CLAIMING DEDUCTIONS FOR INTEREST PAID

Q I bought my first home for $400,000 with a basic no-frills loan set-up and have been diligently paying off my interest and principal for the past six years.

Over the last four years, I've rented the property out and have been claiming tax deductions on it.

I have now refinanced the loan to $500,000 (bad investment, I know) with a 100% offset account to unlock the equity to finance my next investment property purchase.

I intend to keep the LVR at 80% and continue to claim tax deductions on the new loan amount.

Have I unknowingly created a problem for myself with the ATO for dodgy use of equity? Is it advisable that I use the equity for a principal place of residence only? Many thanks in advance for your advice.

A As it is matched against rental income, the basic rule for interest to be deductible is that the principal loan funds borrowed have to be applied to an income-producing asset such as a rental property.

The security given to the lender that provides the loan is not as relevant.

Lenders often promote minimising the interest expense by reducing the principal, whether through the regular repayment plan or a faster mode. This is fine while the property is being occupied as the main residence.

Issues arise when the use of the property changes from private to investment when it is rented out. The preferable position would be for the initial loan to have features including interest-only plus an offset deposit facility. This would leave the original principal loan as is, but the interest expense would fall as more of the capital/repayment is deposited into the offset deposit facility.

As the usage of the property changes from main residence to rental investment, the interest expense should be deductible against the rental income. Where funds in the deposit facility are withdrawn, the entire interest expense should be deductible.

Often the principal of the loan is reduced through regular interest and principal repayments; interest expenses on additional redraw will only be deductible where the funds are used to acquire income-producing assets, including rental properties, but not the existing property.

Where an existing loan is refinanced to access more funds as the property has grown in value, the deductibility of interest will depend on how the loan funds are applied. It is deductible where funds are applied towards income-producing purposes.

Apportionment is necessary where the loan is used to fund both a rental investment and a private asset. Record-keeping is essential in these situations.

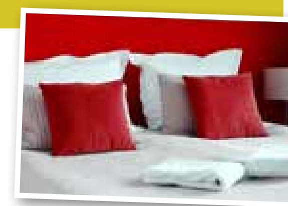
– Shukri Barbara

The views provided are of a general nature only and should be considered as general education. Readers should not act on the information above without obtaining professional advice relevant to their circumstances. The article is intended as information only.

QS Corner

TIP #67

In this month's QS Corner – it's all about Airbnb!



Have you ever thought about renting a room out in your house on Airbnb for a few extra bucks?

I know I have.

Airbnb, in case you haven't heard, is a website that allows you to offer short term accommodation to others, or, you stay at someone else's place.

But what are the tax implications and can you claim depreciation?

The simple answer is Yes! If you rent out one bedroom of your 2 bedroom apartment… you can claim depreciation based upon a pro-rated ratio.

This tends to be based upon a floor area calculation and split between the portion set aside to produce income and that portion not.

BUT there is a big catch.

By renting out part of your house you will not be able to claim the full Capital Gains Exemptions that applies to your main residence.

So you need to do a cost-benefit analysis that takes into account rental income received, depreciation claimed and potential Capital Gains Tax (CGT) payable.

TIP: If you think the market has peaked and will be flat for a while - then this strategy could be worthwhile. Get the property valued at the point you start renting out the property and if the value is the same in 10 years' time...well, there would be no CGT payable anyway!

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For free property depreciation and construction cost calculators, visit:
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