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Rental property: Tax approach adjusts for COVID-19

The COVID-19 pandemic has placed property owners, and tenants in many cases, in unfamiliar territory. Many tenants have been paying reduced rent or ceased paying because their income has been adversely affected.

While rental income may be reduced, owners will continue to incur normal expenses on their rental property and will still be able to claim these expenses in their tax return as long as the reduced rent charged is determined at arms' length, having regard to the current market conditions. This applies whether the reduction in rent was initiated by the tenants or the owner.

Also remember that many banks have moved to defer loan repayments for stressed mortgagees. In these circumstances, rental property owners are still able to claim interest being charged on the loan as a deduction, even if the bank defers the repayments.

Short-term rentals

In circumstances where COVID-19 has adversely affected demand, including the cancellation of existing bookings for a short-term rental property, deductions are still available provided the property was still genuinely available for rent.

If owners decide to use the property for private purposes or offer the property to family or friends for free, offered it to others in need or stopped renting the property out, the ability to claim deductions is lost for those respective periods.

To determine the proportion of expenses that can be claimed for short-term rental properties affected by COVID-19, or indeed bushfires and other natural disasters, a reasonable approach is to apportion expenses based on the previous year's usage pattern. That is unless an owner can show it was genuinely available for rent for the relevant period. See also below for some common mistakes with short-term rentals.

Deductions for vacant land no longer available

For the 2020 year, expenses for holding vacant land are no longer deductible for individuals intending to build a rental property on that land where the dwelling is not yet built. This also applies to land for which you may have been claiming expenses in previous years.

However, this does not apply to land that is used in a business, or if there has been an exceptional circumstance like a fire or flood leading to the land being vacant.

This can be a difficult area in regard to taxation, so further advice may be an option to consider.

General common rental property mis-steps

Travel to rental properties
Residential property owners can't claim any deductions for costs incurred in travelling to residential rental property unless they are in the rare situation of being in the business of letting rental properties.

Incorrectly claiming loan interest
Taxpayers that take out a loan to purchase a rental property can claim interest (or a portion of the interest) as a tax deduction. However, directing some of the borrowed funds to personal use, such as paying for living expenses or going on a holiday, is not deductible use. The ATO uses data and analytics to look closely and ensure that deductions are only claimed on the portion of the loan that relates directly to the rental property.

Capital works and repairs
Repairs or maintenance to restore something that's broken, damaged or deteriorating in a property you already rent out are deductible immediately. Improvements or renovations are categorised as capital works and are deductible over a number of years.

Initial repairs for damage that existed when the property was purchased can't be claimed as an immediate deduction but may be claimed over a number of years as a capital works deduction.

Short-term rentals

The ATO reports that it often finds taxpayers with short term rental properties claiming for 100% of their expenses when they actually use the property for their own use or provide it to family and friends for free or at a reduced rate. Properties need to be rented out or be genuinely available for full rent to claim a deduction.

Factors such as reserving the property or leaving it vacant over peak periods, not charging the market rate and the types of terms and conditions of the bookings are all taken into consideration when deciding if active and genuine efforts are being made to ensure a property is available for rent.

If a property is not genuinely available for rent, the ATO expects that deductions will be limited to the days when it is. If you are allowing friends or family to stay in the property at a reduced price, you need to limit your deductions to the amount of rent received for these periods.

Don't forget to include all your rental income, especially from sharing economy platforms. The ATO matches data received from these providers to information in tax returns and has in the past followed up on discrepancies uncovered. And one last point is to not to forget any possible CGT implications on sale.