Umbrella Property Accountants

Tax Treatment Rental Property Purchase Costs

Description of purchase-related cost	Tax deduction?	Cost base?	ATO References
1. Purchase price of property: ❶ • Building • Depreciating assets – new • Depreciating assets – second-hand • Land	 No ❷ Yes ❹ No ❺ No ❸	 Yes ❸ No No Yes	 Division 43 Division 40 S.40-27 S.110-25(2)
2. Consultant fees: • Finding and/or recommending a suitable property which is later purchased • Buyer advocate fees	No	Yes	S.110-25(3) and ID 2003/361
3. Travel and accommodation costs incurred to inspect a property for potential purchase	No	No	S.8-1 and Division 110
4. Building/pest inspection report	No	Yes	S.110-25(3)
5. Payment to vendor of settlement adjustment for council rates, etc.	Yes	No	S.8-1, *FCT v Morgan*
6. Stamp duty on purchase of a property ❻	No	Yes	S.110-25(3)
7. Legal fees (including conveyancing costs) ❻	No	Yes	S.110-25(3)
8. Borrowing costs (e.g., loan establishment fees, mortgage insurance, stamp duty, etc.)	Yes ❼	No	S.25-25
9. Investment/financial advice and/or attending investment/property seminars • Managing current rental properties (including maximising rent) • Establishing a strategy or plan for making future rental property investments	 Yes No	 No No	TD 95/60
10. Tax advice related to the property	Yes	No	S.25-5
11. Mortgage insurance	Yes ❼	No	S.25-25
12. Building insurance	Yes	No	S.8-1
13. Quantity surveyor report	Yes ❽	No	S.25-5
14. Search fees (e.g., to check land titles, etc.)	No	Yes	S.110-25(3)
15. Conveyancing kit	No	Yes	S.110-25(3)
16. Penalty interest for delayed settlement	Yes ❾	No	S.8-1
17. Forfeited deposit for a property that fails to settle – consequences for the purchaser	No	No ❿	TR 1999/9

❶ *The **purchase price** of a rental property **must be allocated** between the property itself (i.e., building and land) and any depreciating assets contained in the property. In the absence of any specific arm's length allocation in the sale contract, the 'cost' of each depreciating asset is so much of the purchase price that can be reasonably attributed to each asset. A reasonable apportionment could include apportioning the purchase price amongst each of the depreciating assets in proportion to their market value at the time of purchase. Refer to S.40-195, ATO ID 2002/818 and TD 98/24.*

❷ *Although the purchase price is not deductible under S.8-1, a* ***building write-off*** *deduction may be available under Division 43 generally at the rate of 2.5% per annum in respect of eligible capital works expenditure (e.g., expenditure related to the construction, extension and/or alteration of the building).*

❸ *The purchase price of the property forms part of the first element of the property's cost base under S.110-25(2) for CGT purposes. However, when the property is eventually sold, the cost base of the property may need to be reduced by any building write-off amounts the vendor was entitled to claim under Division 43 (noted above). Refer to S.110-45(2) and (4), TD 2005/47 and PS LA 2006/1.*

❹ *Broadly, the cost of a* ***new depreciating asset*** *is written off either:*

- *in the year of purchase (where the $300 immediate write-off under S.40-80(2) applies);*
- *as part of a low-value pool (for assets costing less than $1,000); or*
- *otherwise over the asset's effective life. Refer also to TR 2014/4.*

❺ *Broadly, the cost of a* ***second-hand depreciating asset*** *acquired after 9 May 2017 (including as part of the acquisition of the property) is* ***not*** *eligible for depreciation deductions. Refer to S.40-27.*

❻ ***Stamp duty*** *and* ***legal fees*** *related to a crown lease (e.g., for properties acquired in the ACT) are deductible under S.25-20 and, therefore, will* ***not*** *form part of the property's cost base for CGT purposes.*

❼ *If the total* ***borrowing costs*** *incurred (including the cost of any mortgage insurance) exceeds $100, they are claimed over the term of the loan or five years, whichever is shorter. If the total borrowing costs do* ***not*** *exceed $100, the entire cost is deductible in the year it is incurred. Refer to S.25-25.*

❽ *The ATO has previously advised that the cost of obtaining a* ***building cost estimate*** *from an appropriately qualified person (e.g., a quantity surveyor) for the purposes of claiming the building write-off, would be considered a deductible tax-related expense under S.25-5. Furthermore, in the ATO's publication: "Rental properties 2022", quantity surveyor's fees are listed as a deductible expense in relation to a rental property.*

❾ *A deduction is only available provided that* ***penalty interest*** *is in the nature of interest (which is normally the case) and there is a genuine intention to use the property exclusively for income-earning purposes.*

❿ *Although a* ***forfeited deposit*** *does not form part of the cost base of the property as such (given that the purchaser does not end up taking up ownership of the property),* ***the purchaser may still be entitled to a capital loss*** *under the CGT rules, as explained in the following Tax Tip.*

TAX TIP – CGT consequences of forfeited deposit for purchaser

A **forfeited deposit** will form part of the cost base of the purchaser's bundle of contractual rights, being the relevant asset which is acquired for CGT purposes when the contract was entered into.

Therefore, when the contract is cancelled and the deposit is forfeited, the purchaser may be entitled to a **capital loss** under **CGT event C1** or **CGT event C2**, broadly as follows:

(a) **CGT event C1** will be triggered where the purchaser's rights under the contract are 'lost or destroyed'. According to the ATO, this will occur where the purchaser's default is genuinely **involuntary** (e.g., the purchaser's finance falls through or there are extenuating personal circumstances, such as the death of a spouse or severe illness).

In this case, a **capital loss** will generally arise, which is equal to the forfeited deposit plus any incidental costs incurred by the purchaser (e.g., legal fees). This is because there would generally be **no** disposal proceeds (i.e., the market value substitution rule does **not** apply).

(b) **CGT event C2** will be triggered where the purchaser's rights under the contract are 'surrendered, abandoned or forfeited'. According to the ATO, this will occur where the purchaser's default is **voluntary** in nature (e.g., the purchaser changes their mind).

In this case, a **capital loss** can basically only arise to the extent of any incidental costs incurred by the purchaser (e.g., legal fees). This is because, the disposal proceeds in this case are generally equal to the market value of the property less the amount still to be paid on settlement (i.e., the disposal proceeds are generally equal to the forfeited deposit amount).

Further reference should be made to TR 1999/19.