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ATO warning to rental property owners: don't let your tax return be a 'fixer-upper'

The ATO warns rental property owners to ensure that their tax returns are correct this tax time.

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The Australian Taxation Office (ATO) is warning rental property owners that their tax returns are in the spotlight this tax time.

ATO Assistant Commissioner Rob Thomson explained the ATO has found the majority of rental property owners are making errors in their tax returns, despite 86% using a registered tax agent.

The most common mistake is not understanding what expenses can be claimed and when. In particular, the difference between what can be claimed for repairs and maintenance versus capital expenses.

Other mistakes on the ATO's radar include overclaimed deductions and a lack of documentation to substantiate the expenses claimed.

'We understand rental property owners may already have long lists of things to fix in their properties. But by getting your tax return right the first time, you'll avoid having to add 'fix up tax return' to your to-do list down the track,' Mr Thomson said.

The ATO receives data from a range of sources like banks, land title offices, insurance companies, property managers and sharing economy providers, and cross checks this data to determine the accuracy of tax returns lodged by rental property owners.

'If you use a tax agent, make sure you let them know all about your rental property, including full records of your expenses. If you have a nagging question or something doesn't make sense, make sure you ask your agent when you're working with them.'

‘Rental property investments and taxation can get tricky, so it pays to get the right advice from the very beginning. Don’t rely on things you hear at a Sunday afternoon barbeque’, Mr Thomson said.

Dodgy deductions

Rental property owners can claim deductions only to the extent they’re incurred in producing income. This means any costs you incur in generating rental income each year, may be claimed for the same period. There are some exceptions.

‘It’s normal for landlords to have to fix or replace damaged items in a rental property. But there is a bit of a myth that all expenses can be claimed immediately.'

‘A repair can usually be claimed straight away but capital items, think dishwashers, curtains or heaters, can only be claimed immediately if they cost $300 or less, otherwise they need to be claimed over time,’ Mr Thomson said.

‘We sometimes see rental property owners ‘double dip’ on expenses that the property manager has arranged and included on the property’s income and expenses report for the year. Often, property managers will pay for expenses like repairs from the rent received. The amount they then remit to the property owner is net of these expenses. They will also send the property owner a copy of the invoice for their records.’ Mr Thomson said.

Rental property owners can only claim for amounts that they incur, so even if there are two records for the same expense, the amount can only be claimed once.

One of the most common deductions claimed by rental property owners is interest on mortgages. Based on previous years data, the ATO estimates incorrectly reporting interest expenses account for 42% of the $1.2 billion Individuals Not in Business tax gap associated with rental properties.

A common issue with interest deductions is where taxpayers are redrawing or refinancing a loan for their rental property and using the money to pay for private expenses like a new car, school fees or a holiday, then claim the whole amount of interest charged on the investment loan for the year as a deduction.

‘For example, if you have an $800,000 mortgage for a rental property and then add $50,000 to the loan to upgrade your family car, you can only claim the interest on the initial $800,000, not the interest on $850,000.’

‘It’s also not a matter of simply paying back the private part of the loan and then claiming all interest as deductible. Payments must be apportioned between the private and investment components for the life of the loan,’ Mr Thomson said.

A deduction can be claimed for levy payments to body corporate administration funds and general-purpose sinking funds at the time they are incurred, as long as the fees are used for routine maintenance of common property. However, if the body corporate requires payments to a special purpose fund to pay for a particular capital expenditure, like replacing the roof of an apartment building, these levies are not deductible until the capital works are complete and the expense has been billed to the body corporate.

Costs relating to borrowing expenses, including loan establishment fees, lender’s mortgage insurance and title search fees, are also commonly being claimed incorrectly. These costs are generally claimed over a 5-year period or the life of the loan, whichever is less. State or territory stamp duty can’t be claimed as a deduction while you rent the property (except in the Australian Capital Territory). You need to keep these records until you sell, when the amount will be added to your cost base to reduce any capital gain you may have on the sale.

Risky records

A lack of documentation to substantiate claims of expenses and deductions is another leading cause of errors.

‘You need to keep detailed and complete records, including receipts, invoices and bank statements for interest expenses. You should also detail how you calculate your deductions and any apportionments. This will allow you or your tax agent to correctly complete your tax return,’ Mr Thomson said.

Records can be paper or electronic, but must include details such as:

- The name, ABN or business name of the supplier
- the amount of the expense

- the nature of the goods or services you purchased
- the date you bought the goods or services
- the date the document was produced.

Claims for capital works aren't based on the purchase price of your property, but the construction cost when it was built. This information can be used to create a comprehensive capital works deduction schedule. A quantity surveyor or suitably qualified professional can help to prepare a capital works deduction schedule, but this is not mandatory.

'Taxpayers are responsible for what they include in their tax return, even when using a registered tax agent. If you don't have sufficient records, you can't claim it,' Mr Thomson said.

Careless capital expense claims

The ATO is also warning rental property owners about incorrect claims for capital expenses.

Repairs such as fixing a dishwasher can generally be claimed immediately but buying a new dishwasher cannot.

Some expenses including improvements and capital works must be claimed over time, for example remodelling the bathroom in your rental property. In most circumstances, capital expenses are claimed at 2.5% over 40 years. Any unclaimed capital works expenses are added to the cost base of the property for capital gains tax purposes when you sell.

'Spending money to fix something could be a repair, initial repair, capital works, or a depreciating asset. Our Investor toolkit can help you to understand the difference, as the amount you can claim as a deduction this tax time will depend on which category it falls into,' Mr Thomson said.

Case study: Claiming cooktops

A taxpayer in Melbourne purchased a rental property and listed it on the rental market. The ATO selected the taxpayer for review shortly after.

During the review, the taxpayer's registered tax agent provided a list of deductions claimed, where it was identified that certain assets were listed as immediate deductions.

The taxpayer was claiming new blinds, a cooktop and air conditioners as immediate deductions which was incorrect. The items should have been categorised as depreciating assets and claimed over time.

The taxpayer also purchased a new cooktop for their personal home in the same transaction and tried to claim both cooktops in their tax return. The ATO queried this as the rental property only had one kitchen.

The taxpayer didn't provide proper records to their registered tax agent and the agent also didn't question the claims. This meant mistakes were made in the taxpayer's return that were avoidable.

The taxpayer's return was adjusted by the ATO, and the taxpayer also had to pay penalties and interest.

Notes to journalists

There are a range of **resources** available on our website, including the **Investors toolkit** that provides guidance for anyone earning money from their investments.

See **ato.gov.au/rentalvideos** for our rental video series.

ATO file footage is available for use in news bulletins from our media centre.

A headshot of ATO **Assistant Commissioner Rob Thomson** is available for download from our media centre.

Assistant Commissioner Rob Thomson is available for interviews on request to the Media Unit.

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