

Rental properties

Avoiding common mistakes

There have been a number of common mistakes identified in the income tax returns of rental property owners. To help you, we've compiled a list of what you should do and common mistakes to avoid.

CONSTRUCTION COSTS

Certain types of construction – including extensions, alterations and structural improvements – can be claimed as capital works deductions. However, the land on which a rental property is constructed cannot be claimed. Instead, the land forms part of the cost for capital gains tax purposes.

Deductions can be claimed for the decline in value of some types of depreciating assets in residential rental properties (for example, curtains, blinds, dishwashers, refrigerators, stoves, television sets and hot water systems). However, construction costs are not depreciating assets.

Common mistakes include:

- claiming the cost of the land component as part of the cost of constructing the rental property.
- claiming construction costs as a decline in value of depreciating assets deduction instead of a capital works deduction.

Refer to *Rental properties* (NAT 1729) for a comprehensive list of residential property items and whether they are depreciating assets or capital works.

INITIAL REPAIRS AND CAPITAL IMPROVEMENTS

Initial repairs to rectify damage, defects or deterioration that existed at the time of purchasing a property are capital expenditure and may be claimed as capital works deductions over either 25 or 40 years, depending on when the repairs were carried out.

Capital improvements (such as remodelling a bathroom, or adding a pergola) should also be claimed as capital works deductions.

ⓘ A common mistake is to claim initial repairs or capital improvements as immediate deductions.

INTEREST

Taxpayers sometimes use their loan facility for both investing and private purposes – for example, to purchase or renovate a rental property and to buy a motor boat. The interest expense on the private portion of the loan (the motor boat) is not deductible.

ⓘ A common mistake is to claim a deduction for interest on the private portion of the loan.

LEGAL EXPENSES

Conveyancing expenses incurred on the purchase and sale of your property are not deductible. Instead, these form part of the cost for capital gains tax purposes.

ⓘ A common mistake is to claim a deduction for conveyancing costs.



TRAVEL EXPENSES

Where travel related to your rental property is combined with a holiday or other private activities, you may need to apportion the expenses. You may be able to claim local expenses that are directly related to the property inspection and a proportion of accommodation expenses.

ⓘ A common mistake is to claim a deduction for the cost of travel when the main purpose of the trip is to have a holiday and the inspection of the property is incidental to that.

DEDUCTIBLE BORROWING EXPENSES

The correct way to claim borrowing expenses of more than \$100 is to spread the deduction over five years or over the term of the loan, whichever is less. If your borrowing expenses are \$100 or less, you can claim the full amount in the income year they are incurred.

ⓘ A common mistake is to claim all deductible borrowing expenses in the first year they are incurred.

APPORTIONMENT OF RENTAL EXPENSES

In some situations, rental expenses may need to be apportioned. For example, if your holiday home is used by you, your friends or your relatives free of charge for part of the year, you are not entitled to a deduction for costs incurred during those periods.

It is also important that you have a clear intention to rent the property. If you made no attempt to advertise the property or set the rent so high it is unlikely a tenant could be found, we would find that you had no intention of renting your property and your rental claims would not be allowed.

ⓘ Some common mistakes are:

- claiming deductions for any expenses relating to your private use of the property
- claiming deductions for a property that is not genuinely available for rent.

OWNERSHIP INTERESTS

If you purchase a rental property as a co-owner and are not carrying on a rental property business, you must divide the income and expenses for the rental property in line with your legal interest in the property. This is despite any written or oral agreement between co-owners stating otherwise.

ⓘ A common mistake occurs when a property is purchased by a husband and wife (as co-owners) and the income and expenses are not split in line with their legal interest in the property.

➤ Refer to *Rental properties* (NAT 1729) for more information on how rental income and expenses should be split between co-owners.

WHAT RECORDS DO YOU NEED TO KEEP?

You need to keep proper records in order to make a claim, regardless of whether you use a tax agent to prepare your tax return or you do it yourself. You must keep records of:

- **the rental income you receive and the deductible expenses you pay** – keep these records for five years from 31 October or, if you lodge later, for five years from the date your tax return is lodged
- **your ownership of the property and all the costs of purchasing/acquiring it and selling/disposing of it** – keep these records for five years from the date you sell/dispose of your rental property.

➤ For information about easy ways to keep your records, refer to 'asset registers' in chapter 3 of part A of *Guide to capital gains tax* (NAT 4151).

➤ MORE INFORMATION

For more information about rental property expenses you can claim, refer to:

- *Claiming capital works deductions* (NAT 72840)
- *Claiming legal expenses* (NAT 71957)
- *Claiming interest expenses* (NAT 71956)
- *Claiming borrowing expenses* (NAT 71958)
- *Claiming repairs and maintenance expenses* (NAT 72841)
- *Rental properties* (NAT 1729)
- *Guide to capital gains tax* (NAT 4151)
- *Guide to depreciating assets* (NAT 1996).

To obtain copies of these publications or for more information:

- phone our publications distributions service on **1300 720 092**
- visit our website at **www.ato.gov.au/rental**
- phone us on **13 28 61** between 8.00am and 6.00pm, Monday to Friday.

If you do not speak English well and want to talk to a tax officer, phone the Translating and Interpreting Service on **13 14 50** for help with your call.

If you have a hearing or speech impairment and have access to appropriate TTY or modem equipment, phone **13 36 77**. If you do not have access to TTY or modem equipment, phone the Speech to Speech Relay Service on **1300 555 727**.

OUR COMMITMENT TO YOU

We are committed to providing you with guidance you can rely on, so we make every effort to ensure that our publications are correct.

If you follow our guidance in this publication and it turns out to be incorrect, or it is misleading and you make a mistake as a result, we must still apply the law correctly. If that means you owe us money, we must ask you to pay it but we will not charge you a penalty. Also, if you acted reasonably and in good faith we will not charge you interest.

If you make an honest mistake in trying to follow our guidance in this publication and you owe us money as a result, we will not charge you a penalty. However, we will ask you to pay the money, and we may also charge you interest.

If correcting the mistake means we owe you money, we will pay it to you. We will also pay you any interest you are entitled to.

If you feel that this publication does not fully cover your circumstances, or you are unsure how it applies to you, you can seek further assistance from us.

We regularly revise our publications to take account of any changes to the law, so make sure that you have the latest information. If you are unsure, you can check for a more recent version on our website at www.ato.gov.au or contact us.

This publication was current at **March 2009**.