Rental Property Tax **Deductions Overview**

The purchase of an investment property will be one of the biggest decisions of your life, both emotionally & monetary. It is therefore imperative that you get it right. There are so many factors to consider from location, the price you pay, the finance side of things, the structure to purchase in, the rental property manager, the taxation consequences and the list goes on!

Unless you are an expert in each of these areas, it is important to surround yourself with the best professionals in every one of these fields.

Generally, the owner of a property (known as the landlord) is assessable for income tax on all income received, but may claim deductions for losses and outgoings incurred in gaining that income.

The following is a checklist of some common types of expenses which a landlord may generally claim as a tax deduction: -

- Advertising & promotion
- Agent's commission for collection of the rent
- Audit/Accountancy Fees
- Bank charges
- Borrowing & mortgage discharge costs
- Building write-off allowance
- Cleaning
- Depreciation on furniture & fittings
- Gardening
- Insurance premiums
- Interest on monies borrowed to purchase the property
- Lease incentives
- Lease preparation, registration & stamping

- Legal costs: -
  - In recovering arrears of rental
  - Evicting defaulting tenants
  - Investigating credit worthiness & preparing leases
- Management/Body Corporate fees
- Postage
- Power supplied (gas & electricity)
- Rates – Council, Water & Land Tax
- Repairs & maintenance
- Safe deposit box fees to hold title documents
- Secretarial & bookkeeping fees
- Servicing expenses
- Stationery
- Tax advice costs & tax return preparation
- Telephone
- Travel - inspection costs

These are examples of many expenses incurred by a landlord which are allowable as deductions but are not limited to the above.

Chan & Naylor Tip

It is very important that you are fully aware of the tax deductions available to you as a property owner. This will help you to legally minimise your taxation liability and receipts should always be maintained (for a minimum of 5 years) to enable you to maximise any possible tax deductions.

Common Rental Tax Deductions Explained Further

Any expenses incurred in relation to maintaining a rental property are generally tax deductible. The purpose of these notes are to firstly let you know where we believe many taxpayers have found problems and secondly, to convey the Australian Taxation Office's view of the relevant laws on some of the more typical tax deductions available to be claimed.

Interest Deductions

The deductibility of interest is determined by the use of the borrowed money rather than the security provided. Simply, if the borrowed monies are used to purchase an investment property, whether it be commercial or residential, the interest & charges are generally tax deductible. Conversely, if the funds are used for private purposes, the interest is not deductible.

>> As an example, a taxpayer owns his current home outright. He decides to build a new home to live in with his family and to rent his old home. He takes out a loan to build his new home using his old home as security. The money borrowed to build the new home is for private purposes, therefore, the interest is not a deductible expense. The fact that he has a mortgage against his old home, that he now decides to rent, does not alter the fact that the money was used privately. He is, therefore, not entitled to a tax deduction.

>> For example, interest paid on money borrowed but used in part for private purposes - for example, to buy a jet ski - would need to be apportioned to exclude the interest applying to the private expenditure. This is the case even if any

such loan was secured against a rental property.

A few other items to consider in relation to the deductibility of interest are as follows: -

1. Where an investment property is held in joint names, interest deductions should be split according to the legal ownership of the property and not claimed solely by the higher income earning partner.

2. Interest paid in advance will usually be deductible in the financial year in which it is paid, provided the interest is for a period of less than 13 months.

3. Generally, any extra voluntary payments towards the principal of an investment loan are not tax deductible.

4. The tax deduction for any interest paid is not the amount of the loan repayments. Generally, any repayment comprises both interest and principal (unless it is an interest only loan). Taxpayers should only claim the interest portion of any loan repayments.

Repairs & Maintenance

Generally, there are 2 main types of repairs that a landlord will incur.

1. Initial repairs at time of purchase, and

2. Repairs because of tenant damage.

Let's have a look at each type of repair closer.

Initial repairs at time of purchase

Any expenditure incurred on initial repairs of recently acquired premises, where the expenditure is incurred in repairing defects existing at the date of purchase, is capital expenditure and generally not tax deductible.

However, a taxpayer may be able to include any initial repair costs undertaken for building write-off deductions and may also be included when working out any possible capital gains and/or losses when they dispose of the property.

Repairs because of tenant damage.

Generally, the question that needs to be asked in relation to such expenditure, is around Repairs versus Improvements.

>> Repairs - taxpayers can generally claim a deduction for maintenance and repairs to their investment property. A repair will involve restoring an item to its original condition. Examples of such expenses would include replacing broken windows, maintaining plumbing or repairing electrical appliances.

>> Improvements - taxpayers cannot claim a tax deduction for the costs of any alterations, additions or improvements to their investment property. For example, the building of a carport or garage or the installation of an air-conditioner. Some of these items could be depreciated.

Depreciation

Depreciation provides a basis for writing off the capital cost of an item over its estimated life. The cost of an item for depreciation purposes includes the original purchase price plus any installation costs incurred.

There are two main types of depreciation available to be claimed: -

1. Improvements

Depreciation is generally allowable as a tax deduction of any major expenditure where the expenditure has an effective life of greater than 12 months. For example, the installation of an airconditioner or perhaps the building of a decking area.

2. Structural items

Depreciation is generally not allowable on any items that form part of the building structure. Structural items can be distinguished from items of plant or articles by considering two factors: -

a) An item is part of the building structure if it cannot be detached without causing significant damage to the item or to the building - for example, built in wardrobes, wall insulation, plumbing or electrical wiring.

b) Some items which may be removed without causing significant damage such as kitchen cupboards, bathroom vanity units, doors and door furniture, would be essential parts of what comprises a residential building, therefore, are also not depreciable.

Building Write-Off Allowance

A taxpayer can claim a deduction for capital expenditure incurred in constructing and/or improving a rental property. This deduction is allowable on any capital works commenced after the 17 July 1985.

Any deduction claimed in respect of construction costs of certain buildings and structural improvements must be based on the actual costs incurred or, in circumstances where a taxpayer is genuinely unable to determine the actual costs, on an estimate by a quantity surveyor.

Unless they are otherwise qualified, valuers, real estate agents, accountants and solicitors generally have neither the relevant qualifications nor the experience to make such an estimate.

We hope that this summary gives you guidance on the types of investment property tax deductions available to help you legally minimise your taxation liability.

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