IT 2167 - Income Tax: rental properties - non-economic rental, holiday home, share of residence, etc. cases, family trust cases

This document has been Withdrawn.
There is a Withdrawal notice for this document.

TAXATION RULING NO. IT 2167

INCOME TAX: RENTAL PROPERTIES - NON-ECONOMIC RENTAL, HOLIDAY HOME, SHARE OF RESIDENCE, ETC. CASES, FAMILY TRUST CASES

F.O.I. EMBARGO: May be released

REF
H.O. REF: 84/990-1 DATE OF EFFECT:

B.O. REF: VIC: VJ 342/1 DATE ORIG. MEMO ISSUED:

F.O.I. INDEX DETAIL

REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1187168	RENTAL PROPERTIES	
	INTEREST AND OTHER	51
	DEDUCTIONS	53
	NON-ECONOMIC RENTAL	
	HOLIDAY HOME	
	SHARE OF RESIDENCE	
	AND SIMILAR CASES	
	FAMILY TRUST CASES	

PREAMBLE

From time to time questions arise about the extent to which losses and outgoings incurred in connection with rent producing properties are allowable as income tax deductions. The sorts of situations in which the questions arise are:-

1. Arms length letting of an identified part of a residence, e.g. a bedroom, with access to general living areas of the residence.

2. Letting of property to relatives

3. Payment by family members of an amount for board and lodging.

4. Occupancy of part of a residence on the basis of occupants sharing household costs such as food, electricity, heating, etc.

5. Letting of a holiday home or potential retirement home for part only of a year.

6. Letting of a residence during a transfer in place of employment.

7. Purchase of a residence by a family trust and the subsequent leasing of it to family beneficiaries in the trust.

2. Before canvassing how the relevant provisions of the income tax law are considered to operate in these situations, it is appropriate to make some general comments.

3. In Press Release, No. 45 of 30 June 1983, the Treasurer announced that the Commissioner of Taxation would not be

changing the long standing practice of allowing deductions in full for interest on moneys borrowed to invest in rent-producing properties where the interest and other outgoings exceeded the rental income in any year. There is nothing in this Ruling which would detract from the Treasurer's statement. In the situations to which this Ruling applies the questions which arise are concerned with apportionment of losses and outgoings where a property is not wholly used for rental purposes and with determining whether particular receipts are assessable income.

4. The second point to be made is that, ordinarily, where a taxpayer grants a lease or licence of property, whether wholly or in part, whether at arms length or otherwise, the amount received as rent or in respect of the licence is assessable income. This is illustrated by the decision in FCT v Kowal, 84 ATC 4001: 15 ATR 125.

5. It is necessary to make the qualification "ordinarily" because some cases may arise, particularly where the arrangements are not at arm's length, where an amount described as or said to be rent is not of income nature and, therefore, not assessable income. In FCT v Groser, 82 ATC 4478: 13 ATR 445, for example, the taxpayer permitted his invalid brother to live in a house which the taxpayer owned. The taxpayer arranged to receive his brother's invalid pension so that he could use the moneys to provide for the brother's maintenance. It was arranged that $2 per week would be deducted for rent of the taxpayer's house. The Court held that the weekly amounts of $2 were not assessable income. They were a contribution to the funds out of which the taxpayer proposed to maintain his brother. The arrangements were simply not of a kind which produced a receipt of income as that term is normally understood.

6. A third point to make is, that in determining the extent to which losses and outgoings incurred in connection with rent producing properties are allowable as income tax deductions, there is no basis for distinguishing between fixed costs, such as interest and insurance, and other costs. It has been suggested that, in cases where part of a private residence is let, the reasoning of the Courts in the home office cases would lead to the conclusion that the fixed costs attributable to the private residence, e.g. interest, insurance, etc., are essentially of a private or domestic nature and that no part of them is allowable as an income tax deduction.

7. The suggestion does not accord with the official approach. In paragraph 5 of Taxation Ruling No. IT 191 it is stated that, where a taxpayer derives assessable income from self-employed activities carried out at his home, an income tax deduction may be allowed up to a reasonable amount in respect of rent, interest, insurance, etc. paid in respect of the home. The employee accountant who conducts a tax agent's practice from his home, the employee architect who does freelance work at a room in his home are examples of situations to which paragraph 5 of Ruling No. IT 191 applies. It is considered that a taxpayer who derives assessable income from letting part of his private residence is in the same category as the examples referred to and is entitled to appropriate income tax deductions for rent, interest, insurance, etc.

8. The final point to be made is that, while this Ruling

deals with the apportionment of losses and outgoings incurred in connection with rent producing properties, not all losses and outgoings will necessarily be apportioned. For example, there will be no queston of apportioning depreciation on furniture in a room which is let to a tenant for the whole of a year. On the other hand there would be a need to apportion depreciation on jointly-used facilities, e.g. refrigerator, washing machine, etc. Expenditure on repainting a room let to a tenant for the whole of a year would qualify for deduction in full under section 53 but the cost of repainting the entire house would need to be apportioned. It will be a question of applying the relevant provisions of the income tax law to each claim for decuction.

Arms length letting of an identified part of a residence, e.g. a bedroom, with access to general living areas

9. This heading typifies a situation which is commonly encountered. A variety of arrangements may occur in situations of this nature. The rent payable may cover variable or running costs such as electricity, heating, etc. or the arrangements may require the tenant to pay, in addition to rent, a separate amount towards variable or running costs. The heading would also cover situations where board and lodging is provided.

10. The situations represented under this heading call for apportionment of expenditures incurred in respect of the residence to determine what amounts may be allowed as income tax deductions. Inevitably it will be a question for decision in each case. As a general approach apportionment should be made on a floor area basis, i.e. by reference to the floor area of the residence to which the tenant/lodger has sole occupancy together with a reasonable figure for access to the general living areas including garage and outdoor areas. If, for example, the tenant/lodger had sole occupation of one room in the residence and shared the general living areas equally with the owner/occupier, it would be appropriate to add one half of the floor area of the general living areas to the floor area of the room of sole occupancy in order to make the necessary apportionment. In some cases access to the general living area may be restricted to the kitchen, bathroom, a laundry - it would be necessary to restrict the reasonable figure for access to general living areas to those rooms.

11. Where the tenant/lodger, in addition to paying rent, or an amount for board and lodging, is required to make a separate contribution to specific variable or running costs such as electricity, heating, etc., the question arises whether the separate contribution is assessable income. On the basis that the separate contribution represents part of the reward of the owner of letting part of his residence, the amounts are considered to be assessable income. If the arrangements are such that the separate contribution is made on a precise sharing of costs basis the assessable income will be offset by allowable deductions. If the separate contribution is a fixed amount income tax deductions will be allowed for the part of the variable or running costs attributable to the tenant/lodger's use of the relevant facilities.

12. The approach to be followed in cases arising under this heading has been framed on the basis that the rent charged by

the owner represents a normal commercial rent. If the amount charged is significantly less than the normal commercial rate, enquiries would be justified to ascertain the reason for the lower charge. The basis of apportionment in cases of this nature will be determined on the facts of each case having regard to the reason for the lower charge.

Letting of property to relatives

13. Where property is let to relatives the essential question for decision is whether the arrangements are consistent with normal commercial practices in this area. If they are, the owner of the property would be treated no differently for income tax purpose from any other owner in a comparable arms length situation.

14. If property is let to relatives at less than commercial rent other considerations arise. Unless the arrangements are comparable to those in FCT v Groser referred to earlier, the rent would represent assessable income. It would not necessarily follow, however, that losses and outgoings in relation to the property would be wholly deductible. The ultimate resolution of the matter would depend upon the purposes of the taxpayer in acquiring the property and in letting out to relatives.

15. In the Kowal case, for example, the Court found that the taxpayer had two purposes or objects in mind in acquiring the relevant property. One was to provide his mother with a good home at moderate cost. The other was to earn assessable income. The Court further found that the second purpose or object was the predominant one and, in the result, allowed income deductions for 80% of the losses and outgoings falling within sub-sections 51(1) and 67(1). In the Groser case, on the other hand, the Court expressed the view that, if the weekly rental had been assessable income, it would have allowed no more than $104 by way of deduction under sub-section 51(1) - the reason for this being that private or domestic purposes for the expenditure predominated over the purpose of producing assessable income.

16. As has been said earlier, decisions in these cases will ultimately depend upon the facts of each case. As a matter of experience it is unlikely that there will be sufficient information provided in return forms to enable a final decision to be made. In these circumstances, and as a working rule, income tax deductions for losses and outgoings incurred in connection with the rented property may be allowed up to the amount of rent received. Whether any additional deduction is to be allowed will depend upon the nature of any further information provided by the taxpayer.

Payment by family members of an amount for "board and lodging"

17. Arrangements of this nature, whether the payment is said to be for board only or for lodging only or for both, are considered to be in the nature of domestic arrangements not giving rise to the derivation of assessable income by the recipient of the payments. It follows that the question of income tax deductions for losses and outgoings does not arise.

Occupancy of part of a residence on the basis of the occupants' sharing household costs such as food, electricity and cleaning, etc.

18. What will be decisive in cases of this nature will be the characterization of the arrangements, i.e., do they produce assessable income. Situations arise where the owner of a residence permits persons to share the residence on the basis that all the occupants, including the owner, bear an appropriate proportion of the costs actually incurred on food, electricity, etc. Arrangements of this nature are not considered to confer any benefit on the owner. There is no assessable income and the question of allowable deductions does not arise.

19. Care should be taken to ensure, however, that what may be termed ordinary tenancy arrangements are not dressed up in the form represented by the above heading. If the owner were not party to the sharing arrangements or if the occupants made a fixed contribution to the owner for household costs, there would be a presumption that the payments made by the occupants contained an element of reward to the owner for the occupancy of the residence. Enquiries will be necessary in these cases to establish the extent of the benefit to the owner which should be included in his assessable income. Income tax deductions for losses and outgoings attributable to the residence would be determined on the same basis as applies under the heading "arms length letting of an identified part of a residence, e.g. a bedroom, with access to general living areas of the residence".

Letting of a holiday home or potential retirement home for part only of the year

20. The problem involved under this heading relates to properties which are essentially private residences. They are located in holiday resort-areas or away from mainstream residential areas. The properties may be let for short periods of time, e.g. during school holidays. In some instances friends or relatives of an owner may occupy a property for holidays at no or minimal cost. For the greater part of the year, however, the properties will be either occupied by the owner for short periods or remain unoccupied.

21. The minimal amounts received from friends or relatives in these cases are not considered to be assessable income. The occupancy arrangements in these cases are in the nature of domestic or family arrangements and the amounts received by the owner from friends or relatives are re-imbursements for costs incurred during the period of occupancy.

22. On the other hand the rent received from the commercial letting of the properties i.e. the letting of the properties, at a commercial rental, is clearly assessable income. It is a question of deciding what amount of the losses and outgoings incurred in connection with the properties is allowable as an income tax deduction.

23. Again this will be a question to be determined in the light of individual cases. In Case No. P116, 82 ATC 590 : Case No. 49, 26 CTBR (NS) 372, a property was let for 16 days during the year of income, occupied by the owners for 107 and

vacant for the balance of the year. Taxation Board of Review No. 1 apportioned the losses and outgoings attributable to the property on a time basis and allowed a decuction for the proportion that the property was let, i.e. 4.4%.

24. As a general rule the approach of the Board in the case cited should be followed in comparable cases, i.e. the time basis should be used to determine the income tax deduction allowable in respect of the relevant losses and outgoings. Where the information supplied in a return of income is insufficient to enable a final decision to be made, the income tax deductions allowed should be limited to the amount of rent received. Whether a further deduction is to be allowed will depend upon the nature of any additional information provided by the taxpayer.

25. A question which may arise in cases coming under this heading is whether the apportionment of losses and outgoings attributable to a property should take into account the periods during which the property was not only let at a commercial rental but also available for letting at a commercial rental. The question is, of course, one for decision in individual cases. Nevertheless, a period of time during which a property was available for letting should only be taken into account where it is established that active and bona fide efforts to let the property at a commercial rental were made during the relevant period.

26. An associated problem that arises in cases under this heading is the extent to which travelling expenses incurred by the owner of the property in inspecting and maintaining the property are allowable as income tax deductions. The answer will depend, of course, on the nature of the travel. If, for example, it is undertaken to prepare the property for incoming tenants or to inspect the property at the conclusion of the tenancy, the costs of travel would be allowable as an income tax deduction. If, on the other hand, the travelling is associated with the owner's personal use of the property or with the general maintenance of it, the costs of travel would not be allowable as an income tax deduction.

Letting of a residence during a transfer in place of employment

27. Where a residence is let on a normal commercial basis during the period of transfer, losses and outgoings in relation to the residence and which are eligible for income tax deduction would be allowable as income tax deductions.

28. There would be a need for apportionment on a time basis if the residence was let for less than a year.

Purchase of a residence by a family trust and the subsequent leasing of it to family beneficiaries in the trust.

29. Situations under this heading are designed to obtain an income tax deduction for losses and outgoings which would otherwise be characterized as private or domestic expenditure. By way of illustration, a family trust may be established to acquire what is in fact the private residence of the beneficiaries of the trust. Financial arrangements for the purchase of the residence by the trustee may be highly geared.

The trustee will let the residence to one or both parents at a commercial rental and the family would occupy the residence as the family home. The trustee lodges a return of income disclosing the rental as assessable income and claiming income tax deductions for the losses and outgoings attributable to the residence. Income from other sources is channelled into the trust to absorb the losses arising from the rental of the residence to the parents.

30. In situations such as this it is apparent that, had the parents acquired the residence in their own right, the losses and outgoings attributable to the residence would not have been allowable as income tax decuctions - they would have been private or domestic expenditure. In cases of this nature that have arisen, the deductions claimed by the trustee have been reduced. A case in point has been heard by a Taxation Board of Review and is currently awaiting decision. In the meantime it should not be accepted in cases of this nature that the rent payable by the parents is assessable income of the trustee or that the losses and outgoings attributable to the residence are allowable as income tax deductions.

COMMISSIONER OF TAXATION
4 July 1985