June 2019 Rental News

Optio Advisor

Audits of ‘Dodgy’ Rental Deductions

Rental property owners are being warned to ensure their claims are correct this tax time, as the tax office has announced it will **double** the number of audits scrutinising rental deductions, with a specific focus on:

- over-claimed interest;
- capital works claimed as repairs;
- incorrect apportionment of expenses for holiday homes let out to others; and
- omitted income from accommodation sharing.

Assistant Commissioner Gavin Siebert said:

“A random sample of returns with rental deductions found that nine out of 10 contained an error. We are concerned about the extent of non-compliance in this area and will be looking very closely at claims this year.”

“We use a range of third-party information including data from financial institutions, property transactions and rental bonds from all states and territories, and online accommodation booking platforms, in combination with sophisticated analytics to scrutinise every tax return,” Mr Siebert said.

“Once our auditors begin, they may search through even more data including utilities, tolls, social media and other online content to determine whether the taxpayer was entitled to claims they’ve made".

The number one cause of the ATO disallowing a claim is taxpayers being unable to produce receipts or other documents to support a claim. ‘

Furnishing fraudulent or doctored records will attract higher penalties and may also result in prosecution.

The tax office has also reminded taxpayers that, since 1 July 2017, they can no longer claim travel expenses related to inspecting, maintaining or collecting rent for a residential rental property, unless they are an "excluded entity".

Capital Works or Repairs?

Do you know the difference between capital works and repairs?

Repairs or maintenance are things that are done to restore something that is broken, damaged or deteriorating. The damage must be the result of using the property to generate rental income. The repair basically restores the property to its former condition. Repair costs are deductible in the year that they were incurred.

Improvements includes work done that has the effect of renewing or replacing a substantial part of the structure. This includes renovations of whole rooms within the property, work that extends the life of the property or improves the value of the property. Improvements or renovations are categorised as capital works and are deductible over a number of years.

Initial repairs for damage that existed when the property was purchased such as repairing damaged floorboards or walls, can’t be claimed as an immediate deduction. These things would increase the value of the property. These expenses may be claimed over a number of years as a capital works deduction.

Deduction of Holding Costs

Deductions can generally only be claimed in relation to a rental property during a period that the property is either actually rented to tenants or genuinely available for rent. In the past, an exception to this rule was the deduction of costs incurred in holding a property (interest, rates, land tax, insurance) where there is the intention to generate income from the property at some stage in the future. Providing the intention to use the property to generate income existed at all times, a deduction was allowed for costs incurred before the property was rented and rent received.

As part of the 2018/19 Federal Budget, the government has proposed that it would deny deductions for expenses associated with holding vacant land (i.e. where the land is **not** genuinely held for the purposes of producing assessable income). The proposed laws however extend this denial beyond vacant land.

The proposed law includes the circumstances that where the land contains residential premises that have been constructed or substantially renovated, will still be considered to be "Vacant" land until those premises are lawfully able to be occupied (an occupancy certificate has issued) and actually rented or it can be demonstrated to be available for rental.

This means that an individual taxpayer will not be able to deduct the costs of holding land which has residential premises, until they are actively seeking to derive income from the property. The proposed law does not allow these holding costs to be carried forward and deducted against future rental income. Instead it is proposed that the holding costs be added to the "cost base" of the property and allowed as a deduction against the sale proceeds of the property when calculating capital gains tax.

At this stage a draft of the proposed legislation has been released, but the actual legislation has not been introduced into Parliament and is therefore not yet law. The proposed starting date for the changes to deductibility is 1 July 2019, so if you are planning renovations which will make your property unavailable for rental, or the purchase of vacant land on which to construct a rental property, you should take into consideration how the proposed changes will affect your tax situation.

Rental Property Travel Deductions

Deductions for travel expenses relating to your residential rental property have not been deductible since **1 July 2017**. This deduction restriction applies to all residential rental properties regardless of when they were purchased.

The denied travel expenses include not only motor vehicle travel, but also bus, train and air fares, accommodation and meals whilst travelling, parking and road tolls. The denied travel also includes travelling to meet with real estate agents, attend body corporate meetings and travel to collect materials to undertake repairs and maintenance.

Prepaying Investment Loan Interest

It can be helpful to bring forward any expenses that can be paid before 30 June and claim them in the current financial year. You may be able to negotiate with your finance provider to pay next year's interest upfront for the investment property loan and be allowed a deduction this year. Most taxpayers can claim a deduction for up to 12 months ahead.

Note that whilst this strategy boosts this year's deduction, it results in a lower deduction being available in the following year. The use of this strategy is most effective when you have a taxable income that will be much higher this year compared to next year.

Tax agent
00169002

Optio Accountants

8/53 Monash Road
Tarragindi QLD 4121

PO BOX 360
Holland Park QLD 4121

Phone: 07 3221 2000
Email:
client@optioacc.com.au
Web:
www.optioacc.com.au

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