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TAXATION ACCOUNTANT

New Rental Property Purchase

What do I need to complete my Tax Return?

The following lists the information required to complete the first income tax return after the purchase of a Rental Property:

- Purchase Contract*
- Solicitors Settlement Statement*
- Loan Establishment Documents (showing all fees charged)*
- Income and Expenses – use the **Rental Schedule** provided on the website*
- Quantity Surveyors Report – This is a depreciation report which summarises the costs of all internal fixtures and fittings, and the actual building cost. This report has a one off cost and then unlocks the hidden tax benefits of a rental property lasting for up to 40 years (40 tax returns).*

The following information simply provides an explanation of how many common purchase costs are treated.

Tax Treatment of Common Rental Property Purchase Costs

The following table summarises the **general** tax treatment of the more common costs associated with the acquisition of a rental property. The checklist is intended to provide a guide only and, therefore, many items may require a more detailed examination as to their treatment.

It should be noted that the reference to “**Tax deduction**” in the table means a deduction in the year the relevant expenditure is incurred, unless otherwise stated. Furthermore a reference to “**Cost base**” is a reference to the cost base of the property itself for CGT purpose.

Please note this information has been taken directly from the National Tax & Accountant's Association Ltd 2011 Tax Schools Seminar notes. It was highlighted under “*ATO's Individual Audit Hot Spots for 2011*” and was provided as the ATO has increased compliance in this area due to incorrect claims by tax payers!

Description of acquisition Cost	Tax deduction?	Cost base?	References
Purchase price of property ❶ <ul style="list-style-type: none"> • Depreciable assets • Building/structures • Land 	Yes ❷ Yes ❸ No	No Yes ❹ Yes	Division 40 Division 43 S.110-25(2)
Consultant fees incurred to find/recommend a suitable property which is later purchased	No	Yes	S.110-25(3) & ID 2003/361
Travel and accommodation costs incurred to inspect a property for potential purchase	No	No	Division 110
Building/pest inspection report	No	Yes	S.110-25 (3)
Payment to vendor of settlement adjustment for rates, etc.	Yes	No	S.8-1, <i>FCT v Morgan</i>
Stamp duty on purchase ❺	No	Yes	S.110-25(3)
Legal Fees (including conveyancing) ❻	No	Yes	S.110-25(3)
Borrowing costs (e.g. loan establishment fees Mortgage insurance, stamp duty on loan)	Yes ❼	No	S.25-25
Investment/financial advice <ul style="list-style-type: none"> • Managing current rentals or Maximizing rent • Establishing a strategy or plan For making future rental investments 	Yes No	No No	TD 95/60 & ID 2003/324
Deposit Bond/bank guarantee fees	No	Yes ❽	S.110-25(2) & ID 2003/113
Tax advice related to the property	Yes	No	S.25-5
Mortgage Insurance	Yes ❾	No	S.25-25
Building Insurance	Yes	No	S.8-1
Quantity Surveyor Report	Yes ❿	No	S.25-5
Search fees (e.g. on land titles)	No	Yes	S.110-25(3)
Conveyancing kit	No	Yes	S.110-25(3)
Penalty Interest for delayed settlement	Yes ⓫	No	S.8-1

❶ The purchase price of a rental property must be allocated between the property itself (i.e. building and land) and any depreciable assets contained in the property. In the absence of any specific arm's length allocation in the sale contract, the "cost" of each depreciable asset is so much of the purchase price that can be reasonably attributed to each asset (refer to S.40-195). Refer also to ATO ID 2002/818.

❷ Broadly, the cost of a depreciable asset is written off either: in the year of purchase (where the \$300 immediate write-off under S.40-80(2) applies), as part of a low-value pool (for assets costing less than \$1000), or otherwise over the asset's effective life.

❸ A deduction may only be available for the building write-off under Division 43. This is generally claimed at the rate of @ 2.5% per annum of eligible expenditure on the construction of the building itself or on any extension, alteration, or improvement to the building. This does not extend to the cost of the land, so will differ from the purchase price of the entire property.

❹ The purchase price of the property forms part of the first element of the property's cost base under S.110-25(2) for CGT purposes. However, when the property is eventually sold, the cost base of the property may need to be reduced by any building write-off amounts the vendor was entitled to claim under Division 43 (noted above). Refer to S.110-45(2) and (4), TD 2005/47 and PS LA 2006/1

❺ Stamp duty and legal fees related to a crown lease are deductible under S.25-20 and, therefore will not form part of the property's cost base for CGT purposes. Refer to former ATO ID 2001/614 (now withdrawn due to being a "straight application of the law")

❻ If the total borrowing costs incurred exceed \$100, they are claimed over the term of the loan, or five years, whichever is shorter. If the total borrowing costs do not exceed \$100 the entire cost is deductible in the year it is incurred.

❼ The bank guarantee fees will form part of the cost base of the guarantee, being the relevant asset acquired for CGT purposes, not the rental property. Refer to S.110-25(2) and to ID 2003/113

❽ THE ATO has advised that the cost of obtaining a building cost estimate from an appropriately qualified person (e.g. a quantity surveyor) for the purposes of claiming the building write-off, would be considered "tax-related expenditure" for the purposes of former S.69 of the ITAA 1936 (now S.25-5 of the ITAA 1997).

❾ A deduction is only available provided that penalty interest is in the nature of "interest" (which is normally the case) and there is a genuine intention to use the property exclusively for income-earning purposes.

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