The Tax and Record Keeping Consequences of Holiday Rentals Such as Airbnb

Update – The ATO have released a draft ruling TR 2025/D1 about holiday homes that are used for both private and rental income purposes. The ruling does not allow a tax deduction for any of your ownership costs such as rates, insurance, interest, depreciation, land tax, repairs and maintenance unless the property is mainly used to produce income. Mainly is not about the majority of weeks in a year. It also considers how the peak times are used and how genuine your attempts are to make it available for rent.

Obviously, you have to declare the income you receive and are entitled to claim expenses but the long-term consequences of a property earning income is capital gains tax (CGT) which means keeping records for the rest of the time you own it. This will even apply to your home in most circumstances.

When the Property is Not Your Main Residence

This can include a property that you totally devote to short term rental or your holiday home that you rent out when you are not there. In the latter case you will need to record the days you use it for private purposes, the days it is available for rent, the days actually rented and apportion the expenses accordingly. Expenses directly relating to the earning of income, such as advertising don't need to be apportioned. How you divvy up the expenses relating to the days it is available for rent depend on just how seriously you are holding it as a rental. This is discuss in more detail further on.

Depreciation - Certainly building depreciation can be claimed if the property was built or renovated after 16th September, 1987. It is now the plant and equipment depreciation that gets a bit tricky since the May 2017 budget. If you stay in the property yourself then the plant and equipment will be considered to have been used for private purposes and from that point onwards will no longer qualify to be depreciated when the property is rented out.

Repairs – These can be apportioned according to the ratio of use during the year even if you under take them while you are staying there.

Negatively Geared - This is when a property costs you more in tax deductible expenses than it earns in rental income. The ATO is always on the look out to deem these arrangements non-commercial and limit your tax deductions to the amount of income you received.

If it is a holiday home obviously you have to apportion the expenses between the time it was used for private purposes and the time it was rented out. But what about the time in between? This is when you will be arguing that it was available for rent so the expenses for that period should be tax deductible and the ATO will be arguing that you didn't work hard enough to find someone to rent it. They will say you didn't really want anyone staying there because you want to keep it for yourself so it is a non-commercial rental.

Even if there is no private use of the property the ATO will still try to argue that you have some other purpose for holding the property other than producing income. For example that you bought it for capital growth and don't really want people in it. Have you ever met anyone who does that? Apparently the ATO have.

Here are some of the issues they will point to as evidence that your arrangement is not commercial and therefore you can only claim expenses up the amount of rent received.

- Not having the property listed on multiple online accommodation sites. The catch is of course if you multi list then you risk a double booking and if you cancel a booking these sites will punish your listing. Further some sites don't vet their guests so are best avoided.
- Charging above the average price compared with other online listings. Bad luck if you are offering top of the range accommodation.
- Not offering special deals and promotions. The race to the bottom, which is why so many of these gig economies fail.
- Not offering free Wi-Fi, Foxtel and a coffee machine.
- The ATO even judge how well you have written the description in your listing to make sure it is up beat enough and mark you down if you don't get enough reviews from guests which is a bit of a catch 22.

This is seriously true, we have this in writing as a response to an objection we lodged.

Capital Gains Tax – If you lived in the property before it became a rental then you can consider covering it with your main residence exemption under the 6 year rule, section 118-145 ITAA 1997. Of course you won't be able to cover wherever else you are living during that time. The 6 year rule allows you to cover the property with your main residence exemption for up to 6 years while it is being rented out or an indefinite period of time if it is not being rented out. The catch is that being available for rent counts in the 6 years. You have to take it off the market to shift into the indefinite period.

You may be aware that the 6 year period resets if you move back into the property as your main residence. To do this you must live there not just holiday there. So you need to be able to go to work and school from there and properly set up home.

When the Property is Your Main Residence

This is where the tax office get greedy clutching at the little bit of capital gains tax they will receive and as a consequence you are left with a record keeping nightmare. But first let's look at the rental income side.

Sharing your home with your guests:

IT 2167 states that if you are receiving money from people staying in your home, that exceed their share of expenses such as food and electricity (mortgage payments don't count as expenses) then you must declare the income you receive and claim a portion of the expenses for the period as a tax deduction. Some of these would be worked out on a floor area basis maybe 100% of the bedroom they use and 50% of the common areas. You would also need to add an additional percentage to apportion for the time it is used to produce income and the time it is not. The sorts of expenses you can apply this to would be electricity, rates, insurance, interest and maintenance costs. Of course, you can claim 100% of any expenses that solely relate to your guests, such as their food and advertising costs. You are entitled to claim a portion of the building depreciation if it was constructed or renovated after 16th September 1987 but plant and equipment depreciation such as furniture and linen is a lot more difficult since the May 2017 budget. The catch is it can't have been previously used by you so the only items that would qualify would be brand new stuff that does not get used while paying guests are not there.

It is important to note that using part of your home to produce income in this way is going to mean you lose part of your main residence exemption. The percentage you use to calculate the deduction for expenses will apply to your CGT calculation. The 6 year rule will not help you here as that requires you to be absent from the property.

At the first time the property is used to produce income, assuming up until that date it has always been covered by your main residence exemption, section 118-192 ITAA 1997 resets its cost base to market value at the time you first advertise it for rent. Here is another trap in the fine print.

For CGT purposes the bleeding starts the minute you advertise your home for rent but you don't qualify to claim any expenses as a tax deduction until you have a guest because before then it is being used for private purposes.

Renting out your home while you are not there

Alternatively, you might consider renting out your home while you are away on holidays or travelling for work. This would mean that 100% of the property is used by your guests so no need for the first piece of apportionment above. You just need to apportion the expenses on a days used by you and days used by guests. In most cases you are still caught in the CGT trap, that it will not be covered by your main residence exemption for the period it is available to earn income.

Think also about the trap that if you are going to wait until you get a booking before you take off on your holiday then you may list your home on Airbnb a long time before you go away to ensure you have a guest. It is from that time, of listing, that you will lose your main residence exemption even though you are still living there.

The capital gains tax consequences will shock you on this one. The ATO claim that even though you are not living there while your guests stay there you still can't use section 118-145 ITAA 1997, the 6 years absence rule. That section requires you to cease using the property as your home and they argue that it is still your home, you are just away on holidays, citing things like some of your personal affects are still there, it is still your address on the electoral roll, your licence, your mail still goes there etc. They also suggest that the power and gas need to be disconnected but this is only one of a list on this page https://www.ato.gov.au/General/Capital-gains-tax/Your-home-and-other-real-estate/Your-main-residence/Treating-a-dwelling-as-your-main-residence-after-you-move-out/ of points they consider, you don't need to meet all of the requirements.

Example 3 on the page considers a couple to be absent (ceased using it as their home) from their property even though they leave the electricity connected and store some personal effects in their home and go away for 3 to 4 months. Nevertheless, it would take some pretty careful planning to utilise the absence rule when you rent out your home while you are on holidays.

This means that renting your home out while you are away for a short period of time is likely to expose the property to CGT i.e. resetting the cost base as above and needing to keep records for the rest of the time you own the property so you can calculate the total CGT to apportion it. If you can handle the record keeping, consider section 110-25(4) ITAA 1997 which allows you to increase your cost base by anything associated with holding the property that is not otherwise claimed as a tax deduction so this would include even cleaning materials while you are living there not to mention insurance, interest, rates, lawn mower fuel etc.

Until just recently the ATO have kept this all very quiet, to themselves because they really weren't sure how they were going to apply a piece of legislation that was written around 20 years ago. Nevertheless, now they have made a decision it will apply retrospectively.

We had heard the ATO were considering this so tried to get more information. It took nearly 5 months of battling the ruling process. Finally lodging a complaint when they refused to answer the ruling request on the basis I didn't need to know how airbnbing my home would affect my main residence exemption until I actually sold it and they didn't have to answer my question until then. Then I pulled out the big guns and asked Noel Whittaker to rattle the chain of their media unit and we got an answer. While the answer wasn't good news at least it gave us a road map on how to stay out of the CGT trap.

You need to be able to understand the rules to follow the rules.
- Kitty Flanagan

Now that you understand the law there are two things to consider, whether you want to expose your home to CGT and whether doing so will actually cost you more than the rent you receive. Every circumstance will be vastly different but here is an example to give you an idea.

Example:

You first rent your house out when its market value is $600,000, from that point you have to keep records of all expenditure relating to the house.

When you sell you calculate the full capital gain from the date you first listed it to rent out, to the date of sale, then apportion it between days covered by the main residence exemption and days not. The days it was not covered will be the days it was available to rent, not necessarily the days it actually earns income. It is listed on Airbnb for 10 weeks before you find a tenant, who takes it for three weeks.

That is a total of 13 weeks it was available to produce income: a quarter of the year. Let's assume you do the same for the next four years and the house goes up in value by 5% a year, that is $729,304 – a gain of $129,304.

That $129,304 capital gain may be reduced to, say, $100,000 if you have kept good records. Under the pro rata time rule, 25% of the capital gain will be taxable. After the 50% CGT discount that is $12,500. If your marginal tax rate is 39% the tax on that gain would be $4,875.

If the above scenario was repeated for four years you could probably expect to receive a total of $12,000 income. This assumes a net rent of $1000 a week after Airbnb fees, breakages, cleaning, and possibly a small deduction for interest. After paying tax at 39% you only received $7,320 for the four years. Deduct from this the CGT of $4,875, leaving you a paltry $2,445, while the taxman gets $9,555. Not to mention the mountains of records you will need to preserve.

Conclusion:

There is going to be some CGT consequence if you rent out your home for a short period of time. The way to avoid this is to not list it for rent until you vacate. Change your address to another home on everything and remove most of your personal effects. Also make sure you go away for at least 3 or 4 months.

Don't think it won't catch up with you? It is a no brainer now for the ATO with all their data matching.

The only way out of the CGT is to die while you are living in the property and not be using it to produce income at the time, including not having it listed on Airbnb. If you can manage this your heirs will inherit it at market value at your date of death and all of your CGT liability will be forgiven and forgotten, section 128-15 ITAA 1997.

Link to a spreadsheet that will help you keep the CGT records you will need if you are renting out your home https://www.bantacs.com.au/shop-2/protecting-your-home-from-cgt/