THE RENTAL INVESTMENT UPDATE

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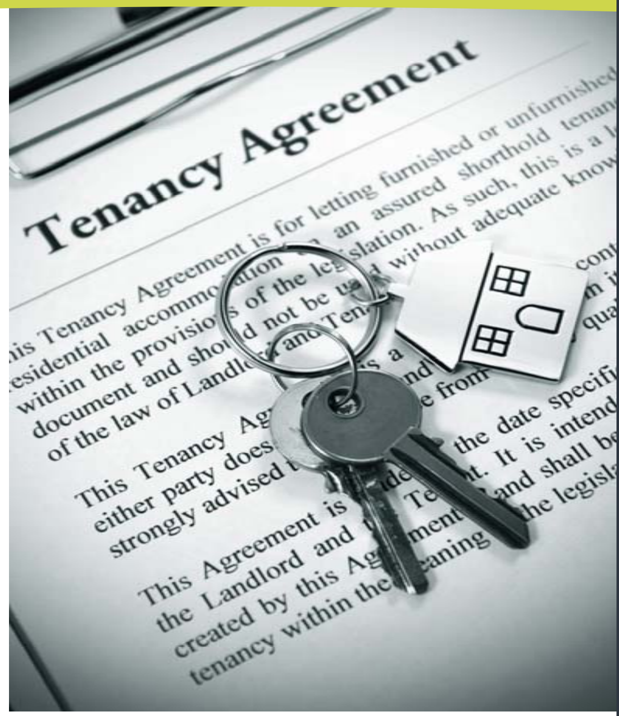
INTEREST DEDUCTION GUIDELINES FOR RENTAL PROPERTIES



The following checklist summarizes the general guidelines that need to be considered when claiming interest deductions in relation to a rental property. The checklist deals with a range of common situations in which interest deductions may be available in respect of a rental property.

1. Interest can be claimed as a tax deduction to the extent that a loan was used to acquire a rental property. Where any part of a loan was used for private purposes (e.g., to buy a family car), interest on this portion of the loan is not deductible.

2. Interest is generally deductible over a period that a rental property is either genuinely available for rent (e.g., listed with a real estate agent for rent) or actually rented to tenants.

3. As *exceptions* to **2.**above, interest can be deductible during a period that: a rental property is being built; work Is done to a rental property after purchase to prepare the property for rental (e.g., to make the property more attractive to tenants) and a rental property is taken of the market for repairs/improvements, provided that the taxpayer's intention was always to use the property for income-earning purposes (i.e., as a rental property).

4. As a further *exception* to 2. interest can also be deductible during the period prior to the settlement date for the purchase of:

- an existing rental property;
- land (upon which a rental property will be constructed); and

a rental property acquired 'off-the-plan' provided that the taxpayer's intention was always to use the property for income-earning purposes (i.e., as a rental property).

CLAIMING INTEREST DEDUCTIONS FOR A RENTAL PROPERTY

5. Interest deductions can be claimed in respect of the outstanding balance of any loan that exists on a taxpayer's former residence during a period when a taxpayer's former home is available for rent or rented to tenants (i.e. interest deductions are available when the property becomes income producing).

6. Interest deductions can be claimed where borrowed moneys are used:
for repairs and/or renovations to a rental property;
to buy depreciable assets for a rental property; or
to pay for deductible rental property expenses.

7. Interest expenses incurred on a joint loan used to purchase a jointly owned rental property are basically claimed according to the legal ownership interests of each owner (e.g., on a 50/50 basis).

8. Interest on a joint loan used to buy a rental property solely in the name of one of the parties to the loan may be deductible in full in the name of the owner of the property.

9. Interest deductions must be apportioned in respect of a mixed purpose loan account (e.g., a loan account which was originally used to acquire a rental property, but whose balance subsequently fluctuates as a result of regular deposits and withdrawals which are used for private purposes).

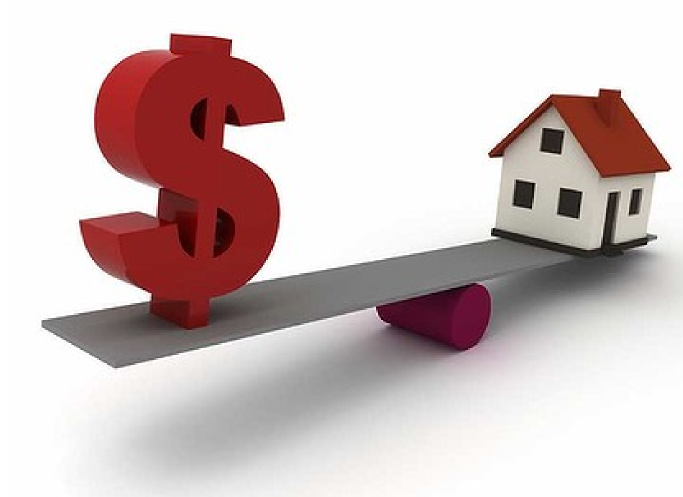
10. Interest deductions in relation to a linked or split loan are generally limited to the interest amount that would have been charged under a normal principal and interest loan (i.e., no deduction is available in respect of compound interest, which is interest that accrues on capitalised interest).

11. Penalty interest incurred on the early repayment of a rental property loan (e.g., due to refinancing the loan) is deductible in certain circumstances.

12. NO deduction is available for deposit bond/bank guarantee fees incurred in respect of the purchase of a rental property.

13. Interest is generally deductible after a rental property is sold in respect of any loan shortfall amount where certain conditions are met.

14. Borrowing expenses (e.g., establishment fees, legal fees, stamp duty, valuation and survey fees, and broker's commission) are generally ***not*** fully deductible in the year in which they are incurred.



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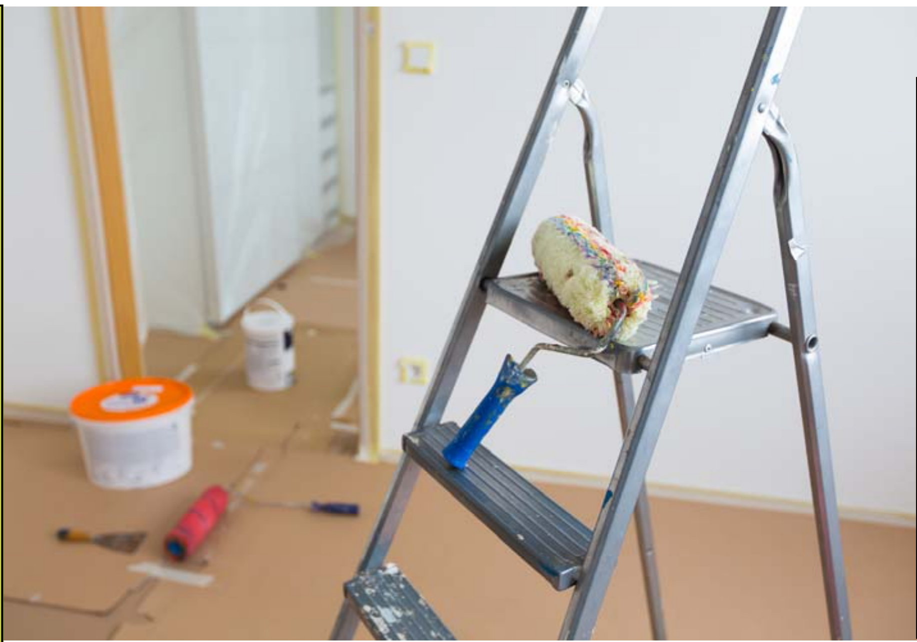

REPAIRS TO A RENTAL PROPERTY FORMERLY USED AS A HOME

In recent years, there has been an increasing tendency for home owners to use an existing home as a rental property, especially in circumstances where a new home has been purchased.

In these situations, it is common for tax-

payers to undertake repairs and maintenance to their existing home in order to make it more attractive to prospective tenants. However, it has been identified that many taxpayers tend to claim deductions for repair and maintenance expenditure before the property is available for rent and/or actually rented to tenants.

Generally, a landlord is entitled to claim a deduction (in whole or in part) for expenditure incurred on repairs to a rental property, under S.25-10, where:

- the expenditure qualifies as a 'repair'; at the time the expenditure is incurred, the property is being **held or used** (wholly or partly) for income-producing purposes; and the expenditure is **not** of a capital nature.

According to the ATO, **no** deduction will be available for repair expenditure that is incurred before a taxpayer's home is **held or used** for income-earning purposes (e.g., before the property is genuinely available for rental). agent}

For example, where a taxpayer moves out of their home and undertakes repair work to the property before the property is put on the market for rent (e.g., listed with the local real estate to make it more attractive to prospective tenants, **no** deduction can be claimed for repair expenditure that is incurred before

TAX TIP

Where appropriate, a taxpayer should consider 'holding off' undertaking house repairs to the former home until the property is either genuinely available for rent (eg listed with a real estate agent for rental) or actually rented to tenants.

In these circumstances, a deduction for repairs may be available even though:

- The property was previously used by the taxpayer for private purposes (i.e. as the taxpayers home) and;
- Some or all of the defects, damage or deterioration are attributable to the period the property was used as the taxpayers' home.