- Division 40 of the Income Tax Assessment Act 1997 allows Self-Managed Super Funds (SMSFs) to claim depreciation deductions for the decline in value of qualifying “plant and equipment” assets

Division 43

- Division 43 of the Income Tax Assessment Act 1997 allows Self-Managed Super Funds (SMSFs) to claim deductions for capital works

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Division 40 & 43

Division 40

Applicable to:

- Appliances like ovens, dishwashers, and air conditioners.
- Carpets, curtains, and blinds.
- Furniture and fittings.
- Plant and equipment .

(Both residential and commercial property held under SMSF)

Specific eligibility requirements and rates will vary based on the assets.

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Division 40 & 43

Division 43

Applicable to: Building structures and fixed items.

These can include buildings or extensions, alterations or improvements to a buildings, alterations and improvements to a leased buildings including shop fit outs and leasehold improvements and structural improvements such as sealed driveways fences and retaining walls

Rate: 2.5% per year over 40 years.

Eligibility: Buildings constructed after September 15, 1987.

Exemptions : But doesn't cover land, soft landscaping and residential properties built before 15 September 1987

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Types of Depreciation

- **Prime Cost Method** - The Prime Cost Method, also known as the straight-line method, is used to depreciate assets evenly over their effective life
- **Diminishing Vale Method** - Diminishing value method, also known as the **reducing balance method**, is a depreciation technique commonly used in accounting, including within Self-Managed Superannuation Funds (SMSFs).

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Prime Cost Method in SMSF

Prime Cost Method in SMSF

1. **Application**:
    - **Consistent Depreciation**: The same amount is depreciated each year.
    - **Predictability**: Easier to forecast and manage cash flows.
2. **Advantages**:
    - **Simplicity**: Straightforward calculation and application.
    - **Stability**: Provides a consistent expense amount each year.

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Prime Cost Method in SMSF

Calculation: = Asset Cost * $\frac{\text{Day held}}{365}$ * $\frac{100\%}{\text{Asset's effective life}}$

Example: prime cost method, ignoring any GST impact

Laura purchased a photocopier on 1 July 2023 for $1,500 and she started using it that day. It has an effective life of 5 years. Laura chose to use the prime cost method to work out the decline in value of the photocopier. The decline in value for 2023–24 is $301, worked out as follows:

$$\mathbf{1{,}500 * \frac{366}{365} * \frac{100\%}{5}}$$

If Laura used the photocopier wholly for taxable purposes in 2023–24, she is be entitled to a deduction equal to the decline in value. The adjustable value of the asset at 30 June 2024 is $1,199

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Diminishing Value method in SMSF

1. **Application in SMSFs**:
   - SMSFs use this method to calculate depreciation for assets like property or equipment.
   - It aligns with the reality that assets tend to lose value more rapidly in their early years of use.
2. **Advantages**:
   - **Asset Suitability:** Suitable for assets that lose value quickly or have higher initial usage.
   - **Strategic Planning:** Can be part of a broader tax planning strategy within the SMSF

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Diminishing Value method in SMSF

Calculation:

For depreciating assets, you started to hold on or after 10 May 2006 the formula for the decline in value is:

$$= \text{Base Value} * \frac{\text{Days held}}{365} * \frac{200\%}{\text{Assets effective life}}$$

Example: diminishing value method, ignoring any GST impact

Laura purchased a photocopier on 1 July 2023 for $1,500 and she started using it that day. It has an effective life of 5 years. Laura chose to use the diminishing value method to work out the decline in value of the photocopier. The decline in value for 2023–24 is $602, worked out as follows

$$\mathbf{1{,}500 * \frac{366}{365} * \frac{200\%}{5}}$$

Compliance for Rates

Compliance:

- **ATO Guidelines**: Ensure the asset's effective life is determined according to the Australian Taxation Office (ATO) guidelines.
- **Record Keeping**: Maintain accurate records of the asset's purchase date, cost, and effective life.

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Second-hand depreciating assets you can't claim

For Division 40 Second-hand depreciating assets for residential rental properties are depreciation items previously used or installed ready for use by you or another entity.

Example: assets previously used

In August 2017, Donna purchased a 2-year-old apartment and immediately rented it out. A year before Donna purchased the apartment, the previous owner installed new carpet and, upon purchasing the property, Donna installed a second-hand television.

Donna can't claim deductions for the decline in value of the carpet or the television because they were both previously used.

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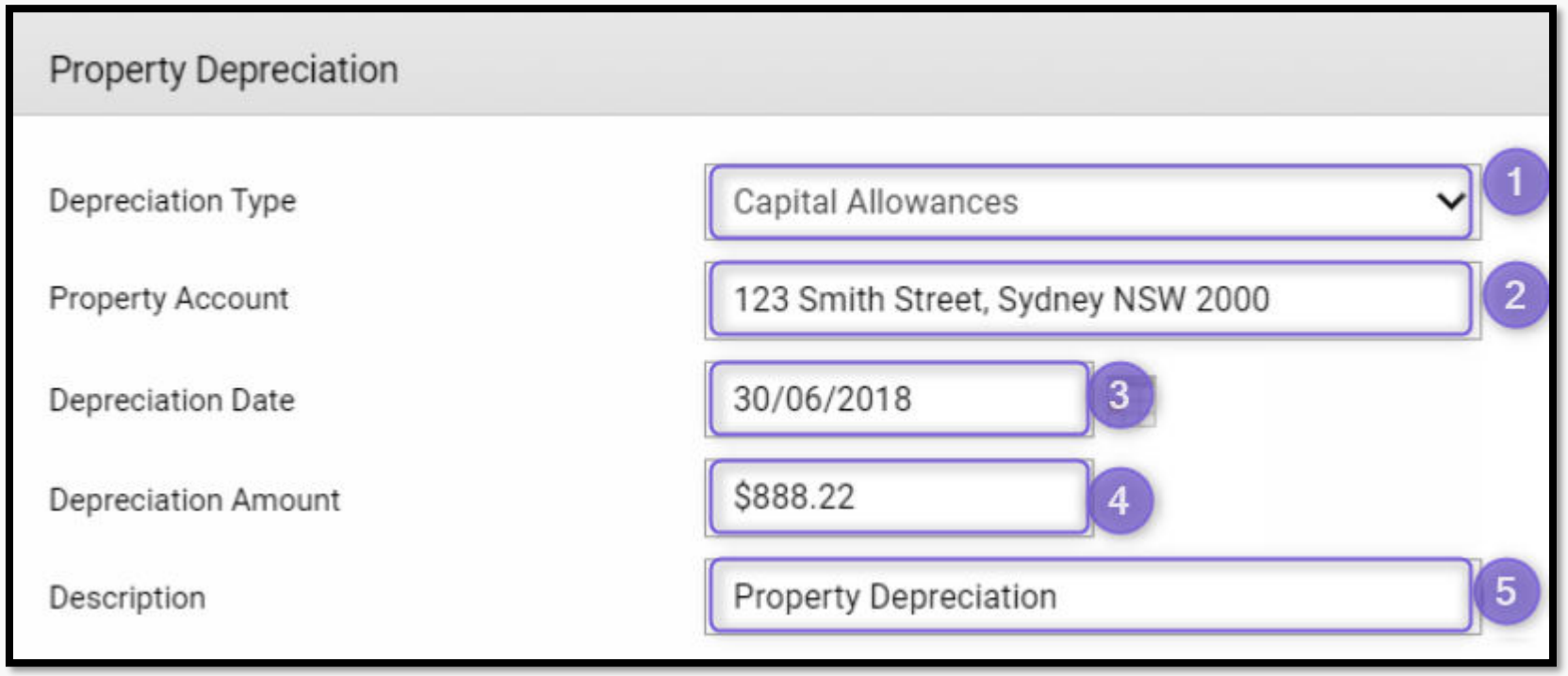
How to Process in Class Super

Navigate to Fund Level **> Transactions > Fund Expenses > Depreciation.**

1. Enter the **Depreciation Type**, by clicking on the drop-down box.
   Use "Capital Allowances" for Division 40 depreciation or "Capital Works Deduction" for Division 43 depreciation.
2. Search and select the **Property Account**, this is the property the depreciation relates to.
3. Enter **Depreciation Date**.
4. Enter **Depreciation Amount**
5. Enter **Description or** use the default description populated from Class.

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How to Process in Class Super



6. Click the **Submit** button.

How to Process in BGL 360

Based on the depreciation schedule provided the below journal to be posted in BGL



Unmatched (0) Manually Matched (0) Auto Matched (0) Journal Bank Statement Corporate Action System Journal De

	Status	Date	Ref	Account	Units	Debit	Credit	Description
☐		30/06/2023	227391074	33400/28HanoverStreet (28 Hanover Street, Oakleigh VIC, Australia) 77250/28HanoverStreet (28 Hanover Street, Oakleigh VIC, Australia)	0.000000	63.03	63.03	Depreciation - 28, Hanover Street, Oakleigh



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