



Claiming Property Expense When Not Rented

The big question is – **“What is Exceptional Damage Beyond Your Reasonable Control?”** The answer in the case of the above photo would depend on a DNA test because if your family does the damage, no tax deduction.

What a segue! Sounds a lot more interesting than discussing the latest piece of legislation affecting property investors, but bear with me, maybe you will catch my enthusiasm for all things tax.

From 1st July 2019 claiming a tax deduction for expenses during the construction of a residential rental property, by Mum and Dad investors is no longer permitted. This will also include the costs of holding the vacant land before construction.

The legislation only made its way through parliament on 16th October 2019 but nevertheless applies from 1st July, 2019 so many people are in for a nasty surprise when they do their 2020 tax return. Fortunately, on its way to parliament there were a few carve outs.

Regarding vacant land there is a recognition that if it is producing income that the ATO is going to tax, then you should be entitled to a deduction for the associated expenses. So, the loss of tax deductibility does not apply if the vacant land is used in a business even if that is just agistment or for that matter to run your own cattle.

But what about the property investor that is not a business entity? Certainly no how, no way, if you buy land and construct a rental property. You do not qualify for a tax deduction for any holding costs until it is listed for rent and actually able to be occupied.

The legislation goes much further than this. It doesn't just attack vacant land. It attacks any property that is not listed for rent. This means if you buy a property that you want to renovate before putting it on the rental market then you cannot claim a tax deduction for any expenses, even holding costs, while you are getting it ready to rent. But what about if those renovation/repairs became necessary due to tenant damage? Well, I will give you exactly what the 1997 ITAA says.

Section 26-102(6)(c) The circumstance was exceptional and beyond the reasonable control of you and your associates (paraphrased).

The legislation also goes on to say you are only allowed 3 years to undertake the repair and you must keep records to prove the exceptional circumstances. The heading for that section is natural disasters or other exceptional circumstances so the ATO can't narrow it down to just natural disasters. But I wonder if they can argue tenant damage was within the control of your property manager?

That is all I can tell you at this stage. We expect this section was intended to allow time to repair tenant damage, but it doesn't actually say so nor does the explanatory memorandum. The ATO will eventually come out with a ruling providing more detail. They may just limit it to initial structure problems such as the Opal tower. In fact, it may be those recent problems that are the reason for this new exception. The worry is that the ATO will take a very narrow view knowing Mum and Dad investors are unlikely to be able to afford to fight them in court and the legislation itself already has a carve out for bigger investors.

Obviously from the above, electing to undertake a renovation before or in between renting the property out is going to prevent you from claiming all expenses associated with the property during the renovation period. The property must actually be habitable and listed for rent. Here is the relevant section:

Section 26-102(4)Not being a substantial and permanent structure if it is residential premises constructed or substantially renovated, while you hold the land unless:

- (a) The residential premises are lawfully able to be occupied
and
- (b) The residential premises are leased, hired or licensed or available for lease, hire or licence.

I expect you would be ok to paint between tenants as long as it was still being listed so people could inspect and move in the next day or so.

I am well known for my contempt for the promotion of scrapping depreciation deductions, due to the very limited circumstance that the tax deduction is actually available. This legislation reduces that even further. You are not allowed to claim rental property expenses during a renovation, so you are now not allowed to claim anything you scrap.

You have got to ask why they didn't specifically list tenant damage considering they mentioned natural disasters.

For the whole bill go to

https://parlinfo.aph.gov.au/parlInfo/download/legislation/bills/r6369_aspassed/toc_pdf/19129b01.pdf;fileType=application%2Fpdf