Messenger Zerner

Chartered Accountants

TECHNICAL GUIDE NO 8

RENTAL PROPERTIES

Many taxpayers purchase commercial, industrial or residential properties for investment purposes, and require assistance in preparing income and expense schedules for their tax returns. It is important that properties are always purchased with the intention of generating a rate of return consisting of net rents and capital gain that exceed the cost of borrowing funds to purchase the property. The tax concessions available are secondary to the investment decision and assist in making the investment more commercially attractive. Here are some points to consider when purchasing a property for rental.

1 Negative Gearing

Negative gearing is borrowing funds to purchase a property such that the interest cost exceeds the net rents received and creates a deductible tax loss. It is expected that the capital gain accruing over the ownership period will exceed these losses so that an overall investment gain is achieved.

2 Deductions

The following property expenses are tax deductible:-
Council rates, water rates, emergency services levy, land tax, insurance, strata maintenance, agent management fees, lease fees, advertising, repairs and maintenance, depreciation, property inspection costs (travelling), interest and borrowing costs.

3 Depreciation

Deprecation on “movable” fixtures and fittings can be claimed. This includes a hot water service, stove, air-conditioner, light fittings, curtains and blinds, carpets and other loose furniture and equipment. Items that are not subject to deprecation are kitchen and other built-in cupboards, bathroom shower screens, baths and vanity basins and laundry basins. An appropriate cost needs to be assigned to these assets at the date of purchase. (refer next point)

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4 Building Allowance

A building allowance can be claimed on properties constructed after 17 July 1985 at the rate of 2.5% pa on the actual construction cost, not on the value at the date of purchase. If this actual cost is not known, then the Taxation Office requires a professional valuation to be done by a qualified quantity surveyor. This report should also include the value of the fixtures and fittings at the date of purchase. Even if the original property was constructed before 1985, any renovation or extensions done after that date can be subject to the building allowance claim. The cost of the quantity surveyor's report is tax deductible.

5 Repairs and Maintenance

The cost of normal repairs and maintenance incurred as tenancy wear and tear are tax deductible. Any larger renovation or improvement costs are capital and subject to either depreciation or building allowance claims. The issue of the deductibility of repairs and maintenance is very complex and advice should be sought before proceeding on large expenditures.

6 Borrowing Costs

Upfront borrowing costs on loans such as application fees and stamp duty on mortgages are claimable over five years or the period of the loan if less than 5 years.

7 Capital Gain

The taxable capital gain on the sale of a rental property is calculated as follows:-

Gross sale proceeds less selling cost and fixtures and fittings allocation.	X
Less Purchase cost including stamp duty and conveyancing costs less fixtures and fittings allocation.	X
Capital Gain	X
Less 50% General Discount	X
Taxable Capital Gain	X

The cost and proceeds for fixtures and fittings is extracted from the above amounts and dealt with separately on the depreciation schedule. The taxable capital gain is included on the taxpayers tax return and taxed at the marginal rates of the taxpayer.

Summary

The tax treatment of purchasing, renting and selling of properties can be very complex, and we recommend that you obtain advice from us on any larger or unusual transactions before proceeding.