

NEGATIVE GEARING & REAL ESTATE



WHAT IS NEGATIVE GEARING?

- You borrow to acquire an investment
- The interest and other costs you incur are more than the rental income you receive from the investment (cash loss)
- This cash loss is offset against income from other sources, thus reducing your taxable income and the amount of tax you have to pay

HOW NEGATIVE GEARING WORKS

Case Study

- John, who earns \$80, 000 per year, **borrow**s \$285, 000 to purchase an investment property
- He pays **interest** at 8% per year to the bank (interest-only loan)... Total interest expense for the year is \$22, 800
- John is able to claim a tax deduction for cash rental expenses incurred, as well as, the decline in value of the property

HOW NEGATIVE GEARING WORKS

Rental Income

\$285 per wk

\$14, 820

Less Cash Expenses

Interest

\$22, 800

8% Agents Fee

\$1, 186

Council Rates

\$1, 500

Water Rates

\$1, 000

Insurance

\$500

Other

\$500

(\$12, 666)

Less Depreciation

Building (\$160, 000 @2.5%)

\$4, 000

Plant & Equipment (\$30, 000 @ 15%)

\$4, 500

Total Loss

(\$21, 166)

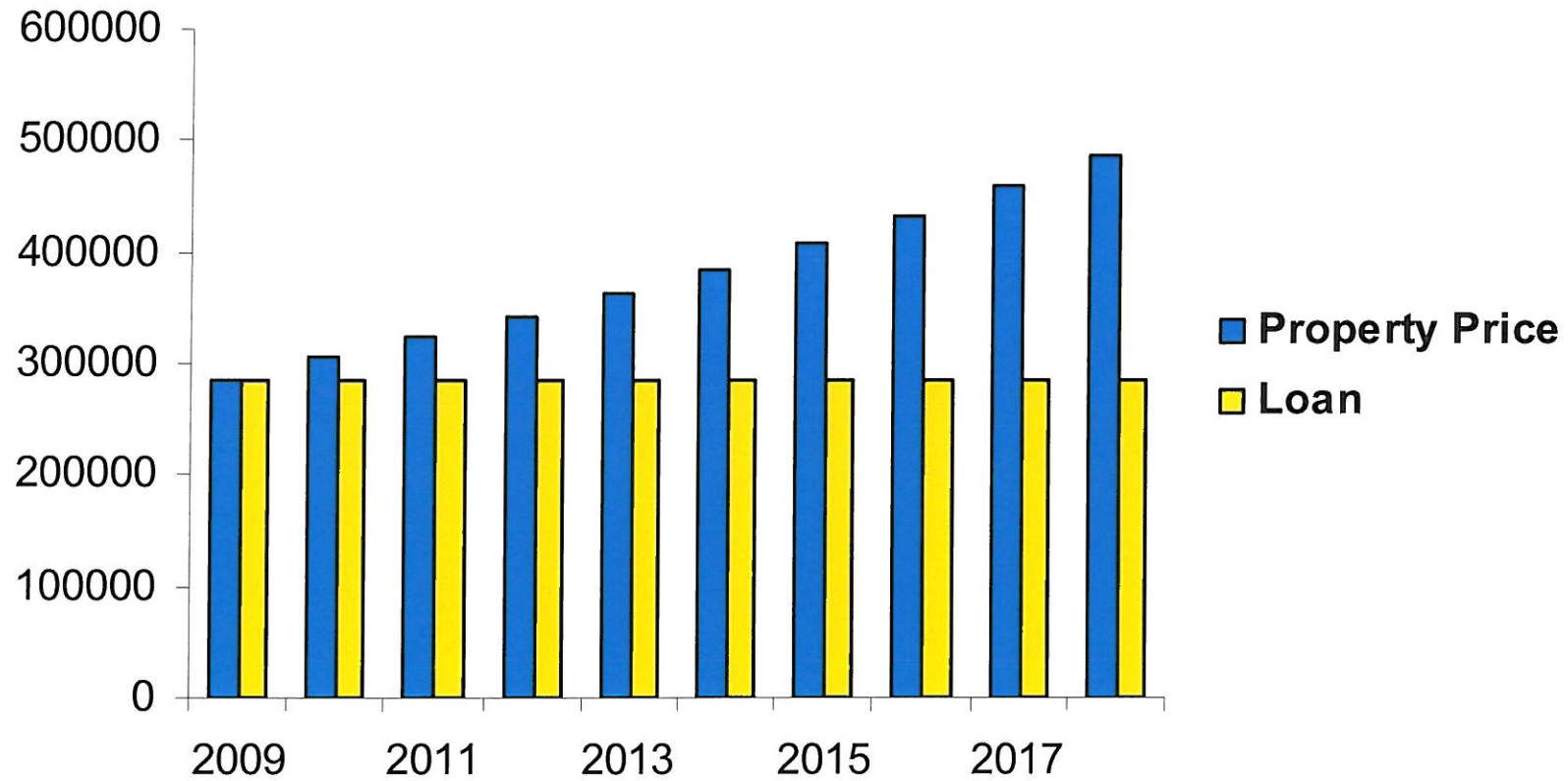
HOW NEGATIVE GEARING WORKS

- After annual interest repayments of \$22, 800, John has made a loss of \$21, 166 during the year
- However, John is able to offset his net loss (\$21, 166) against his other income
- Negatively geared property means lower net income for the year **but** lower income tax bill

HOW NEGATIVE GEARING WORKS

	No Investment Property	With Investment Property
Salary (Gross)	\$80, 000	\$80, 000
Net Loss from Property	N/A	\$21, 166
Assessable Income	\$80, 000	\$58, 834
Tax Payable	\$20, 300	\$13, 132
Net Income	\$59, 700	\$45, 702
Tax Saving	\$7, 168	
Cost per Week (Cash Loss-Tax Refund / 52wks)	$(12, 666 - 7, 168 / 52)$ = \$105	

PROPERTY VALUE & DEBT



TIPS

Do's

- Engage a professional to prepare a Schedule of Depreciation and Capital Allowances Report
- Borrow Interest Only (unless no other debt)
- Incur repairs and maintenance expenses after property is classified as a rental

Don'ts

- Don't begin repairs until after property established as a rental
- Claim capital improvements as a deduction
- Don't pay principle off the loan if other debt exists

COMMON MISTAKES

- Claiming costs associated with the purchase of property e.g. stamp duty as immediate deductions. These expenses form part of the cost base
- Claiming the cost of the land component as part of the construction cost of the rental property
- Claiming deductible borrowing expenses in the first year they are incurred (need to be spread over 5 years)