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COVID-19 and residential rental property claims

Many residential rental property owners have had their rental income affected by COVID-19. As a result of this income year **not** being business as usual, the ATO has provided answers to some typical scenarios that may crop up in this area for tax time.

Q If tenants are not paying their full rent or have temporarily stopped paying rent as their income has been affected due to COVID-19, can a property owner still claim deductions on their rental property expenses?

A Yes. If tenants are not meeting their payment obligations under the lease agreement due to COVID-19 and you continue to incur normal expenses on your property, then you will still be able to claim these expenses in your tax return.

Q A property owner is considering reducing the rent for tenants whose income has been adversely affected by COVID-19 to enable these tenants to stay in the property (they are not in default of their rent). Will the owner's deduction for rental property expenses be reduced because of this?

A No. If they decide to reduce the rent to enable tenants to remain in the property (thereby maximising rental return in a changed market), their deduction for rental property expenses will not be reduced.

Q If the bank defers loan repayments for a period due to COVID-19, can a property owner continue to claim interest on the loan as a deduction?

A Yes. If interest continues to accumulate on your loan, it will be an expense that you have incurred and is therefore deductible. Interest remains deductible on the loan even if the bank defers the repayments.

Q Is a rental property owner able to access the new increased instant asset write off for their property?

A No. If you are a property investor, you cannot access the instant asset write-off deduction.

Q COVID-19 is adversely affecting demand, including cancellation of existing bookings, for a property that is usually rented out for short-term accommodation, but has also previously had some private use by the owner. Will they be able to continue to deduct expenses associated with this property in the same proportion as they were entitled to claim before COVID-19 for the period that demand is adversely affected?

A The amount you can claim will depend on how the property had been used before COVID-19 and how the owner had planned to use it during the COVID-19 period. If the reason for the adverse effect on demand for the property is because of COVID-19 (or the bushfires before that), a property owner can continue to deduct expenses associated with their property in the same proportion as they were entitled to deduct before COVID-19.

If they had started to use the property in a different manner than before COVID-19, the proportion of expenses able to be claimed as a deduction may change. Examples of changed use includes:

- Increased private use of the property by the owner, their family or friends
- A decision to permanently stop renting out the property once the COVID-19 restrictions end.
  Source: Butler Settineri

Laws on bankruptcy changed to help cope with COVID-19

The government has temporarily changed bankruptcy law to help protect people who are facing unmanageable debt as a result of the economic impacts of COVID-19. If you are in financial difficulty, application can be made for temporary debt protection, which prevents recovery action by unsecured creditors, for six months.

The threshold of debt that can trigger bankruptcy has also been increased from $5,000 to $20,000.

The body governing Australia's insolvency and bankruptcy regulations, the Australian Financial Security Authority, says being granted a temporary debt protection means enforcement action cannot be taken by unsecured creditors to recover money owed to them. This means they cannot garnish your wages, or have a bailiff or sheriff seize goods.

Note however, that creditors that hold a security over an asset (such as a car, or a house under a mortgage arrangement) can still repossess that asset. These are known as secured creditors. Also, temporary debt protection does not apply to some types of debt, such as HELP debts, child support and fines imposed by Court Order.

During the period under the protection order, which is six months, but used to be 21 days before the COVID-19 changes, a person can seek advice from a free financial counsellor, negotiate a payment plan with creditors, or consider if any of the insolvency options available may be a viable choice.

Once you apply for a temporary debt protection order, you cannot apply again for a further 12 months. After the initial six months is up, the person who applied for the protection is not automatically made bankrupt. If you don't apply for bankruptcy, creditors can still pursue you for the debt.

Importantly however, a temporary debt protection is viewed by the courts as an "act of bankruptcy" (formally known as "declaration of intention to lodge a debtor's petition"). This means that a creditor could use the fact that a person lodged temporary debt protection as the basis for an application to a court to make that person bankrupt. Source: ButlerSettineri

Are you in the ATO crosshairs?

As we head towards the end of the financial year, many people will be thinking about deductions to reduce taxable income. But, as always, it is important to be prudent and avoid mis-claiming to avoid an audit from the Australian Taxation Office.

The ATO has previously said that a small number of individuals over-claim expenses, amounting to losses of around $8.7 billion dollars in taxation revenue.

The following areas are currently being targeted by the tax office:

- individuals claiming high work expenses
- landlords over-claiming interest costs on investment property loans
- failure to properly declare capital gains on property sales.

The ATO uses sophisticated data matching to scrutinise financial transactions and expense claims. Together with state revenue authorities, the tax office receives information from various organisations including employers, banks, share registries and other government agencies about taxpayer's transactions and assets.

For workers, the ATO has also developed benchmark statistics for average deductions for different occupations and uses this data to identify taxpayers whose claims are well above average. This may trigger an audit. The ATO tends to target taxpayers in the top 10 per cent of claimants for a given profession.

How COVID-19 affects tax claims

For many of us, working from home expenses will be greater this year. The ATO expects a substantial jump in people claiming deductions for working from home or for protective items required for work. But at the same time the ATO expects to see lower travel expenses and laundry costs.

The tax office has introduced a temporary "short-cut method" that applies from 1 March 2020 to 30 June 2020 which can be used by Australians who have incurred expenses for working from home because of COVID-19. It covers all deductible expenses, so taxpayers cannot claim for any other working from home expenses. If taxpayers prefer, they can use other existing methods to decide claims.

"What you can claim really depends on your circumstances. Whilst we are trying to make it easier for people to claim what they are entitled to, we are also asking people to take a bit of extra care if their circumstances have changed this year, "says assistant Commissioner Karen Foat.

However, particularly large claims may still prompt the ATO to ask questions, such as substantiating the number of hours worked using a diary or timesheet.

"The ATO has made it clear that they will be examining claims for such items as protective clothing and work-related travel where the COVID-19 restrictions would suggest that in some cases such claims should be reduced".

Property investors 'a perennial target'

As for workers, the ATO applies a similar method in deciding which landlord claims to scrutinise depending on the size of deductions.

"People who tend to claim average deductions related to rental properties probably won't attract attention. But for those people sitting in the top 10 per cent of deductions, in terms of the amount they claim, then the ATO might target those taxpayers. It may only be 2 per cent who are mis-claiming and the other 8 per cent may have large deductions for valid reasons such as depreciation.

Another area which commonly attracts the attention of the ATO is 'debt recycling' to boost deductions of interest costs.

The ATO is always on the lookout for debt recycling. So if, for example you have $100,000 BHP shares and just before June 30 you sold them and you use the $100,000 to pay down your home loan, then take out an investment loan and soon after buy back those $100,000 worth of BHP shares, than the ATO may see this as debt recycling. You may get into trouble if you are just trying to change your tax position to get a benefit to avoid paying tax.
Source:Morningstar

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