

# ***PCG 2026/2 - Apportionment of rental property deductions - ATO compliance approach***

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⚠ There is a Compendium for this document: **PCG 2026/2EC** .



## Practical Compliance Guideline

# Apportionment of rental property deductions – ATO compliance approach

### **📌 Relying on this Guideline**

This Practical Compliance Guideline sets out a practical administration approach to assist taxpayers in complying with relevant tax laws. Provided you follow this Guideline in good faith, the Commissioner will administer the law in accordance with this approach.

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### **What this Guideline is about**

1. When you use a property to produce assessable income and hold it for another use (for example, part of a property is rented out and part of the property is your residence), losses and outgoings related to the property will need to be apportioned on a ‘fair and

reasonable' basis to work out the deduction that can be claimed under section 8-1 of the *Income Tax Assessment Act 1997*.

2. It may be difficult to determine what is fair and reasonable because it will depend on the facts and circumstances that relate to how you use your rental property.<sup>1</sup> This Guideline sets out methodologies that we will accept as fair and reasonable in common situations. If you are eligible to use this Guideline and work out your apportionment using the most appropriate methodologies detailed in this Guideline, the Commissioner would not have cause to apply compliance resources to investigate your claim.<sup>2</sup> You will need to keep records to support your view that the Guideline applies to you, and how you made your apportionment calculations.

3. The methodologies set out in this Guideline build on and are consistent with the approach taken in Taxation Ruling TR 2026/1 *Income tax: rental property income and deductions for individuals who are not in business* and previously in Taxation Ruling IT 2167 *Income Tax: rental properties – non-economic rental, holiday home, share of residence, etc. cases, family trust cases* (now withdrawn). They are not exhaustive of methods that may be appropriate to your circumstances. You can use a different method to work out your apportionment of expenses, but you will not be covered by this Guideline, and you will need to establish why the method that you have chosen is fair and reasonable in your circumstances. You will need to keep records to support how you made your apportionment calculation, and why the method that you have chosen is fair and reasonable.

4. All further legislative references in this Guideline are to the *Income Tax Assessment Act 1997*, unless otherwise indicated.

### **What is not covered by this Guideline**

5. This Guideline does not apply to:

- individuals who use rental properties in carrying on a business<sup>3</sup>, or
- entities that are not individuals.

6. This Guideline does not apply to deductions that relate to the ownership or use<sup>4</sup> of your property which is a holiday home.<sup>5</sup> There is an exception to deductions being denied in full where you use your holiday home (or hold it for use) mainly to produce income in the nature of rents, lease premiums, licence fees or similar charges.<sup>6</sup> When this exception applies, you can use this Guideline to apportion your deductions for any private use of your rental property.

<sup>1</sup> Paragraphs 25 to 29 and 78 to 79 of Taxation Ruling TR 2026/1 *Income tax: rental property income and deductions for individuals who are not in business* explain 'fair and reasonable' apportionment.

<sup>2</sup> There may be circumstances where, because of the disproportion between the amount of your income when compared to the amount of your deductions from your rental property, the principles in Taxation Ruling TR 95/33 *Income tax: subsection 51(1) – relevance of subjective purpose, motive or intention in determining the deductibility of losses and outgoings* apply and the methods relating to apportionment based on time and area in this Guideline do not apply to you. See paragraph 52 of this Guideline.

<sup>3</sup> See paragraphs 12 to 18 of Taxation Ruling TR 97/11 *Income tax: am I carrying on a business of primary production?* for indicators of being in business if you are unsure whether you are carrying on a business.

<sup>4</sup> See paragraphs 35 and 94 to 95 of TR 2026/1 for an explanation of which losses and outgoings relate to the ownership and use of a holiday home.

<sup>5</sup> If your property is a holiday home and deductions for expenses are denied under section 26-50, you cannot apportion expenses which relate to those denied deductions because deductions for these expenses are not available to you, see paragraphs 30 to 35, 86 to 95 of TR 2026/1.

<sup>6</sup> See paragraphs 37 to 43 and 103 to 126 of TR 2026/1 and also PCG 2026/3 *Application of section 26-50 of the Income Tax Assessment Act 1997 to holiday homes that you also rent out – ATO compliance approach*.

**Date of effect**

7. This Guideline applies to years of income commencing both before and after its date of issue.

**Terms used in this Guideline**

8. For the purposes of this Guideline, and for ease of expression:
- 'Holiday home' refers to a property, which is a type of leisure facility<sup>7</sup>, that is used (or held for use) for your holidays or recreation (or the holidays or recreation of your family members and friends for no rent or at a reduced rate).
  - 'Property' refers to land, a building, or part of a building or other structure that you own or lease.
  - 'Rental property' refers to property which you provide to others under a lease or licence or similar agreement in return for rent, lease premiums, licence fees or other similar charges. Your residence or your holiday home may also be a 'rental property' if it is the subject of a similar arrangement or agreement.

**Multiple rental properties**

9. If you hold multiple rental properties, each property needs to be examined separately to determine what is a fair and reasonable apportionment of deductions for that property. You should apply the principles in this Guideline to each property.

**Expenses related directly to renting out the property**

10. Some expenses relate directly to deriving income from your rental property and do not require apportionment.

11. These expenses can include but are not limited to:
- agents' fees
  - sharing economy platform commissions
  - advertising costs
  - cleaning and laundering costs relating to guest stays.

**Example 1 – agent fees**

12. *Fleur rents out her property through an agent who charges her an ongoing property management fee and a letting fee when they find new tenants for the property. In total, Fleur pays \$3,180 in agent fees which will be fully deductible against her rental income. There is no need to apportion the expense.*

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<sup>7</sup> A leisure facility is land, a building, or part of a building or other structure, that is used (or held for use) for holidays or recreation.

**Where apportionment is required**

13. For deductions which are not denied in full because your property is a holiday home<sup>8</sup>, expenses which relate to deriving income from your property and for another use (such as, private or domestic use)<sup>9</sup> will need to be apportioned on a fair and reasonable basis. What is fair and reasonable usually depends on the:

- period of time the property was rented out – referred to in this Guideline as the ‘time-based’ method
- area of the property rented out (area of the property used by tenants or guests) – referred to in this Guideline as the ‘area-based’ method.

You may need to use a combination of the time-based method and the area-based method if you rented out part of your property for part (or parts) of the year.

**Time-based method**

14. Where deductions are not denied because your property is a holiday home<sup>10</sup>, you can work out the amount you can claim as deductions for your property using the following formula during periods when it is used (or held) for income-producing purposes at any point during the year:

$$\frac{\text{(days used to produce income + days held to produce income)}}{\text{number of days in the income year you owned the property}} \times \text{expenses}$$

Where:

- days used to produce income is the number of days your property is occupied for rent, which includes days for which rent is paid even if the property is not physically occupied
- days held to produce income is the number of days your property is unoccupied but available for rent on commercial terms.

15. In determining the days held to produce income, whether your property is available for rent on commercial terms (for the periods that your property is unoccupied) will depend on the facts and circumstances. Where you are renting out a room in your home, the number of days your property is unoccupied but available for rent on commercial terms will be zero. This is because when a room in your home is not being rented out, it is treated as being used privately as part of your home and is not considered available for rent on commercial terms.

16. Factors that indicate, on an objective analysis, that your property is available for rent on commercial terms include:

- it is advertised in ways which gives it broad exposure to potential tenants
- the rental terms, including the rental rate, are similar to comparable properties in the same area
- requests to rent the property are actively monitored.

<sup>8</sup> If your property is a holiday home and deductions for expenses are denied under section 26-50, you cannot apportion expenses which relate to those denied deductions because deductions for these expenses are not available to you, see paragraphs 30 to 34 and 86 to 93 of TR 2026/1.

<sup>9</sup> As explained in paragraphs 78 to 85 of TR 2026/1.

<sup>10</sup> See paragraph 6 of this Guideline.

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17. Factors that indicate, on an objective analysis, that your property is not available for rent on commercial terms include:

- it is advertised in ways that limit its exposure to potential tenants – for example, the property is only advertised
  - at your workplace
  - by word of mouth
  - during periods when the likelihood of it being rented out is very low
- the property is blocked out for private usage by you or your family and friends (at less than market rates) during periods of likely rental demand
- the location, condition or accessibility to the property mean that it is unlikely tenants will seek to rent it
- unreasonable or stringent conditions are placed on renting out the property, when compared to similar properties, that reduce the likelihood of the property being rented out, such as
  - setting the rent above the rate of comparable properties in the area
  - requiring prospective tenants to provide references for short holiday stays as well as having conditions like ‘no children’
  - making parts of the property inaccessible to tenants
- requests to rent the property are not actively monitored or refusals to rent the property to interested people are made without adequate reasons.

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**Example 2 – private use by owners during peak periods with little or no demand for property at other times**

18. *In summer, chefs Daniel and Kate relocate to and live in a cottage they own so they can work at a nearby restaurant. Because Daniel and Kate do not use the house for their holidays and recreation, it is not their holiday home. The house is located in an area that is popular with summer holidaymakers but has limited rental potential as a holiday destination during the colder seasons.*

19. *When they are not living in the house, Daniel and Kate occasionally rent the property to itinerant workers based on word of mouth only. Daniel and Kate only rent the house out for 14 days of the year.*

20. *On an objective assessment of the relevant factors, the property is not held to produce income during the periods the property is unoccupied. Daniel and Kate can claim a deduction for a proportion of their expenses based on the days the property was used to produce income, being 14 out of 365 days.*

**Example 3 – private use of property by owner where property is actively rented at other times**

21. *Gail and Craig jointly own a rental property. They advertise the property for rent through a real estate agent. Gail and Craig can show that the rental terms, including the amount of rent, for the property are similar to comparable properties in the area. Gail and Craig have instructed the real estate agent to actively monitor requests for rental so as to maximise occupancy for the property.*

22. Gail and Craig do not use the property for their holidays or recreation, so it is not their holiday home. They do however use the property themselves for 30 days during the year.

23. During the year, Gail and Craig's expenses for the property are \$36,629. This includes \$1,828 for the agent's commission and the cost of advertising for tenants. It also includes interest on the funds borrowed to purchase the property, property insurance, maintenance costs, council rates, the decline in value of depreciating assets and capital works deductions.

24. Gail and Craig claim the full \$1,828 as a deduction for the agent's commission and costs of advertising for tenants. They can also claim deductions for their other expenses (\$34,801) based on the time-based method. Gail and Craig will need to apportion their deduction for the year (which is not a leap year) as follows:

$$\frac{\text{(days used to produce income + days held to produce income)}}{365 \text{ days}} \times \text{expenses}$$

$$335 \div 365 \times \$34,801 = \$31,940$$

25. This calculation removes the portion of total expenses attributable to private usage.

### **Time-based method when there is a change in use of the property**

26. Where there is a clear change in use of a property during the year, such as when the property is first used as a rental or stops being used as a rental, the time-based method can be used to apportion expenses between these periods. The change in use of the property should be definite and is determined on the particular facts and circumstances of the actual use of the property. The use of the property is not considered to change merely due to fluctuations in use due to seasonal patterns, such as with a ski lodge or beach house.

### **Example 4 – change in use of the property during the income year**

27. Sachin owns a property in Tasmania which he has rented out for long-term rentals for 10 years. After he retires, he decides to move into the Tasmanian property. He moves into the Tasmanian property on 1 March as his main residence. From that day the property is being solely used for private purposes and he would need to apportion his deductions for that income year.

28. Because Sachin's property stopped being used for income-producing purposes during the year (which is not a leap year), he uses the time-based method. Sachin paid interest of \$28,000 in the year, and he will need to apportion it as follows:

$$\frac{\text{(days used to produce income + days held to produce income)}}{365 \text{ days}} \times \text{expenses}$$

$$243 \div 365 \times \$28,000 = \$18,641.10$$

**Area-based method**

29. If only part of your property is rented out to a tenant or used to produce income, you apportion expenses to reflect the area of the property that is used to produce income using the following formula:

$$\frac{A + (B \div 2)}{C} \times \text{expenses incurred}$$

Where:

- A is the floor area of property solely occupied by the tenant
- B is the floor area of the common areas
- C is floor area of the whole property.

30. Common areas are parts of the property that you share with your tenant, such as kitchens, bathrooms, living areas or outdoor spaces.

**Example 5 – shared property usage**

31. *Kim owns a 2-storey townhouse and rents out the bottom floor to a long-term tenant. They each have exclusive possession of their floor. They share the use of the gardens around the house. The top floor has a large deck and is 55 square metres, the bottom floor is 45 square metres, and the gardens are 35 square metres. Kim works out her apportionment percentage as follows:*

$$\frac{45 + (35 \div 2)}{135} \times \frac{100}{1} = 46.3\%$$

32. *Kim can claim 46.3% of the expenses as a deduction related to the property.*

**Combined area-based and time-based methods**

33. In situations where part of a property is used for only part of a year, you will need to combine the time-based method and the area-based method to apportion the expenses by time and area.

**Example 6 – combined area-based method and time-based method**

34. *Leanne has a 2-bedroom, 2-bathroom unit in a high-rise apartment. Leanne lives alone and mainly uses the master bedroom and the ensuite bathroom. The second bedroom and main bathroom is accessible from the common areas of the unit including the lounge, kitchen and balcony and are mainly used by visitors.*

35. *Part way through the year, Leanne decides to let out the second bedroom using a sharing economy platform to earn extra income. She actively monitors replies from the listing and does not refuse guests when the room is available.*

36. *The unit is 80 square metres in total. The second bedroom being let is 10 square metres. Leanne also gives paying guests access to common areas including the main bathroom, kitchen, lounge and balcony, which totals 50 square metres. She also offers her guests access to her wi-fi for free.*

37. For the period guests are staying and have access to the common areas (along with Leanne), Leanne can claim 50% of the deductible portion of associated costs related to the common areas.

*Step 1 – apply the area-based method*

38. Leanne works out the percentage of the house her guests have access to when they are there using the area-based method:

$$\frac{A + (B \div 2)}{C} \times \text{expenses incurred}$$

Where:

- A is the floor area of property solely occupied by the tenant
- B is the floor area of the common areas
- C is the floor area of whole property.

39. Applying this formula, the percentage of the house Leanne's guests have access to when they are there, using the area-based method, is 43.75%:

$$\frac{10 + (50 \div 2)}{80} \times \frac{100}{1} = 43.75\%$$

*Step 2 – apply the time-based method*

40. Leanne lets out the spare bedroom of her property, being her home, for 100 days of the year (which is not a leap year). She will also need to apportion by time and uses the time-based method (as set out in paragraph 14 of this Guideline) using the following formula:

$$100 \text{ days used to produce income} \div 365 \text{ days}$$

41. Because the room is part of her home, when it is not being rented out it is treated as being used privately as part of Leanne's home. The number of days held to produce income will always be zero, even if the room is advertised for rental while it is unoccupied.

42. By multiplying the time-based method and area-based method together, Leanne will be able to work out what percentage of her yearly expenses are deductible:

$$43.75\% \times 100 \div 365 = 11.99\%$$

43. This means Leanne can deduct 11.99% of her ownership expenses, such as interest on her mortgage, insurance and council rates. She can claim 100% of the expenses associated solely with renting out the second bedroom, such as the sharing economy platform's service fees or commission.

**Renting to family or friends at non-market rates**

44. If you are renting your property to family or friends and not charging rent at a market rate, it is likely your property has a mixed use of producing assessable income and a private or domestic use of providing accommodation for your family or friends. In these situations, your deductions should be apportioned to exclude the private or domestic use

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of the property.<sup>11</sup> Where your expenses that would otherwise be deductible exceed the rent received, we will accept that it is fair and reasonable for you to limit those deductions to the amount of the rental income derived from the property<sup>12</sup>, resulting in no net rental taxable income or loss.

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**Example 7 – non-arm’s length rental to mother**

45. *Jana rents a property to her mother for her to live in. While her mother signed a standard lease agreement, Jana has set the rent at a below market non-arm’s length rate. Jana provides the discount for private or domestic reasons to assist her mother who cannot afford to pay rent at the market rate. Jana includes the amount she receives as rent from her mother as assessable income and claims deductions for her expenses related to the house, such as mortgage interest, capital works and council rates up to the amount of rent received from her mother.*

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46. Similarly, if you are renting out your property to others at non-market rates and the property is being held for multiple purposes including one that has a non-income-producing element, apportionment of expenses will be required.

**Renting to family or friends at market rates**

47. If you are renting the property out to family or friends at a market rate, you do not need to apportion the outgoings when determining your deductions.

48. To establish that the property has been rented at a market rate, you will need to provide evidence of how that market rate was calculated at the time the rent amount was set (for example, a real estate rent valuation or contemporaneous house listings of similar properties in the area).

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**Example 8 – market rate rental to son**

49. *Bartolo owns a residential property that he rents to his son and his family who live in the property. The rent is charged at market rates (obtained from a real estate rental valuation) and the lease operates under a standard lease arrangement. No apportionment of expenses is required for Bartolo in claiming his deductions as he has charged rent at market rates and the only use of the property was to derive assessable income.*

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**Mortgage has multiple purposes**

50. Where a mortgage is taken out against a rental property, (or the property is re-mortgaged) and the funds are not all used for an income-producing purpose, you cannot claim a deduction for all of the interest expenses. In these circumstances it is important to

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<sup>11</sup> The time-based method, the area-based method or a combination of the time-based and area-based method can be used to exclude private or domestic use.

<sup>12</sup> See *Commissioner of Taxation v Kowal* 84 ATC 4001 and TR 95/33.

work out the proportion of the loan that is for income-producing purposes and the proportion that is not.<sup>13</sup>

51. Although beyond the scope of this Guideline, where a loan to purchase a rental property has a redraw facility, amounts withdrawn are not treated as relating to the original purpose of the loan (that is, the rental property), but instead to what was purchased with the withdrawn amounts.<sup>14</sup> A redraw facility is different to a loan offset arrangement used to reduce the interest payable on a loan account.<sup>15</sup>

*Independent pursuit of an objective other than income-producing purpose associated with your property*

52. Where there is an independent pursuit of an objective other than an income-producing purpose associated with your property, as explained in Taxation Ruling TR 95/33 *Income tax: subsection 51(1) – relevance of subjective purpose, motive or intention in determining the deductibility of losses and outgoings*, we consider it fair and reasonable to claim deductions up to the amount of any income from your property. Applying the principles from TR 95/33 to a rental property:

- If an outgoing associated with your property produces an amount of assessable income greater than the amount of the outgoing, there would normally be no need to examine your subjective purpose, motives and intentions for incurring the outgoing.
- If the outgoing associated with your property produces no assessable income, or the amount of assessable income from your rental property is less than the amount of the outgoing, it may be necessary to examine all the circumstances surrounding the expenditure to determine whether the outgoing is wholly deductible. This may include an examination of your subjective purpose, motives or intentions in making the outgoing.
- If, after weighing all the circumstances, including the direct and indirect objectives and advantages, in a common sense and practical manner, it can be concluded that the expenditure is genuinely, and not colourably, used in gaining assessable income from your rental property, a deduction is allowable for the loss or outgoing.
- If it is concluded that the disproportion between the outgoing and the relevant assessable income from your rental property is essentially to be explained by reference to the independent pursuit of some other objective (for example, to derive exempt income or the obtaining of a tax deduction), the outgoing must be apportioned between the pursuit of assessable income and the other objective.<sup>16</sup>

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**Commissioner of Taxation**

20 May 2026

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<sup>13</sup> There is additional information about apportioning split loans and redraw facilities in Taxation Ruling TR 2000/2 *Income tax: deductibility of interest on moneys drawn down under line of credit facilities and redraw facilities*.

<sup>14</sup> Refer to TR 2000/2.

<sup>15</sup> Taxation Ruling TR 93/6 *Income tax and fringe benefits tax: loan account offset arrangements* explains the tax treatment of loan offset arrangements.

<sup>16</sup> Refer to paragraphs 3 to 6 of TR 95/33.

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## References

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*Previous draft:*

PCG 2025/D6

- ITAA 1997 26-50

*Related rulings and determinations:*

IT 2167; TR 93/6; TR 95/33; TR 97/11; TR 2000/2; TR 2026/1

*Cases relied on:*

Commissioner of Taxation v Kowal 84 ATC 4001; 79 FLR 75; 15 ATR 125

*Legislative references:*

- ITAA 1997 8-1

*Other references:*

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**ATO references**

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