

Excessive claims for holiday homes (and similar properties) in the ATO's firing line

The ATO has recently indicated that deductions are often incorrectly claimed in relation to holiday homes and similar properties. This includes properties that are used to provide short-term holiday accommodation through online platforms, such as Airbnb and Stayz.

The ATO has also advised that many Australians own a holiday home, but there are some holiday homeowners who, on average, claim deductions that are **six times higher** than income earned from their property. Refer to the ATO fact sheet: *Do your clients have a holiday home?* (QC 71293)

Deductions that are often incorrectly claimed for these types of properties include claims for interest expenses, council rates, building insurance, utility costs (e.g., gas and electricity) and repairs. Furthermore, the ATO has been particularly concerned that claims are being made for these expenses during periods that a holiday home is:

- vacant and **not** genuinely available for rent; and/or
- actually used or occupied by the owner for private purposes or used by friends and relatives at no cost or at a discount to market value rent.

TAX WARNING – Pertinent questions that clients should be asked

The ATO has indicated that tax practitioners should be questioning clients who own a holiday home about the use of their property for income-earning purposes during an income year (e.g., 2023 income year). This particularly includes questioning clients about:

- the number of days the property was rented out at market value rent during the income year;
- how the property is advertised for rental and whether any restrictions are placed on tenants; and
- whether a client, their family and/or friends, have used the property during the income year.

1 Latest guide to identifying when a holiday home is not genuinely available for rent

When a holiday home is vacant and not actually rented to tenants, deductions can generally only be claimed in respect of the property (e.g., for interest expenses, council rates and building insurance) where the property is **genuinely available for rent**.

Based on the latest ATO and case law guidelines (e.g., the ATO fact sheet: *Holiday homes* (QC 45076)), the following factors may **indicate** that a holiday home is **not** genuinely available for rent:

- (a) **Disguised advertising of property for rent** – A holiday home is advertised for rent through an online accommodation platform (e.g., Airbnb and Stayz), but the property owner does **not** respond to enquiries about the property from prospective tenants.

In actual fact, the ATO's compliance activities for holiday homes in recent years have involved using data matching activities in order to identify taxpayers who use online accommodation platforms to disguise their property as being available for rent in this way.

- (b) **Limited advertising of property** – A holiday home (or property) is advertised in ways that limit its exposure to potential tenants. For example, the property is not listed with a real estate agent for genuine rental (e.g., short-term holiday rental) and is **only** advertised:

- at the owner's workplace;
- by word of mouth; or
- outside annual holiday periods when the likelihood of it being rented out is very low.

In *Bonaccordo v FCT* [2009] AATA 385, a property that had an “available for rent” sign on it (but not listed with a real estate agent) was held by the Tribunal **not** to be genuinely available for rent. According to the Tribunal, this was because the landlord had **not** taken sufficient steps to advertise the property, as the “available for rent” sign was not a seriously perceptible effort to attract tenants in the circumstances.

TAX TIP – Properties that are not listed with an agent can still be genuinely available for rent

A property can still be genuinely available for rent without listing it with a real estate agent, **provided that bona fide and active efforts are being made to rent the property.**

For example, a taxpayer makes their own enquiries through work colleagues and friends, and the taxpayer **actively advertises** the property for rent using other methods, such as:

- placing signage at the front of the property itself, which clearly shows that the property is available for rent; and
- placing advertisements on the noticeboards of a local shopping centre and in the newspapers (e.g., the local newspaper).

- (c) **Location and accessibility of property** – The location, condition of the property, or accessibility to the property, means that tenants will unlikely seek to rent it.
- (d) **Placing unreasonable or stringent conditions on renting the property** – A taxpayer places unreasonable or stringent conditions on renting out the property, which restricts the likelihood of the property being rented out. According to the ATO, this could include a taxpayer:
- setting the rent above the rate for comparable properties in the area; and/or
 - placing a combination of restrictions on renting the property (e.g., requiring applicants to provide references for short stays and having conditions like ‘no children’ and ‘no pets’).
- (e) **Refusing to rent out the property to interested people without adequate reasons** – A taxpayer refuses to rent out the property without a reasonable explanation and/or refuses to follow up on enquiries regarding the property’s short-term hire (or rental). Refer also to *Case V133 88 ATC 847* and *Case P116 82 ATC 590*.

The following example has been partly adapted from the ATO’s fact sheet: *Holiday homes*.

EXAMPLE 2 – Holiday home used privately during ‘peak’ periods and listed for rent during periods of no or little demand

Daniel and Kate have two school-aged children and own a beach house in a beachside location that is popular with summer holiday-makers but only accessible by four-wheel drive vehicles.

During the 2023 income year, Daniel and Kate advertised the property for rent through a local real estate agent. However, Daniel and Kate advise the agent that during each school holiday period, the property is not to be rented out, as they want to reserve the property for their own use.

There is no demand for the use of the property outside the summer holiday period because of the small number of holiday-makers, the location of the property and the limited access to the property. As a result, Daniel and Kate’s holiday house is **not** rented out at all during the income year.

According to the ATO, Daniel and Kate **cannot** claim any deductions in relation to their holiday house, as they do **not** have a genuine intention to earn rental income from the property and/or the property is essentially for private use.

Alternatively, if Daniel and Kate happen to rent out the property for a period (e.g., a two-week period), they can claim a deduction for a proportion of their expenses based on the period the property is actually rented out (e.g., for two weeks out of 52 weeks in the year).

Umbrella Property Accountants

The ATO's spotlight on holiday rental properties

1.1 Evidence the ATO will expect to see in establishing that a holiday home is genuinely available for rent

In establishing that a particular holiday home is genuinely available for rent during an income year that it is vacant, the ATO will expect to see the following type of evidence:

1. **Letters from real estate agents** that had the property listed on their books, outlining:
 - when the property was listed;
 - the criteria used to choose tenants (including any particular restrictions);
 - the interest generated; and
 - whether any potential tenants were rejected upon applying for occupancy of the property (including the reasons for any rejection).
2. The content of **advertising material**, such as newspaper, magazine, and journal clippings.
3. **Letters from business proprietors** that may have allowed the taxpayer to advertise the property for rent within their business premises (e.g., where the property was advertised on the notice board of a supermarket or on the window of a shop).
4. The **taxpayer's verbal evidence** on exactly what efforts were made to rent the property. This is an important factor (particularly where a case is considered before the Tribunal or a Court) in establishing whether bona fide and active efforts were made to rent the property.

1.2 General apportionment guidelines for holiday homes not rented or genuinely available for rent for the entire income year

Deductions in relation to a holiday home must be apportioned (i.e., deductions **cannot** be claimed) for any period(s) during an income year that the property is:

- used for private purposes (e.g., by its owners);
- not rented to tenants; and/or
- not genuinely available for rent.

In these situations, deductions related to a holiday home would generally be apportioned by reference to the following **general** guidelines:

- (a) **Occupancy-type expenses** – Deductions related to interest expenses, council rates, building insurance and land tax would generally be claimed on a **'time basis'** (i.e., for the number of days during the year that the property was actually rented or genuinely available for rent and not used for private purposes).
- (b) **Depreciation and capital works deductions** – These deductions would also generally be claimed on a **'time basis'** (as noted at (a) above).
- (c) **Utility costs** – Deductions related to utility costs (e.g., gas and electricity) would be deductible to the extent they relate to the period(s) that the property was rented to tenants (or genuinely available for rent), calculated on a reasonable basis.
- (d) **Repairs and maintenance** – Deductions for repairs and maintenance to a holiday home would be deductible to the extent to which they relate to deterioration or damage to the property while it was rented to tenants or genuinely available for rent.

Note that, the above methods of apportionment (especially apportionment on a 'time basis') may **not be appropriate** in certain situations (e.g., where a holiday home is solely or predominantly used for private purposes during peak periods, as further discussed below).

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The ATO's spotlight on holiday rental properties

EXAMPLE 3 – Apportioning deductions for a holiday home used mainly for rental purposes during the year

Jack and Jill jointly own a holiday home at a popular beach resort.

The property is usually available for rent during all holiday periods, including weekends, school holidays, Easter and Christmas. Jack and Jill use the property themselves for some weeks during the year in off-peak periods when they are unlikely to find tenants for the property.

Use of the property during the 2023 income year

During the 2023 income year, assume that the property is used as follows:

- Actually rented and genuinely available for rent
 - Occupied by tenants at commercial rent 125 days
 - Genuinely available for rent 198 days 323 days
- Occupied by Jack and Jill 42 days
365 days

Rental income and property-related expenses for the 2023 income year

The **rent** received by Jack and Jill from the property was **\$26,450** for the 2023 income year.

Jack and Jill also incurred total property-related expenses of **\$32,800**. These comprised:

- **interest** expenses;
- building **insurance**;
- **council rates**; and
- **land tax**.

The **depreciation** (or decline in value) **amount** related to depreciable assets in the property (e.g., a hot water system, an oven and carpets) was **\$2,050**.

Calculating the deductible expenses related to the property for the 2023 income year

Jack and Jill's property-related expenses and depreciation will be deductible to the extent (i.e., for the number of days) that their property is rented and genuinely available for rent during the 2023 income year (i.e., for 323 days). On this basis, the **deductible amount** is calculated as follows:

$$\$34,850 \text{ (i.e., } 32,800 + \$2,050) \times 323 \text{ days}/365 \text{ days} = \mathbf{\$30,840} \text{ (rounded)}$$

Calculating Jack and Jill's net loss from the property for the 2023 income year

On this basis, Jack and Jill's total net loss from the property for the 2023 income year would be calculated as follows:

• Gross rental income	\$ 26,450
• Less: Allowable deductions	– <u>\$ 30,840</u>
Net loss	<u>(\$ 4,390)</u> (or \$2,195 each)

Jack and Jill's respective share of the gross rental income and allowable deductions (including their share of the net loss) related to the property must be disclosed at **Item 21** of their respective 2023 individual tax returns.

TAX WARNING – Apportionment dangers for holiday homes that are used for private purposes during peak periods

Situations will arise where a holiday home is used for private purposes (e.g., by the owner(s) and their family) during **peak holiday** periods (i.e., during periods that would otherwise generate the highest amount of weekly rent, such as during the December/January school holidays and Easter).

In these situations, many holiday homeowners may seek to:

- claim deductions for property-related expenses (and depreciation) that relate to the off-peak periods during the year that their holiday home is listed for rent on the basis that their property is genuinely available for rent; and
- apportion their property-related expenses (and depreciation) on a **'time basis'** (e.g., deductions may be claimed for the number of days that the relevant property was listed for rental during off-peak times during the year).

In these circumstances, the ATO is likely to question a **taxpayer's purpose** with acquiring and/or holding a holiday home, including whether the taxpayer has a **dual purpose** (refer to *Fletcher's case* and TR 95/33).

In these circumstances, the ATO may seek to apply a different apportionment method and/or **reduce** a taxpayer's deductions related to their property in any of the following ways:

1. **Limiting deductions to rental income** – The ATO may only allow property-related deductions for the year to be claimed up to the amount of any rental income derived from the property.
2. **'Time basis' of apportionment may not be appropriate** – If deductions are available for property-related expenses incurred during off-peak period(s) that the property was listed for rent, the ATO may argue that a 'time basis' apportionment (i.e., based on the number of days a property is genuinely available for rent) is **not** appropriate.

Instead, the ATO could argue that it may be more appropriate to calculate allowable deductions based on, for example, the amount of rent received during the off-peak periods the property was listed for rent as a proportion of the total rent that could have been received during the peak periods the property was used for private purposes.

3. **No deductions during off-peak periods that the property was listed for rent** – The ATO may **not** allow property-related deductions that relate to off-peak periods during which the property was listed or advertised for rent in the above circumstances. For example, the ATO may take the approach that the property is **not** genuinely available for rent during these periods.

In this case, the ATO may only allow property-related deductions that relate to any periods in an income year during which the property was actually rented to tenants.

The following example has been partly adapted from the ATO's fact sheet: *Holiday homes*.

EXAMPLE 4 – Holiday home used by owners during peak periods

Marie purchased a property in a busy seaside holiday town, which is generally rented out via an online accommodation-sharing platform.

Each year, Marie **blocks out** the school holiday period over December/January and the Easter period for her family's use. The town's busiest times for tourists are during the school holidays, especially during the December and January school holidays when the weather is the warmest.

For the remainder of the year, Marie rents the property out via an accommodation-sharing platform so that she can claim some of the costs of holding the property against the rental income.

Use of the property during the 2023 income year

During the 2023 income year, assume that the property has been used as follows:

- Occupied by Marie and her family over the December/January holidays, the Easter holidays and other school holidays 40 days
- Rented to holiday makers outside school holidays and Easter 25 days

Rental income and deductions for the 2023 income year

The **rent** received by Marie was **\$3,000** for the 2023 income year, which is included in her assessable income for the year.

Marie incurred total property-related expenses of **\$60,000** during the year.

According to the ATO, Marie can only claim deductions for the period that her property is actually rented during the year (i.e., for 25 days). On this basis, Marie's **allowable deductions** would be calculated as follows:

$$\$60,000 \times 25 \text{ days} / 365 \text{ days} = \mathbf{\$4,110} \text{ (rounded)}$$

This would result in a **net loss** for Marie (for the 2023 income year) of **\$1,110** (i.e., \$3,000 rental income less \$4,110 allowable deductions).

2 Claiming deductions for holiday homes rented to friends and/or relatives at a discounted rent

It is often the case that a holiday home is rented to friends and/or relatives of the owner(s) of the property at a discounted rate of rental for different periods during an income year. In these situations, the ATO has identified that deductions are being claimed in full (i.e., without being apportioned) for expenses incurred in relation to the property during these periods.

However, the following table summarises the ATO's general deductibility guidelines for expenses incurred during periods when a holiday home is used by friends and relatives at a discounted rental. The outcomes in the table are based on examples in the ATO's fact sheet: *Holiday homes*.

Expenses vs income	ATO deductibility guidelines
1. Expenses exceed rental income from friends and/or relatives	Where the expenses incurred during these periods exceed the amount of rental income received from friends and/or relatives, deductions will generally only be allowed up to the amount of rental income received. Refer to paragraph 16 of IT 2167 and to TR 95/33. As to whether any additional tax deduction can be claimed will ultimately depend on the taxpayer's circumstances (including the taxpayer's objective(s) or motive(s) in relation to the holiday home – e.g., whether it was predominantly acquired for income-earning purposes).
2. Expenses do not exceed rental income from friends and/or relatives	Where the expenses incurred during these periods do not exceed the amount of rental income derived from friends and/or relatives, deductions can generally be claimed in full for the actual amount of expenses incurred during these periods (and for the actual amount of depreciation and building write-off related to these periods).