June 2025
Rental News

Rental Property Deductions

Back in the 2019/20 year, the tax office undertook a review of 300 returns with rental property claims and found that 90% of those returns required an adjustment to the deductions claimed. Since then, they have increased their reviews of rental property income and expenses in tax returns.

The tax office has advised that they will be specifically focusing on the following:

a) Interest deductions not being correctly apportioned such as where loans are used partly for rental and private purposes. This can occur when money is redrawn from a rental property loan but used for private purchases (e.g. purchase a new car).
b) Expenditure for capital works/improvements that have been incorrectly classified as deductible repairs.
c) Claiming travel expenses in relation to residential rental property, which has not been deductible since 1 July 2017.
d) Not including all income e.g. Airbnb income not disclosed.
e) Overclaiming deduction by not correctly apportioning deductions that relate to expenses relating to rental property and private usage.

To ensure your rental property income and expenditure is correctly recorded, we may send you a questionnaire that will need to be completed and returned to us as part of the preparation of your income tax return this year.

A checklist for Rental Property deductions is available in the resources section on our website.

Rental Income

It is important to ensure all rental income is included in your calculations. Where the property is privately rented, you need to include all receipts during the financial year.

Where the property is rented through an agent, we include all rent received by the agent during the financial year. If the agent does not transfer the June rent to you until July, that rent is still included in the financial year. The rent is received by the agent on your behalf and is included as income at that time.

In your tax return, we do not record the net amount transferred to you from the agent as the income. We are required to include the gross rent received by the agent and also the expenses paid or charged by the agent.

Penalty Interest

Penalty interest charged on the early repayment of a loan will be treated like normal interest charges where a loan is repaid early. However, where the loan is repaid early because the asset it relates to was sold (i.e. rental property was sold), then the penalty interest is not treated like a normal interest deduction but is instead treated as a mortgage discharge cost similar to a bank fee to discharge a mortgage. Either way it is deductible against the income received from the asset the loan relates to.

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Interest Charged on Loan Shortfall

In cases where the proceeds of the sale of the asset was not sufficient to fully repay the related loan, then the interest charged on the ongoing loan is usually deductible.

However, the tax office's guidelines should be followed:

a) The sale proceeds of the asset should be fully applied to repay the related loan
b) If you have the ability to repay the ongoing loan, but choose not to, then the tax office may determine that it no longer relates to the former income earning activity and the deductibility of the interest is lost.
c) Refinancing of the loan usually does not prevent the interest on the new loan from being deductible, providing you take into account any portion of the new loan that relates to private use items.
d) The length of time an existing loan remains outstanding must also be considered. The greater the time since the end of the income earning activity, the more likely that the ongoing loan is being kept unpaid for reasons that don't relate to the former income earning activities and an interest deduction will no longer be allowed.

Vacant Land

Where you acquire vacant land with the intention to build a rental property, the deduction of rates, loan interest and property maintenance costs is not straightforward. Each situation needs to be carefully reviewed to determine the intention of use of the property, the timing of purchase/construction , and the usage of the land prior to clearing and construction.

In some cases these costs become holding costs and are carried forward and deducted when the property is sold. Whilst you may not be able to claim a deduction when incurred, it is still important to record those costs for future reference. Please ensure you let us know if you have purchased property that is vacant land or will become vacant land and used for the purposes of constructing a rental property, so that we can collate the costs incurred.

Mixed Purpose Loans

One of the things that the tax office looks for in their audits of rental properties revolves around mixed purpose loans. A mixed purpose loan occurs when a drawing is made from a rental property loan and used for private purposes. Using the rental property as security for a loan does not automatically make all interest on that loan deductible. It is the purpose of the loan, regardless of the security for the loan, which decides whether the interest is deductible.

If a drawing is made on a rental loan and used for private purposes, the interest charged needs to be split between deductible and non-deductible interest. A further complication then arises when treating the repayments to the loan. Each repayment needs to be split between the deductible and non-deductible portions of the loan according to each portion of the loan. This also applies to bulk repayments to the loan, even if the repayment was designed to repay the private drawing in full.

The same issue arises if you are seeking to redraw additional repayments that had previously accumulated and then use that amount for private purposes. The redraw is still treated as a private portion of the loan and interest needs to be split between deductible and non-deductible. The best strategy would have been to use an interest offset account (if available) to accumulate any extra repayments to be available for redrawing at a later time.

The best strategy to remove the private portion of a mixed loan will be to refinance the loan into two separated loans, one for the deductible amount and one for the non-deductible amount. Any bulk repayments should then be paid to the new non-deductible loan until it is repaid.

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