HEAD OFFICE
Lane Cove
Suite C, 161 Burns Bay Road
Lane Cove NSW 2066
ACN: 107 994 767

P: 02 9428 4000
F: 02 9428 4037
E: info@ozwideloans.com.au
W: www.ozwideloans.com.au

TAX TIPS FOR RENTAL PROPERTIES

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Rental properties are on the Australian Tax Office (ATO) radar screen, and many thousands of taxpayers with rental properties can expect to be contacted to explain and justify what they put in their tax return. If you have a rental property, here are some tax tips to consider.

1. Be able to justify your claim. Make sure you have receipts to justify the deductions you are claiming, and can justify the connection between the expense and deriving the rental income (eg it wasn't also for a private purpose).

2. Low cost depreciable assets.

- $300 or less. You generally get an immediate deduction for depreciable assets costing $300 or less. However if you purchased other items during the same tax year and together they form part of a set or are substantially identical, and the combined cost is more than $300, then each item must be separately depreciated.
- Between $300 and $1,000. Depreciable assets costing between $300 and $1000 can (subject to certain conditions) be "pooled" and the total cost depreciated at 37.5%, which may be quite favourable compared to separately depreciating them.

3. Allocating total purchase price. If you purchased the property with depreciable assets (eg dishwasher, clothes dryer), you must allocate the total purchase price between the property and other items on a reasonable basis. If the sale contract does allocate the purchase price, the ATO may challenge it if the amounts allocated appear unreasonable.

4. Part of the building. Items such as built-in wardrobes, swimming pools, electric cabling, and security screens are treated as being part of the building and are not depreciable assets. Expenditure on "capital works" - the building and surrounding structures, driveways etc - is generally deductible over 40 years at 2.5%. There are restrictions on claiming it on capital works already constructed when you purchased the property.

5. Improvements. The cost of repairs to the property that amount to an improvement, and don't merely restore it back to its original condition, is generally capital and not deductible.

6. Repairing existing wear / damage. The cost of renovations or repairs to fix damage or wear in existence at the time you purchased the property is generally capital and not deductible.

7. Renovate and sell. If your intention was to renovate and sell at a profit, rather than a long-term income producing investment, you may be taxed on the entire profit as a "profit-making scheme". It falls outside the capital gains tax (CGT) rules so you will not be eligible for the 50% CGT concession mentioned below.

8. Body corporate fees. Body corporate fees are generally deductible. However if a component is for a special-purpose sinking fund rather than general running of the complex, it may be capital and not deductible.

9. Travel to inspect property. You can claim a deduction for the cost of travel to inspect the rental property. If there was also a private purpose to the trip - eg a holiday or to visit family or friends - then you can only deduct a portion of the travel cost (potentially none if the property inspection was merely incidental to the private purpose for the trip).

10. Below market rent. If the property is rented to family or friends for below market rent, the ATO may treat this as a "private" arrangement and only allow you to claim sufficient deductions to offset the rent, but not to make a tax loss.

11. Mortgage with redraw facility. If the mortgage to purchase the property has a redraw facility, think carefully before re-drawing to fund something private such as buying a car or a holiday. The interest expense must be apportioned between the "deductible" and the "private" portion of the total borrowings, and the calculations can be complicated.

12. Selling the property. Make sure you declare in your tax return any capital gain when you sell the property. If you owned it for more than 12 months (and it wasn't a "profit making scheme" as mentioned above), you are only taxed on 50% of the capital gain (after first offsetting it against any capital losses). If you lived in the property at some stage as your main residence, speak to a Chartered Accountant about whether you qualify for the main residence CGT exemption (the rules can be complex).