Information for Investors – Individuals

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.

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.

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.

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.

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.

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.

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.

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.

Record keeping

One thing is certain: having a record of your expense is the best defence. So, if you make a claim, keep your records with your tax return. You must keep records of:

- rental income and expenses for five years from the date your income tax return is lodged
- ownership and all the costs of acquiring and disposing of your property for five years from the date you dispose of your rental property