New space potential

Pam Walkley assesses adding rentable space to your home

ADDING SPACE UNDER YOUR HOME that can be rented out can be a way to make extra money as long as you do not mind having tenants literally on your doorstep. *Money* reader Leanne built a rental unit under her home at the same time as renovating the house, and is now asking if she and her partner can claim any expenses relating to it. And if they can, which one of them should claim?

In most instances renting out a unit or granny flat attached to a home is likely to be treated as renting out part of the family home. If there is separate permission to subdivide off the land that the unit is on, such as a building fronting a rear road, it may be regarded as a separate investment. Either way you can claim deductions.

Let's assume the renovations added 50% to the size of Leanne's existing home and half is being leased out, meaning 25% of the floor area is used as a rental property.

Also assume the total renovation cost was $300,000 and this amount was borrowed. Because half of the new floor space is being used to earn income, interest on half the loan is deductible against the rental income. The interest on a $150,000 loan (interest only) at 7.5% is $937.50 a month, or $11,250 a year. Other out-of-pocket expenses, such as a share of rates and water, power and maintenance add up to $3000 a year.

Leanne and her partner are also likely to be able to claim depreciation allowances on the part of the new building that is used to produce income. They should seek advice and a depreciation schedule from a quantity surveyor. New building work yields an estimated 5% depreciation allowance in year one, according to Tyron Hyde, director of quantity surveyor Washington Brown. In our example this would equate to $7500.

Which partner is actually able to claim any deductions associated with the part of the home that is rented out is out of Leanne's hands, as it is decided by the ownership of the property. So if the property is owned jointly by the two partners, they will each be entitled to 50% of the deductions associated with it.

Let's say the 25% of the home rents for $200 a week, giving an annual rental of $10,400. Leanne and her partner would be able to deduct all costs and allowances, totalling $21,750, from the $10,400 rental income, leaving a shortfall of $11,350.

If it's jointly owned they can each deduct $5675 from their regular incomes of about $90,000 each, reducing each of their taxable incomes to $84,325 and each tax bill from $21,650 to $19,493.50 (not including Medicare levy).

Of course one trade-off for being able to enjoy these tax breaks is that the entire family home will no longer be capital gains tax free when it is eventually sold.

In this instance, because Leanne and her partner have lived in the home, before using part of it to produce an income they will need to get it valued at the point of time they started to rent it out. Assume that's $450,000. In several years they sell it for $700,000. They make a $250,000 capital gain ($700,000 minus $450,000). Because 25% of the home has been used to bring in an income, 25% of this, or $62,500, is subject to capital gains tax (go to www.ato.gov.au and search "using your home to produce income" for more detail).

Pam Walkley, former property editor with The Australian Financial Review, *has hands-on experience of buying, building, renovating, subdividing and selling property.*

PROPERTY FOCUS

With Lisa Montgomery*

Trends with mortgages and credit are already emerging as the economy continues its slow recovery. Rising rates have already led many to consider moving to a part-fixed loan so they have more certainty plus some flexibility in case their circumstances change. Fixing only part of your loan for a manageable time frame of say two years can address concerns about further interest rate rises, while retaining some balance between fixed and variable rates.

On the subject of credit, more borrowers are willing to hear about various strategies to pay down bad debt so they can concentrate on paying their mortgage and not end up in the same over-leveraged position they may have had prior to the GFC.

These options are worth considering, provided you look closely at all the choices, what each will actually cost and what you will save financially and personally.

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