Australian Government
Australian Taxation Office

Rental properties
Interest expenses

If you take out a loan to purchase a rental property, you can claim the interest charged on that loan, or a portion of the interest, as a deduction. However, the property must be rented, or genuinely available for rent, in the income year for which you claim a deduction.

What can you claim?

You can claim the interest charged on the loan you used to:

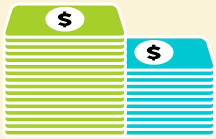
- purchase a rental property
- purchase a depreciating asset for the rental property (for example to purchase a new air conditioner for the rental property)
- make repairs to the rental property (for example roof repairs due to storm damage)
- finance renovations on the rental property
- you can also claim interest you have pre-paid for up to 12 months in advance.

What you can't claim?

You cannot claim interest:

- for the period you used the property for private purposes, even if it's for a short period of time
- on the portion of the loan you use for private purposes when you originally took out the loan, or if you refinanced
- on a loan you used to buy a new home if you do not use the new home to produce income, even if you use your rental property as security for the loan
- on the portion of the loan you redraw for private purposes, even if you are ahead in your repayments.

If you have a loan you used to purchase a rental property and also for another purpose, such as to buy a car, you cannot repay only the portion of the loan related to the personal purchase. Any repayments of the loan are apportioned across both purposes.



Rental property owners should remember three simple steps when preparing their return:

1. Include all the income you receive
This includes income from short term rental arrangements (eg a holiday home), sharing part of your home, and other rental-related income such as insurance payouts and rental bond money you retain.

2. Get your expenses right

- Eligibility – Claim only for expenses incurred for the period your property was rented or when you were actively trying to rent the property on commercial terms.
- Timing – Some expenses must be claimed over a number of years.
- Apportionment – Apportion your claim where your property was rented out for part of the year or only part of your property was rented out, where you used the property yourself or rented it below market rates. You must also apportion in line with your ownership interest.

3. Keep records to prove it all
You should keep records of both income and expenses relating to your rental property, as well as purchase and sale records.

Example:

Claiming all interest incurred

Kosta and Jenny take out an investment loan for $350,000 to purchase an apartment they hold as joint tenants.

They rent out the property for the whole year from 1 July. They incur interest of $30,000 for the year.

Kosta and Jenny can each make an interest claim of $15,000 on their respective tax returns for the first year of the property.

Example:

Claiming part of the interest incurred

Yoko takes out a loan of $400,000 from which $380,000 is to be used to buy a rental property and $20,000 is to be used to buy a new car. Yoko's property is rented for the whole year from 1 July. Her total interest expense on the $400,000 loan is $35,000.

To work out how much interest she can claim as a tax deduction, Yoko must do the following calculation:

Total interest expenses × (rental property loan ÷ total borrowing) = deductible interest

That is:
$35,000 × ($380,000 ÷ $400,000) = $33,250

Yoko works out she can claim $33,250 as an allowable deduction.

Example:

Interest incurred on a mortgage for a new home

Zac and Lucy take out a $400,000 loan secured against their existing home to purchase a new home.

Rather than sell their existing home they decide to rent it out.

They have a mortgage of $25,000 remaining on their existing home which is added to the $400,000 loan under a loan facility with sub-accounts, that is, the two loans are managed separately but are secured by the one property.

Zac and Lucy can claim an interest deduction against the $25,000 loan for their original home, as it is now rented out.

They cannot claim an interest deduction against the $400,000 loan used to purchase their new home as it is not being used to produce income even though the loan is secured against their rental property.

Example:

Interest incurred on funds redrawn from the loan halfway through the year

Tyler has an investment loan for his rental property with a redraw facility. He is ahead on his repayments by $9,500 which he can redraw.

Halfway through the year, Tyler decides to redraw the available amount of $9,500 and buys himself a new TV and a lounge suite.

The outstanding balance of the loan at that time is $365,000 and total interest expense incurred until then is $9,300.

The total interest for the year is $19,000.

Tyler can only claim the interest expense on the portion of the loan relating to the rental property using the following calculation:

Total loan balance – redraw amount = rental property loan portion

That is:
$365,000 – $9,500 = $355,500

To work out how much interest he can claim, he does the following calculation in respect of the period following the redraw:

Total interest expenses x (rental property loan portion ÷ loan balance at the time of the redraw) = deductible interest

That is:
$9,700 x ($355,500 ÷ $365,000) = $9,448

Tyler can claim interest of $18,748 being $9,300 plus $9,448.

This is a general summary only

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