How Far Will ATO Go in pursuing Landlords and Deductions?

With their improved systems and their vast resources, ATO usually takes the weakest case to court in their pursuit to establish a precedent that they can apply to all other cases. This is difficult as the majority of situations are never black and white … they all shades of grey. See below for such as a pursuit by ATO and the outcome.

While the stock market has only recently showed signs of life, it has been weak. Many people have concluded that managing their own funds for retirement is a better alternative. Using the low tax rates and asset protection benefits available to SMSF have attracted many to form one. Due to increasing interest and queries we are receiving we are planning a few articles on the basics of SMSF formations. Look out for those in the future.

The tax compliance year is in full swing. Many clients have rushed in to get their refunds in before Christmas. To help save time/money and guide them through the process, ***Property Tax Specialists*** clients receive a comprehensive checklist and templates.

Contents

Landlords, the ATO and deductions

One in seven taxpayers in Australia are property investors. Each year we claim around $5 billion in rental losses. So you can understand the Australian Tax Office's (ATO) close scrutiny of the deductions claimed by landlords. But a recent case before the Administrative Appeals Tribunal (AAT) demonstrates how far the ATO will go to test the boundaries of what is and isn't deductible.

In this case the taxpayer owned a property in country NSW. The owner stated that the property was available for rent but she had been unable to find tenants. As a result, the property did not derive any income for a number of years. The owners however had incurred the costs of interest on the property loan, maintenance costs, and rates, which they claimed as a deduction.

The Tax Commissioner had a different view and denied the deductions. **The central issue was whether the property was genuinely available for rent**. If it was not available for rent then the expenses incurred by the taxpayer are not deductible. If the property was available for rent, then the expenses are deductible. This is because you must show that the expenses were incurred in gaining or producing income, even if no income was actually produced in that income year.

What's interesting in this case is how far the ATO will go. The ATO used **electricity** and **telephone records** **to argue that the taxpayer had been living in the property and that it was not genuinely available for rent**. Fortunately for the taxpayer, the **AAT accepted** that she had only lived in the property while carrying out repairs and maintenance work. So, even if a property is not deriving rental income during the relevant income year, taxpayers may still be entitled to deductions for interest expenses, council and water rates and other holding costs. The key issue is whether the property is genuinely available for rent and **whether continuing efforts are being made to improve the property to attract renters**.

The AAT also accepted the taxpayer's argument that she had genuinely tried to rent the property. She had evidence of some limited newspaper advertising but stated that the most effective way to find tenants for this particular property was through word of mouth.

The case did not go all the taxpayer's way. The AAT upheld the Commissioner's decision to disallow a number of deductions because of a **lack** **of supporting documentation**.

Broadly, there are two types of rental property expenses you can claim:

- Expenses you can claim **in the year that you paid for them** – for example,
  > council rates,
  > repairs,
  > preparation of lease agreements,
  > insurance and
  > loan interest; and
- Expenses that are deductible over a number of years - these are either:
  - Depreciating assets - where deductions are claimed against income over the life of that asset. For example, if you replaced an electric hot water system in your rental property, you can claim a deduction for the hot water system over its life, in this case 12 years.
  - Capital works – where deductions are claimed for building construction and structural improvements. For example, remodelling a bathroom or building a pergola are considered to be capital works and written off at the rate of 2.5% per year.

If it's **new**, **bigger** and **brighter** than what was already there, it's **likely to be capital expenditure** and depreciated. But, to claim a deduction, the property must be genuinely available for rent.

If we can assist you with any additional information about your rental property and how to manage it effectively, please contact us.

Did you know this about SMSF's?

- 36,270 new Self Managed Superannuation Funds (SMSF) were established between 1 July 2011 and 30 June 2012.
- As at 30 June 2012, there were 478,263 SMSFs holding $438,995 million in assets.
- The median assets per SMSF as at 30 June 2011 was **$539,486** (the average was $963,002).

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For those who may be they are missing out we are preparing a few articles on SMSF basics. If you are interested in being on the mailing list to receive these, respond to this newsletter with 'SMSF' on the subject line.

Quote of the month

"It is not in the stars to hold our destiny but in ourselves."

William Shakespeare

Checklists and Templates

To make the compilation & reporting task for 2012 tax returns easier, clients of **Property Tax Specialists** receive checklists and templates to facilitate the process ... **saving them time and money** ... the 'write' way is having clear documentation. ATO way means time/money wastage with audit investigation.

Two heads are better than 1? Discuss your plans? Call to chat ...

Contact us if you would like to

- review & discuss your current property & tax situation ... maybe the next deal or
- whether or not to sell a property, which one in the portfolio should be sold
- your asset protection strategy. What is your risk profile? High ..medium ..low
- structuring your next investment property. In whose name should it be?
- Should you rent out your home and live closer to work in a rented space
- Should you invest your capital in 1 Main Residence or 2 smaller rental properties
- planning to legally minimise your tax position or just to explore the possibilities
- Subdividing a block or your Main Residence … Capital Gain or Business Profit?
- Is your Self Managed Super Fund ready to acquire a property
    1. with limited recourse loans
    2. from lending institutions or yourself
- prepare your next tax return or application to reduce your PAYG Withholding

We look forward to being of service. We also look forward to your **referrals**.

To improve our service we welcome all constructive comments on this newsletter and other materials.

Call/email **Shukri Barbara** at Property Tax Specialists at Shukri@propertytaxspecialists.com.au

DISCLAIMER

The material and contents provided in this publication are informative in nature only. It is not intended to be advice and you should not act specifically on the basis of this information alone. If expert assistance is required, professional advice should be obtained. Contact your accountant or Property Tax Specialists at info@propertytaxspecialists.com.au or call 02 9411 8133

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