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All expenses are not equal

Rental properties often need upkeep and sometimes, more significant repairs. However, in the eyes of the Australian Taxation Office, not all types of expenditure are equal!

For taxation purposes, there are three major types of expenditure property investors should be aware of, all of which are subject to different taxation treatments.

1. expenses that cannot be claimed (e.g. utilities charges, and acquisition and disposal costs).

2. expenses for which immediate deductions can be claimed (e.g. rates, insurance, legal expenses and repairs).

3. expenses for which deduction claims can be made over a number of income years (e.g. borrowing expenses such as stamp duty, title search fees and capital works).

When considering the deductibility of renovations, such as replacing a bathroom, the effective life of the existing structure must also be factored in. Houses are generally depreciated over 40 years (at 2.5% per year), but the residual value of the existing structure is also taken into account.

Example

Tony owns a rental property built 20 years ago, and needs to replace the now obsolete bathroom at a cost of $20,000. The original value of the bathroom was assumed to be $8,000, with the result being depreciation of $4,000 (being 2.5% times 20 years times $8,000), and a residual value of $4,000. As a result, Tony will be able to claim a tax deduction for the $4,000 residual value, plus 2.5% of the renovation cost ($375), for a total deduction of $4,375 this income year.

Timely and quality maintenance of investment properties can provide significant benefits through the improvement of rental yields. However, for taxation purposes, the treatment of these expenses can vary, so it is worth discussing with your accountant or adviser before you commit to expenses.

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