Australian Government
Australian Taxation Office

# Rental mortgage – interest expenses


Congratulations on buying or refinancing your investment property. We found that almost one-third of people made mistakes when claiming their interest deductions. This information will help you get your claims right in your tax return.

## Key points

Remember the following three key points:

- The property must be rented, or genuinely available for rent at the time you incur the interest
- Only claim the interest on the loan that relates to your rental property, not your private expenses
- Keep all your records that show how you calculate your interest.

## What you can claim

You can claim interest amounts if both of the following apply:

- The rental property is rented, or genuinely available for rent at the time you incurred the interest.
- The loan amount relates to the rental property and is for any of the following – to
  - purchase the property
  - buy a depreciating asset (for example, an air conditioner)
  - make repairs (for example, roof repairs due to storm damage)
  - finance renovations on the rental property (for example, a new pergola).

You can also claim interest if you have pre-paid your loan for up to 12 months in advance.

If your rental property was damaged or destroyed and is uninhabitable and you can't earn rental income, you can claim mortgage interest while doing repairs or renovations to make the property habitable again so you can earn rental income.

## What you can't claim

You can't claim:

- your full loan repayment amount
- the full interest amount charged on the loan for
  - any periods you used the property for private purposes, even if it's a short period
  - any amount used for a non-deductible or private purpose other than for the rental property – for example, to go on holidays or buy a boat (even if you withdrew an amount because you were ahead on your repayments)
  - money you used to buy a new home to live in (even if you use your rental property as security).
- the purchase of vacant land to build a rental property – you may no longer claim the interest on your mortgage until the property contains a residential premise that both
  - can be lawfully occupied
  - is available for rent or is rented.

## Loan accounts used for private and rental property

If you have a loan to purchase a rental property and for private purposes such as to buy a car, you:

- can only claim a deduction for the interest relating to the rental property
- must apportion any repayments of the loan across both the private and rental purposes based on the value of the loan (you can't pay back the private portion first)
- must keep accurate records so you can calculate the interest that applies to the rental property portion of the loan (which you need to keep for five years after you sell the property, even if you refinance the loan).

## Redraw vs offset accounts

If you borrow to purchase an investment property, choosing between redraw and offset can have a significant effect on your tax. Both can save you money on interest repayments and reduce your home loan term.

To be certain about what suits you best, seek professional advice.

### Offset account

An offset account is a separate savings account linked to the loan account:

- The balance is not used to pay down the loan directly, but offsets the outstanding balance to reduce interest.
- You can use funds from the offset account for private purposes, as you haven't increased the loan balance.

All interest may still be deductible.

### Redraw facility

A redraw facility is a feature attached to your loan and allows you to withdraw any extra repayments you have made:

- As you make extra deposits the investment loan balance decreases as does the interest charged on the loan.
- When you redraw any extra payments your loan balance goes up.

If your redraw is for personal items, then the extra interest charged is not deductible.

## Examples – using a redraw and offset account

### Example 1: Redraw of funds

Tyler has an investment loan for his rental property with a redraw facility. He is ahead on his repayments by $9,500, which he can redraw. Halfway through the year, Tyler decides to redraw the available amount of $9,500. He buys himself a new TV and lounge suite, both for private use.

The outstanding balance of the loan at the time is $365,000.

The total interest expense incurred for the period before the redraw is $9,300. The total interest for the year is $19,000. Therefore, the total interest expense for the period after the redraw is $9,700 ($19,000 – $9,300).

Tyler can only claim the interest expense after the redraw on the portion of the loan relating to the rental property. As the redrawn amount of $9,500 was used for a private purpose, Tyler works out the rental property loan portion after the redraw using the following calculation:

**total loan balance after the redraw – redraw amount = rental property loan portion after the redraw**

**$365,000 – $9,500 = $355,500**

Tyler needs to apportion the interest for the period after the redraw. He does this using the following calculation:

**total interest expenses for the period after the redraw × (rental property loan portion after the redraw ÷ loan balance at the time of the redraw) = deductible interest for the period after the redraw**

**$9,700 × ($355,500 ÷ $365,000) = $9,448**

The total interest amount Tyler can claim for the year is $18,748 ($9,300 + $9,448).

### Example 2: Interest on loan to purchase new home

Billie is offered a job in Darwin and decides to relocate her family there. She borrows $200,000 from the bank and purchases a home in Darwin. After two years the balance on Billie's home loan is $186,000.

Billie receives a $50,000 windfall and decides to pay off her home loan. This reduces the balance to $136,000.

Billie is then offered a job in Perth. She decides to take the job and relocate her family. She rents out her home in Darwin and borrows to purchase a new residential property in Perth. Billie redraws $50,000 from the Darwin loan and uses this as a deposit for her new home in Perth.

Billie can deduct the interest accrued on the outstanding loan principal of $136,000 that is related to her Darwin property from the date it is available for rent, as the new borrowing of $50,000 is used as a deposit on the residence in Perth. The interest on that borrowing won't be deductible as it is incurred for a non-income producing purpose.

## This is a general summary only

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