

Tenant Abandonment & Capital Allowances for Landlords

COVID-19 has had a number of consequences for commercial landlords, many of them arising when tenants relinquish their leases and abandon the property, including their fit-outs.

It goes without saying that this situation is a far from ideal for a landlord, however, this does not mean that it is all bad. Landlords may inherit the tenants abandoned Division 43 Capital Allowances in accordance with the *Income Tax Assessment Act 1997*, which may result in significant tax deductions. This applies to both leases abandoned due to COVID-19 or otherwise.

What Is Tenant Abandonment?

When a tenant vacates the premises either at the end of the lease, or at any time before that, without making good the premises in accordance with the lease, the tenant is said to have abandoned it.

At such time, all items of tenant's installations and tenant's property will be considered abandoned and will become the property of the landlord.

When this occurs, the ownership of the Division 43 Capital Works transfers to the landlord. The landlord then has two options:

1. they can continue to claim the balance of the Division 43 allowances based on an annual claim of 2.5% of the original construction cost; or
2. they can claim the remaining value as a balancing adjustment, should they carry partial or full demolition of the fit-out in order release the property to a new tenant.

Example

The cost to a tenant of installing a fit-out within a retail or commercial property is, in this example, \$500,000.00.

The Division 43 components of the fit-out primarily consist of internal partitions, hard floor finishes and elements of electrical, mechanical and hydraulic services. The value of the Division 43 components is approximately \$300,000, or 60% of the capital cost incurred by the tenant.

As a landlord, you generally cannot claim deductions for the balance of the capital cost that relates to any Division 40 components, which include workstations and furniture.

After four years the tenant relinquishes their lease and vacates the premises. They abandon the fit-out and the beneficial ownership reverts to the landlord.

In this scenario, the landlord has two main options available to them.

Option 1 - Lease out the premises with the fit-out to a new tenant

The landlord may continue to claim the inherited Division 43 deductions at a rate of \$300,000.00 x 2.5%

or **\$7,500.00** per annum.

Option 2 - Demolish the fit-out to meet the requirements of a new tenant

The landlord can claim the residual value of the Division 43 Allowances as a balancing adjustment which is approximately \$7,500.00 per annum x 36 years = **\$270,000.00**.

In addition, provided they have not received a consideration from the tenant to make good, they can also claim the costs they have incurred to demolish the fit-out and make good the premises.

If you need any assistance with any matter set out in this document and/or any legal matters, please do not hesitate to contact us at **CLS Legal** on **(02) 9279 0919** – we focus on the outcomes.

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