Income Tax Tips, Traps & Pitfalls
Real Property Rentals

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November 2018
Assessable Income

- Assessable income consists of ordinary income and statutory income.
- Ordinary income is income according to ordinary concepts.
- Statutory income is income that is assessable by virtue of a specific provision in the income tax legislation.

Assessable Income (cont.)

- Income according to ordinary concepts include three categories:
  - income from rendering personal services including employment income;
  - income from carrying on a business; and
  - income from property - rent, interest, dividends.
Capital / income distinction

- Distinction importance pre-CGT and post-CGT
- “Income comes in and that income tax is a tax on income” (Lord Macnaghten in London County Council v A-G [1901] AC 26 at 35)
- Not helpful to distinguish between income, capital and windfall gains
- Character of moneys in hands of one does not determine character in hands of another.

Landlord issues

- Rental income
  - Mostly investment and not carrying on of business
  - Usually on a receipts basis
  - Income in advance – can pro-rata – ATO ID 2003/526
Landlord issues

- Rental income
  - Assessable income amounts
  - Rental income earned
  - Rental bond money entitled to
  - Certain insurance proceeds (loss of rental)
  - Reimbursement or recoupment of deductible expenditure (eg. repair to damaged property)
  - Certain government rebates (energy saving appliances)

Capital / income distinction

- Periodicity – recurring receipt – only indicator not determinative of character

- One-off transactions can give rise to income

- Profit-making plan (intention) – s 15-15 (previously section 25A)
Capital / income distinction

Sale of land assessed as ordinary income where:

- land is acquired in isolated commercial transaction for purpose of development, subdivision and sale, but development and subdivision do not proceed and land is sold (TD 92/126)

Capital / income distinction

Sale of land assessed as ordinary income where:

- land is acquired for development, subdivision and sale but the development is abandoned and the land is sold in a partly developed state (TD 92/127)
Sale of land assessed as ordinary income where:

- land is acquired for development, subdivision and sale but, after some initial development, the project ceases and is recommenced in a later income year (TD 92/128).
Capital / Income distinction

- Assignment of right to future income – capital or income determined under general principles
- If transaction entered into with intention of making profit, amount is assessable income
- *Myer Emporium* principle - sale of a right to future interest was income - converted future income into present income.
- Section 102CA(1) applies in broad manner post-*Myer* (7-year assignment rule)

Capital / Income distinction

- If any consideration is paid otherwise than in cash, the money value of that consideration is deemed to have been paid or given: Section 21
- Section 21 does not apply to consideration that is “a promise to pay money”
- Div 45 deems consideration receivable for disposal of certain interests in leases to be the sum of the money value received plus amount of any reduction in a liability of the taxpayer and the MV of any other benefit obtained.
Capital / Income distinction

- Included in assessable income if property was acquired for purpose of profit-making by sale
- Dominant purpose at time of acquisition is basis

Derivation of income

- Taxpayer is generally taken to have received amount when it is applied or dealt with in any way on taxpayer's behalf or as taxpayer directs
- Derivation – cash basis or accruals basis
- Income from property generally on a cash basis
Derivation of income

- Where sale of real property results in assessable income, the income arises at the time of settlement, not when the contract is entered into.

- Mere loss of dispositive power over property, without delivery of property does not result in derivation of assessable income - *Gasparin v FCT* (1994) 28 ATR 130

- Same principle applies to income derived by a property developer from "off the plan" sales contract - ATO ID 2004/439

Derivation of income

- Where sale of real property results in assessable income (profit-making intention), the income arises at the time of settlement, not when the contract is entered into.
Income from isolated transactions

In Taxation Ruling TR 92/3 Commissioner states that profit from an isolated transaction is generally assessable income when both of the following elements are present:

- the intention or purpose of the taxpayer in entering into the transaction was to make a profit or gain; and
- the transaction was entered into and the profit made in the course of carrying on a business or in carrying out a business operation or commercial transaction.

Income from isolated transactions

In Gutwenger v FCT (1995) 30 ATR 82, Full Federal Court held that profit from sale of subdivided lots was not income according to ordinary concepts - land was originally purchased by taxpayer's wife and gifted to him one month before it was actually subdivided.

In Casimaty v FCT (1997) 37 ATR 358 where the proceeds from the sale of subdivided rural land were not assessable.
Assessable Income

Income from isolated transactions

- Recently in *August v FCT* [2013] FCAFC, profits from the sale of real property was held to be income according to ordinary concepts.
- In *August v FCT* the Court rejected the taxpayers’ contention that the relevant properties were acquired as long-term investments.
- This principle is in alignment with s15-15 ITAA 1997 which provides that assessable income of a taxpayer includes profit arising from carrying out of a profit-making undertaking or plan.

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**August v FCT  (Full Federal Court)**

**FACTS**

- Taxpayers - husband and wife - were beneficiaries of trust which undertook some property dealings
  - Trustee purchased property in Melba (a suburb in Canberra) to develop and be tenanted, comprising six shops.
  - Shops were subsequently sold in March 2006 for $2.35 million.
  - Trustee also entered into JV with other parties to acquire properties in Hume (another suburb in Canberra) in 2001.
  - Crown lease for Hume required that lessee commence construction within 12 months and to be completed within 24 months.
  - Development applications were made, but no construction commenced.
  - In October 2005, Hume property was sold to Optus for $5.473 million.
August v FCT  (Full Federal Court)

ISSUE

• Primary issue - whether the income from the sale of the property was income according to ordinary concepts or whether it is capital or capital in nature.

• That is, whether there was profit-making intention pursuant to a scheme or business operation or commercial transaction.

August v FCT  (Full Federal Court)

ARGUMENTS

• Taxpayer contended that Federal Court at first instance had incorrectly focussed on purpose or intention and overlooked that there must also be a scheme or business operation or commercial transaction.

• Taxpayer contended:
  • In relation to the Melba shops, there never was any scheme, and
  • In relation to the Hume property, the property was sold to Optus after the scheme alleged had been abandoned.

• Commissioner contended that “scheme or business operation or commercial transaction” was an inherent element of test, and Federal Court, at first instance, had stated and applied test correctly.
**August v FCT (Full Federal Court)**  

**DECISION**

- Melba property - there was a scheme with intention or purpose that Melba shops be developed, tenanted and sold for profit.
- Hume property - FFC distinguished decision in *Kratzmann v FCT (Cth) (1970) 44 ALJR 293* where no ordinary income because “scheme” was abandoned
- Full Court concluded that Hume property sale remained part of profit-making scheme, even if sale took place without property leased or subdivided – the “scheme” had not been abandoned
- Accordingly sale proceeds are ordinary income as profit-making intention borne out by “scheme, business operation or commercial transaction”

### Derivation of income

- Assessable profit from an instalment sale of a joint venture interest in property by person not in business of property development, but who held interest as "revenue asset", was considered to arise in year of final settlement - ATO ID 2004/407
- In contrast, ATO ID 2004/406 states that share of each instalment retained by developer as fee for arranging instalment sales was assessable when received, as it was not contingent on ultimate settlement of sale contract
Derivation of income

- A forfeited deposit in relation to a sale of land held as trading stock was regarded by ATO as assessable income in the year in which the purchaser defaulted - ATO ID 2004/28

- Treatment of compulsory acquisition proceeds – is it always capital?

Derivation of income

- Income from property (such as interest or rent) generally derived when actually received - cash basis

- However, in ATO ID 2003/526, ATO considered that lump sum payment in exchange for a life time right to reside in a property, which had the character of rent received in advance, was to be brought to account progressively in accordance with the *Arthur Murray* principle.
Rental income earned by co-owners of a property must generally be shared according to their legal interests except where they can establish that their equitable interests are different.

Partnership agreement varying profit and loss entitlements only has effect where there is also a partnership at general law, ie where ownership constitutes a business (TR 93/32).

Amounts received from a lessee, whether as damages or otherwise, for non-compliance with a lease obligation to repair business premises are specifically assessable under section 15-25 to the extent that they are not of a general income nature.
Derivation of income

Other amounts derived by landlords:

- Lease premiums
- Improvements by lessee – section 21A
- Recoupments – Division 20

Allowable Deductions

- General deductions – Section 8-1 – interest, legal expenses, travel expenses, council rates, etc
- Specific deductions – depreciation, repairs, capital works, etc
Landlord issues

- ATO focus areas – *Building Confidence*
  - excessive deductions being claimed for holiday homes
  - husbands and wives inappropriately splitting rental income and deductions for jointly owned properties
  - claims for repairs and maintenance shortly after the property was purchased, and
  - interest deductions being claimed for the private proportion of loans.

Holiday homes

- Excessive holiday home deductions
  - Genuinely available for rent
    - Factors outlined by ATO
  - Is the property let at arm’s length?
    - IT 2167: Family members
Co-owned properties

- Husband and wife properties
- Splitting of income and expenses
- TR 93/32
  - Income tax law partnership
  - Legal interest is the key

Allowable Deductions

- telephone, stamps, stationery
- travel and other expenses in collecting rents and in connection with maintenance and repair of the property
- agent’s commission for rent collection and other management fees
- repairs and ongoing maintenance
Allowable Deductions

- environmental protection expenses
- annual power guarantee payment made on a remote rental property (ID 2002/573)
- fee for the use of a safe deposit box to hold title documents
- secretarial and bookkeeping expenses

Allowable Deductions

- audit fees where reasonably necessary
- tax advice costs, tax return preparation expenses and expenses in objecting or appealing against an assessment
- costs of attending a property investment seminar, to the extent that they related to operating, or maximising the return from, current investment properties (ID 2003/324)
**Allowable Deductions**

- payment of rates and land tax

- strata title body corporate fees for ongoing administration and general maintenance, but not special (SINKING FUND) levies for capital improvements

- insurance premiums

- legal expenses in recovering arrears of rent or ejecting a tenant for non-payment

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**Allowable Deductions**

- interest on moneys borrowed to purchase or refinance the property or to effect repairs – use test

- Borrowing expenses – S25-25

- mortgage discharge expenses – 25-30

- advertising expenses – S8-1

- costs of preparation, registration and stamping of leases, assignments / surrenders of rented premises.
POSSIBLE GENERAL DEDUCTIONS

- General deduction under s. 8-1 may be available to the following outgoings:
  - **Interest**
    - Where borrowed funds are used for an income-producing purpose, the interest will be deductible (provided the negative tests do not apply).
    - When applying the negative tests, interest is generally not deemed to be capital in nature, even where borrowed funds are used for a capital purpose.
    - Interest tends to be inherently of a revenue nature due to its recurrent nature and failure to secure a lasting benefit *FC of T v. Steele* 99 ATC 4242.
  - **Expenditure on the capital protection feature**
    - Where a finance cost has a premium due to a capital protection feature, such as limited recourse borrowings, then the premium will be a capital outgoing.
    - *FC of T v. Firth* 2002 ATC 4346
      - *Division 247 limits interest deductions for capital protected borrowings to acquire listed shares or units (margin loans).*

Allowable Deductions

- **Intention to derive rent is basis for interest deduction** – Steele v FCT

- **Where taxpayer purchases property with intention to derive income, deduction for interest, etc may be available even if no income derived** - Ormiston v FCT 2005 ATC 2340 and recent 2012 decisions

- **Deduction of interest under split loan facilities** – Hart v FCT case and other recent cases / rulings
Interest deductibility

- Interest deductibility
  - Sufficient nexus between rental income and the interest
  - Use test
- ATO concerned with over-claiming deductions where there is private use

Interest deductibility scenarios

- Part of the property is used for income producing purposes
- Borrowed funds applied for private purposes
- Interest incurred after property no longer rented out
- Apportionment may be necessary
Interest deductibility

- Splitting interest income
  - **Scenario 1:** Property jointly held by husband and wife, mortgage under joint names, expenses paid for by husband
    - Husband only entitled to 50% deduction – not 100%
    - Wife can also claim 50% deduction

Interest deductibility

- Splitting interest income
  - **Scenario 2:** Property jointly held by husband and wife, mortgage under husband’s name, expenses paid for by husband
    - Husband and wife claim according to legal interest – 50% each
Interest deductibility

Splitting interest income

- **Scenario 3**: Property held by wife, loan under joint names (secured by family home), income and expenses paid jointly
- Wife can claim 100% of expenses – per some PBRs
- Main residence as security does prevent interest deduction

Interest deductibility

- Rental property sold but loan remains on foot
  - TR 2004/4: deductibility after income producing activity ceases
  - Can be deductible – is nexus broken?
  - Is loan on foot for some other reason
  - Financial resources
  - Liquidity of taxpayer
  - Diversion of funds to paying loan
  - Time since property sold
  - Refinancing of loan
Taxation

Borrowing Expenses

s 25-25

• Are considered to be capital, but made deductible by this section
• Expenses less than $100 are deductible in full in the year incurred
• Expenses greater than $100 are deductible over lesser of:
  • Term of the loan
  • Actual period of loan (if the loan is repaid early); or
  • 5 years
• E.g. Loan application fees, legal fees, valuation costs, stamp duty

Formula: $\text{Remaining Expenditure} / \text{Remaining Days} \times \text{Days in the year}$

Taxation

Mortgage Discharge Expenses

s 25 – 30

• Deductible if:
  • Expenses incurred to discharge a mortgage given as security for money borrowed for income earning purposes
  • Apportion between income producing and private if necessary
REPAIRS

• This is in addition to s. 8-1.
• You can deduct expenditure you incur for repairs to premises or a depreciating asset that you held or used solely for the purpose of producing assessable income (s. 25-10(1)).
• Apportionment on a reasonable basis if a mixed use asset s. 25-10(2) s. 8-1.
• No deduction for capital expenditure
  – Improvements – beyond mere restoration of function.
  – Initial repairs – issues existing at time of acquisition of asset.
  – Emphasis on restoration of function without changing character.
• To be a repair, the asset must be in need of repairing. Hence mere servicing and maintenance may be deductible under s. 8-1.

Taxation

Repairs

s 25-10

• ...the replacement or renewal of the worn out part of something – not the whole thing...
• ... restores to original condition without changing character...
• Deductible if:
  • Expense incurred in year of income; and
  • Expense not capital ; and
  • In relation to premises or equipment; that is
  • Used to produce assessable income ;
    • E.g painting, mending leaks, mending a fence
Taxation

Repairs
• Repair vs improvement
• Likely to be improvement if:
  • New material different to old
  • Increases the value of the asset/s
  • Modification has effected an improvement of the asset
  • Reduces likelihood of future repairs
  • Includes substantial modifications, additions

Repairs
• Repairs to recently acquired property
  • Initial repairs (shortly after purchase) are not deductible
  • Can claim deduction to remedy effects arising during ownership
  • Repairs to property after it has ceased being income producing are deductible if they:
    • Relate to time property was earning income
    • Apportion between income producing and private if necessary
Taxation

Repairs – Example

A landlord has an existing rental property which has been owned for many years. During the current year the following expenses are incurred:

• One room was repainted. It had been painted 7 years earlier. It costs $500.
• The back patio floor had cracked badly over the years and was completely replaced. It cost $2,500.

Which of these expenses are deductible?

Repairs – Example

Example

A taxpayer buys a property. Soon after purchase, it is repainted at a cost of $5,000.

How much is deductible?
Repairs and maintenance

- Improvements vs repairs
- Deduction available under s25-10 ITAA97
- ATO concerned with ‘initial repairs’
- TR 97/23 – Deductibility of repairs
  - Important part of structure?
  - Did it restore ‘efficiency of function’ or more?
  - Replacement – new or better?
  - Any considerable advantage?

Repairs and maintenance

- What happens if income producing activity ceases?
- IT 180: restricted deductions
- Example
Taxation

Lease Document Expenses

s 25-20

- For preparation, registration, stamping of a lease
- Deduction is available to lessor and lessee if lease is used to produce assessable income
- Apportion between income producing and private if necessary

Allowable Deductions

Treatment of specific legal expenses:

- Asserting title
- Breaches to management contract
- Creditworthiness investigation
- Defective building works report
Allowable Deductions

Treatment of specific legal expenses:

- Ejecting tenants
- Injuries suffered on property
- Lease preparation costs
- Opposing building applications

Allowable Deductions

Treatment of specific legal expenses:

- Recovery of mesne profits
- Resisting option to purchase
- Sale of property.
Allowable Deductions

- Treatment of lease surrender payments
- Treatment of cash and non-cash lease incentives
- Salary sacrifice advantages:
  - Double dipping using $300 write-off
  - Reduce Adjusted Taxable Income (ATI)

Special Issues / strategies / planning points

**Income Test Requirements – separate disclosure**

“Adjusted taxable income” means:
- Taxable income
- Reportable superannuation contributions – RESC / RSC
- Total net investment losses
- Reportable fringe benefits (RFB) / Adjusted fringe benefits (AFB)
- Income from certain tax-free Government pensions and benefits
- Target foreign income minus
- Annual amount of child support/child maintenance payments
Special Issues / strategies / planning points

Interest deductions
- Tanti v FCT case
- Willersdorf-Greene v FCT case
- ID 2009/71

Rent expenses
- Claiming deduction from co-owners – ID 2010/193
- Paying spouse to manage property – Brown v FCT & France v FCT cases

Property Investment
Key Tax Changes
2018
Notes Supplement
Recent Tax Changes – Property Investment

Limiting deductions for travel expenditure for residential rental property:

• This legislation received royal assent on 30 November 2017 and is now law. From 1 July 2017, travel expenses relating to inspecting, maintaining, or collecting rent for a residential rental property cannot be claimed as deductions by investors. This law ensures that travel expenditure incurred in gaining or producing assessable income from residential premises is:
  • not deductible; and
  • not recognised in the cost base of the property for CGT purposes.

Recent Tax Changes – Property Investment

Limiting deductions for travel expenditure for residential rental property:

• The amendments are not intended to affect deductions for institutional investors in residential premises.

• The amendments also do not affect deductions for travel expenditure incurred in carrying on a business, including where an entity carries on a business of providing property management services. This means deductions continue to be available for an entity that carries on a business of property investing or a business of providing retirement living, aged care, student accommodation or property management services.
Recent Tax Changes – Property Investment

Limiting deductions for travel expenditure for residential rental property:

- The amendments apply to individuals, SMSFs and smaller trusts (including family trusts) who are not carrying on a business will be impacted by these amendments.
- The amendments apply to residential premises that are used for residential accommodation.
- The following slides include examples from the Explanatory Memorandum.

Example 1.1: Travel expenditure for inspecting property and visiting real estate agent not deductible

- Michael owns an investment property and engages a real estate agent to manage his property which is located across town. The property is leased for residential accommodation and therefore considered residential premises within the meaning of the GST Act.
- Every six months, Michael travels by car to inspect the property. He also meets with the real estate agent once a year to discuss potential rent increases and any other property management issues. Travel expenditure to inspect the property and meet with the real estate agent is for the purpose of gaining or producing rental income from the use of residential premises as residential accommodation.
- Michael incurs fuel costs associated with this travel. The fuel costs are not incurred in carrying on a business. Michael cannot deduct such travel expenditure as it is related to travel and incurred to derive income from the use of residential premises for residential accommodation.
Recent Tax Changes – Property Investment

Example 1.2: Travel expenditure related to residential premises subject to a sublease arrangement not deductible

- Chris is the owner of an investment property, which he has leased out to head tenant Billy. Billy decides to move out of the property but decides not to break the lease. Instead, Billy subleases the property to another tenant, Jared.
- Billy collects rental income from Jared and incurs expenditure travelling to the property to inspect it every month. Billy is prevented from deducting such expenditure, which is related to travel and is incurred to gain or produce assessable income from the use of residential premises as residential accommodation.

Example 1.3: Travel expenditure incurred in carrying on a business deductible

- Mirela operates a business of leasing holiday flats in Coffs Harbour. She undertakes various tasks such as cleaning, laundry, greeting guests and topping up provisions on a daily basis.
- Mirela uses a car to travel between the flats and her garage at home where she keeps her equipment and stock. She uses the logbook method to calculate her travel expenditure.
- Her travel expenditure is incurred in the course of carrying on a business for the purpose of producing assessable income and therefore remains deductible.
Recent Tax Changes – Property Investment

Example 1.4: Travel expenditure in a mixed use property

• Anna owns multiple workshops across Australia as part of her business operations. She owns a two-storey brick shop-house in Melbourne. The building comprises a workshop on the ground floor and an apartment on the first floor.

• The apartment is rented out separately to a couple, Leon and Michelle. Therefore, Anna derives assessable income from both her workshop and the apartment.

• The apartment satisfies the definition of residential premises within the meaning of the GST Act.

Recent Tax Changes – Property Investment

Example 1.4: Travel expenditure in a mixed use property (cont’d)

• Anna travels from her home town in Canberra to her property in Melbourne for the purpose of carrying out maintenance to the floor of the workshop. This maintenance activity is solely related to gaining or producing assessable income from the workshop.

• Anna incurs airfare costs associated with this travel. Anna will be able to deduct her travel expenditure as it relates to gaining or producing assessable income in the course of carrying on her business from her workshop, not from gaining or producing assessable income from the use of her apartment as residential accommodation.
Example 1.4: Travel expenditure in a mixed use property (cont’d)

- Anna takes a second trip from her home town in Canberra to her property in Melbourne for the purpose of carrying out maintenance to the wall of her apartment. This maintenance activity is solely related to gaining or producing assessable income from the apartment. Anna incurs airfare costs associated with this travel. This time Anna will not be able to deduct her travel expenditure as it relates to gaining or producing assessable income from the use of her apartment as residential accommodation.

Recent Tax Changes – Property Investment

Limiting deductions for travel expenditure for residential rental property (Continued):

- The ATO issued LCR 2018/D2 on 2 May 2018, to clarify the new legislative rules regarding the deductibility of Rental Property travel expenses.

- The draft ruling provides commentary regarding the meaning of ‘residential premises’, the carrying on of a business of property investing, and travel expenditure that services more than one purpose.
Recent Tax Changes – Property Investment

• The expression "residential premises" takes it meaning from the GST Act, which is land or a building that is occupied, or is intended to be and is capable of being occupied, as a residence or for residential accommodation.

• In accordance with GST case law, the draft states that the premises must be fit for human habitation and provide shelter and basic living facilities.

Example 1: shelter and basic living facilities (Meaning of ‘residential premises’)

• 13. Julian owns a building that consists of a display area, a storage area, an office, a kitchenette and a toilet. The physical characteristics of the building together with its architectural plan show that the premises were designed as a shop. The building provides shelter and basic living facilities. Julian leases the building to a tenant who furnishes the premises in order to use it as their residence.

• 14. The tenant's occupation of the shop as a residence means that the shop satisfies paragraph (a) of the definition of residential premises in section 195-1 of the GST Act. Julian cannot deduct his travel expenditure incurred in gaining his rental income from the use of the residential premises as residential accommodation.
Recent Tax Changes – Property Investment

Limiting deductions for Plant & Equipment in residential rental property:

• The same taxpayers affected by the amendments denying deductions for travel expenses on residential rental properties may also be impacted by the amendments to the depreciation rules. This legislation received royal assent on 30 November 2017 - is now law.

• The law operates to deny income tax deductions for the decline in value of previously used depreciating assets (plant and equipment) an entity uses in gaining or producing assessable income from the use of residential premises for the purposes of residential accommodation.

Recent Tax Changes – Property Investment

Limiting deductions for Plant & Equipment in residential rental property:

• The changes apply from 1 July 2017, to:
  • previously used plant and equipment acquired at or after 7.30 pm on 9 May 2017 unless it was acquired under a contract entered into before this time
  • plant and equipment acquired before 1 July 2017 but not used to earn income in either the current or previous year.
Recent Tax Changes – Property Investment

Limiting deductions for Plant & Equipment in residential rental property:

• However, the amendments do not affect deductions that arise:
  • in the course of carrying on a business; or
  • for corporate tax entities, superannuation plans (other than SMSFs) and large unit trusts.

• It therefore applies to individuals, SMSFs and smaller trusts (including family trusts) who are not carrying on a business will be impacted by these amendments.

Recent Tax Changes – Property Investment

Limiting deductions for Plant & Equipment in residential rental property:

• Investors who purchase new plant and equipment will continue to be able to claim a deduction over the effective life of the asset.

• The proportion of the decline in value of the asset that cannot be deducted is recognised as a capital loss (or in certain circumstances a capital gain) when the asset ceases to be used.

• The following slides include examples from the Explanatory Memorandum.
Recent Tax Changes – Property Investment

**Example 2.1: ‘Previously used’ assets**

- Craig has acquired an apartment that he intends to offer for rent. This apartment is three years old and has been used as a residence for most of this time.

- Craig acquires a number of depreciating assets together with the apartment, including carpet that was installed by the previous owner. He also acquires a number of depreciating assets to install in the apartment immediately prior to renting it out, including:
  - curtains, which he purchases new from Retailer Co; and
  - a washing machine, that he purchases used from a friend, Jo.

Craig also purchases a new fridge, but rather than place this in the apartment, he uses it to replace his personal fridge, that he acquired a number of years ago for use in his residence. He instead places his old fridge in the new apartment.

**Example 2.1: ‘Previously used’ assets (continued)**

- The amendments do not permit Craig to deduct an amount under Division 40 for the decline in value of the carpet, washing machine or fridge for their use in generating assessable income from the use of his apartment as a rental property as both are previously used. The carpet and washing machine are previously used as the previous owner or Jo rather than Craig first used or installed the assets (other than as trading stock). The fridge is previously used as while Craig first used or installed the fridge, he has used it in premises that were his residence at that time.

- The amendments do not affect Craig’s entitlement to deduct an amount under Division 40 for the decline in value of the curtains. They are not ‘previously used’ under either limb of the definition.
Recent Tax Changes – Property Investment

Example 2.2: Assets installed in new residential premises

- Hannah purchases two apartments off the plan from Developer Co. The apartments are supplied three months after completion – one is already tenanted and the other is vacant.
- In addition to the construction of the apartments, Developer Co has fitted out the apartments, installing ready for use depreciating assets including curtains and furniture prior to settlement and the transfer of the title to Hannah. Developer Co has also fitted out the shared areas of the complex in which the apartment is located, installing ready for use a range of depreciating assets that are the joint property of the apartment owners.

Recent Tax Changes – Property Investment

Example 2.2: Assets installed in new residential premises (Cont’d)

- All of these assets are new at the time of installation. As these assets were first installed by Developer Co, not Hannah, they are previously used and a deduction would not be available under the general rules established by these amendments.
- However, a deduction is still available to Hannah for the depreciating assets (including Hannah’s share of the assets installed in the shared areas of the apartment) for the period she holds the assets as:
Recent Tax Changes – Property Investment

Example 2.2: Assets installed in new residential premises (Cont’d)

- the assets have been installed ready for use in premises that were supplied to Hannah as new residential premises or in other real property supplied as part of the supply of residential premises;
- Developer Co has not claimed any deduction for the decline in value of the assets (and nor has any other entity); and
- either (excluding assets installed in the common property):
  - for assets in the first apartment, the assets were only used or installed in the apartment, which was supplied to Hannah as new residential premises within six months of the apartment first becoming residential premises; or
  - for assets in the second apartment, no entity has resided in residential premises in which the assets have been installed before Hannah held the assets.

Recent Tax Changes – Property Investment

Example 2.3: Resale of a property including depreciating assets

- Gunther purchases a two-year-old property for $500,000 on 10 July 2017. Part of the purchase price relates to six previously used depreciating assets that are included with the residential premises. The assets are worth $1,000, $3,000, $4,000, $6,000, $7,000 and $9,000, respectively, for a total of $30,000.
- Gunther rents out the property. He is unable to deduct the decline in value of any of the depreciating assets he acquired with the property as they are previously used. On 10 May 2021, Gunther sells the property, including these depreciating assets, for $700,000. At the time of sale, the six depreciating assets have a value of $0, $1,000, $3,000, $4,000, $5,000 and $7,000, respectively, so in total $20,000 of the sale price relates to the depreciating assets.
Recent Tax Changes – Property Investment

Example 2.3: Resale of a property including depreciating assets (Continued)

• The sale of the property is a balancing adjustment event.
• As Gunther has not been able to deduct any amount of the decline in value of the depreciating assets, Gunther does not need to make any adjustment to his assessable income for the income year.
• However, as a balancing adjustment event occurs in relation to depreciating assets for which the available deduction has been reduced by these amendments, CGT event K7 occurs.

Recent Tax Changes – Property Investment

Example 2.3: Resale of a property including depreciating assets (Continued)

• As a result of CGT event K7 occurring, Gunther has a capital loss equal to the proportion of the decline in value of the assets that Gunther has not been able to deduct either because of these amendments or because the amount deductible was reduced under section 40-25.
• In this case, the difference between the total termination value of the assets ($20,000) and the total cost of the assets ($30,000) is $10,000 and all deductions for the decline in value have been denied (so the proportion of total deductions denied is 10,000/10,000 or 1). Therefore, the amount of Gunther’s total capital loss because of the disposal of all of the assets is $10,000 ((30,000 – 20,000) *1 = $10,000).
Conclusion

Wrap up
Questions

Thank you