Which fees and charges are tax deductible?

Various costs are involved when buying a property, over and above the purchase price – but, for investors, not all of these expenses are tax deductible. *Michael Quinn*, lawyer, accountant and director of The Quinn Group, explains

There are numerous acquisition expenses that investors must part with when investing in property. These include bank fees and interest costs, body corporate fees, conveyancing costs, stamp duty and lenders mortgage insurance. There are also other tax liabilities.

However, all these extra costs need not leave the avid investor completely out of pocket.

With a little tax knowledge and some professional advice, you may be able to claim a majority of the expenses associated with the purchase, ongoing maintenance and the process of generating income from your investment property as tax deductions.

Preparing tax returns and claiming deductions where investment properties are concerned can be complex, as there are generally no hard and fast rules that can be applied every time.

While there are a range of expenses that can be deducted in relation to investment properties, the criteria for all expenses is not the same.

Under the Australian Taxation Office's (ATO) guidelines, the basic principles of the three main types of rental expenses are:

- those that cannot be claimed
- those that can be claimed as an immediate deduction in the year that they are incurred
- those that can be deducted over a number of income years

Generally, allowable deductions can be claimed for expenses that are incurred for the period that your property is being rented out or is available for rent.

What can't be claimed

Not all fees and costs that are associated with an investment property are able to be claimed as a tax deduction. You are not able to claim a tax deduction for any expenses that are:

- related to the acquisition and disposal costs of the property
- not incurred by you as the property owner – for example, any water or electricity charges that are incurred by your tenants
- not related to the rental and income generation of the property, such as if you personally use your holiday home

Costs such as the purchase cost, conveyancing costs, stamp duty on the property transfer and advertising the property for sale – which are all related to the acquisition or disposal of the property – are not able to be claimed as deductions.

However, in relation to Capital Gains Tax (CGT), you are able to add these costs to the property's cost base, or reduced cost base.

For example, if you purchase an investment property for $250,000, and pay stamp duty of $7,000 and conveyancing costs of $1,500, these fees can't be claimed as tax deductions.

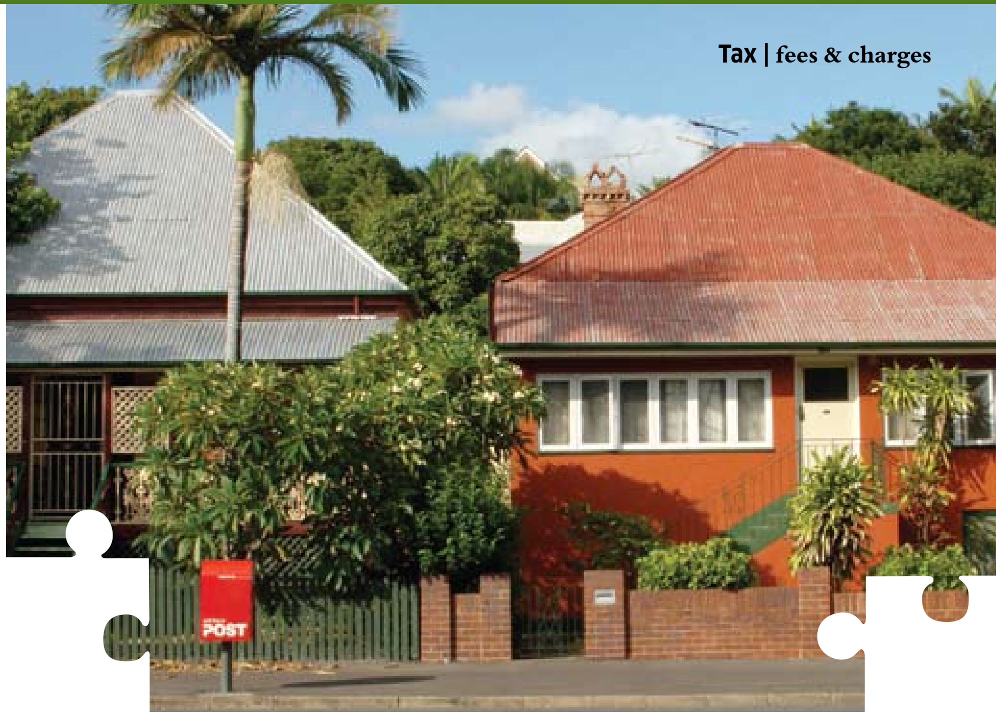
When you sell, however, you add these expenses to your cost base for CGT purposes.

Purchase price	$250,000
Stamp duty	$7,000
Conveyancing	$1,500
New reduced cost base	$258,500

If you then sell the property for $300,000, you won't be liable to pay CGT on the $50,000 difference between sale and purchase price. Instead, you calculate the difference between the sale price and the reduced cost base, and become liable to pay CGT based on that figure – in this example, $41,500.

Mortgage stamp duty presents an interesting deduction case. In NSW, it is no longer a requirement to pay stamp duty on mortgages or property leases. Mortgage stamp duty was discontinued for owner-occupied housing from 1 September 2007, and will be completely abolished on all mortgages – including for investment properties – from 1 July 2012. Similarly, stamp duty on property leases in NSW was discontinued from 1 January 2008.

It should be noted that other states of Australia have different policies regarding mortgage stamp duty and property lease duty. For example, the



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Queensland Government abolished mortgage duty as of 1 July 2008, and in Victoria no mortgage duty has been payable since 1 July 2004. For this reason, it is important that you check with your relevant state revenue office to determine the requirements for the area that your investment property is in.

While in most states mortgage and lease stamp duty are no longer payable, if you have already paid duty on a mortgage or property lease before it was discontinued in your state, you are still able to continue claiming the remaining balance as a deduction over the remainder of the five years (or the life of the loan, whichever is shorter).

What can be claimed immediately

There is a long list of expenses related to the purchase and maintenance of an investment property that are able to be claimed as an immediate tax deduction, and can be claimed in the income year that they were incurred.

Some of the expenses featured in this include:

- the cost of advertising for tenants for your property
- bank charges and interest on loans
- body corporate fees and charges
- council rates, electricity, gas and water charges (unless these are borne by the tenants)
- building, contents and public liability insurance
- some legal expenses and lease document expenses
- pest control
- repairs
- maintenance and service costs
- gardening and lawn mowing costs
- any fees and commissions paid to property agents and quantity surveyors
- any travel and car expenses

Interest charges incurred on loans that you've taken out to purchase the property, or to pay for any necessary repairs or renovations, can be claimed as a deduction – as long as the property is being rented or is available for rent.

If the property is used for private purposes for a portion of the income year, any interest charge deductions must be apportioned for the period of time that the property was generating income or was available for rent.

Some legal costs that are incurred in course of renting an investment property can be claimed as tax deductions. These include costs related

to the eviction of a non-paying tenant or other similar legal matters related to the property.

However, they don't include costs that are related to the sale or purchase of the property, nor for defending ownership of the property title.

In order to claim a deduction for any repairs that are made to a rental property, the costs must be incurred in direct relation to renting the property. For instance, it must be directly related to damage or wear and tear that occurred during the period the property was occupied by tenants.

There is some complexity in relation to repair expenses, though. Some repairs, such as the replacement of an entire structure or renovations, are considered capital in nature and are not able to be deducted. They may, however, be able to be considered as capital works, and therefore qualify for a capital works deduction – or alternatively may be able to be added to the cost base of the property.

Any costs that are incurred by you in the process of travelling to inspect or maintain your investment property, or to collect the rent payments, may be able to be claimed as a deduction. If the sole purpose of the trip is in relation to the property then the full cost can be claimed.

However, if, for example, you fly to Darwin for a holiday for one week and on one day of that week, you travel to inspect your property, you are not able to claim the cost of the flight. You will be able to claim the cost of travelling from your Darwin accommodation to your property, and perhaps a portion of the accommodation costs.

What can be claimed over a number of years

Generally, there are three types of expenses related to rental properties that cannot be claimed immediately, but are able to be deducted over a number of years.

The three expenses are:

- borrowing expenses
- expenses related to the decline in value of depreciating assets
- capital works deductions

Borrowing expenses are those costs that are directly related to taking out a loan for the property, and include items such as establishment fees, title search fees, and any costs incurred in relation to preparing and filing mortgage documents, such as broker fees.

Borrowing fees can sometimes also include valuation fees and lender's mortgage fees. If the total borrowing expenses are less than $100, then the costs are fully deductible in the year that they are incurred. Similarly, if the loan is repaid in less than five years, the remaining balance of these expenses is fully deductible in the income year that the loan is finalised.

It should be noted that any insurance premiums providing for loan payment on your death, and interest charges, are not considered borrowing expenses.

In any income year, you may be eligible to claim a deduction that is equivalent to the decline in value of the depreciating asset – in this case, your investment property – that is held at any time during that year.

There are complex and definitive criteria for determining and calculating if and how much of a depreciation deduction is eligible, so you need to consult a quantity surveyor to quantify these deductions.

Capital works deductions are generally able to be claimed over a 25- or 40-year period. You must ensure that the cost of your capital works deductions does not exceed the total construction costs. You are also not able to begin claiming any capital works deductions until construction has been completed.

As with calculating depreciation of assets, there is a set of defined and detailed criteria that are associated with claiming capital works deductions, and a quantity surveyor is the only professional recognised by the ATO as being able to effectively estimate these deductions.

It may be necessary for you to apportion your rental deductions if the property is only available for rent for part of the income year, or if only a portion of your property is used to generate rental income. This also applies if the property is rented out at non-commercial rates, for example, to a family member for $100 less than market rates.

There are many contributing factors when determining your eligibility for claiming rental property deductions and, as a result, it's important that you always seek the advice of a professional tax accountant. This will not only ensure that you are getting your maximum ATO refund that is legally due to you but also that you are legally compliant and not at risk of receiving any unexpected penalties or fines.

Michael Quinn, director of The Quinn Group, is an experienced lawyer, accountant and educator. If you would like further information or assistance, Michael and the team of legal and accounting professionals at The Quinn Group can be contacted by calling 1300 QUINNS or visiting the website www.quinns.com.au