

# The Complete Guide to Buying a *Negatively Geared Property*



## **CMT ACCOUNTING**

Unit 2, 211 Warrigal Rd  
Hughesdale VIC 3166

Phone: 03 8525 7100 Fax: 03 9579 1112

Email: [info@cmtaccounting.com.au](mailto:info@cmtaccounting.com.au)

Website: [www.cmtaccounting.com](http://www.cmtaccounting.com)

Liability limited by a scheme approved under Professional Standard Legislation.

# Contents-The Complete Guide to Buying a Negatively Geared Property

## Contents

INTRODUCTION.....	3
The History of Negative Gearing.....	4
Negative Gearing Overview.....	4
Negative Gearing and How It Works.....	5
Tax Deductible Loss.....	6
Affordability – The After Tax Cost.....	7
Ownership Structure.....	7
Where To Buy – The Importance of Capital Growth.....	10
When to Buy?.....	12
The Investment Clock.....	13
The Risks.....	14
Getting Finance.....	15
Fixed Versus Variable Rate.....	16
Principal and Interest or Interest Only.....	16
Loan Features and Fees.....	18
The 13 Steps to Negative Gearing of Property.....	19
Keeping Records.....	25
a) Records that impact Capital Gains Tax.....	25
b) Records related to Annual Income and Expenses.....	25
Checklist of Records To Prepare if First Tax Return.....	25
Rent Manager.....	26
Common Mistakes in Tax Returns.....	26
Goods and Services Tax (GST).....	27
Time To Sell.....	28
Selling Costs and Considerations:.....	28
Capital Gains Tax.....	29
Some Capital Gains Tax Complications.....	31
Types of Rental Property Expenses.....	33
Fully Tax Deductible Expenses.....	33
Non Tax Deductible Expenses.....	34
Expenses Deductible Over Time.....	37
A) Borrowing Costs.....	37
B) Capital Works or Building Construction Write-Off.....	37
C) Depreciation or Decline in Value Deduction.....	38
Worksheet – Sample Property – A.....	48
Notes From Meeting.....	49

# INTRODUCTION

As the small percentage of Australia's population who have achieved real wealth and financial independence will tell you, it's not always about how much you earn but what you do with your money that really counts.

Creating wealth through negatively gearing an investment property is a well established practice in this country with approximately 30% of residential properties owned by investors. If you were to believe some people it would all seem very simple. Buy the right property in the right location and then courtesy of the Government's tax concessions have the tenant and the Tax Office partially fund your running costs while you sit back and profit from the appreciating value of the property.

But can using property to make money be that simple?

The truth is, it only works when you have a combination of the right property in the right location, the correct tax advice and ownership structure plus the most suitable loan. Over the years many of our clients have grown their wealth by negatively gearing property but we have also seen some financial disasters. This country now has a 'property investment industry' with many self proclaimed property gurus but there is no substitute for independent, unbiased professional advice.

The purchase of your principal place of residence is often described as an emotional decision from the 'heart' but buying an investment property is a business decision that needs to be made from the 'head'. In business, 'failing to prepare is preparing to fail' which is why your property purchase needs to be thoroughly researched, carefully planned and most importantly, financially sound.

This booklet specifically relates to the negative gearing of a residential property. We assume you intend buying the property in your personal name or owning it jointly with your spouse or partner. We also assume that you are not a property developer, overseas resident or carrying on the business of rental property investment because there are additional, more complex rules that would apply.

Clearly, negative gearing isn't suitable for all investors. Your financial planner will tell you that in any financial planning or wealth creation strategy you need to match an investor's risk profile to the investment type, gearing strategy and time frame. The attraction of borrowing or gearing is that you can invest in a property that might otherwise have been unaffordable and take advantage of the tax concessions. Make no mistake, it can be a risky business because while gearing can amplify your gains, it can also magnify your losses.

This booklet is designed to give you an understanding of the key principles of buying a negatively geared property that you can then discuss with your accountant, solicitor, mortgage broker or buyer's advocate. It is general in nature and covers a broad range of topics including how negative gearing works, where to buy, the risks and the record keeping requirements. It offers you a 13 step checklist to getting started and you can read all about the tax treatment of expenses incurred when purchasing, maintaining and selling a property. It briefly addresses the complex mine field of capital gains tax and provides some tax tips and warnings along the way.

To illustrate the likely costs and tax treatment of the expenditure we have built in a case study that flows through the entire booklet from purchase to sale. The booklet also has worksheets so you can prepare some financial projections and 'what if' scenarios for the property. Finally, based on a number of assumptions we can prepare a 10 year cash flow forecast for a property and also project the profit and loss statement.

As your accountants we are here to guide you through the process and help evaluate the financial soundness of the strategy taking into account your objectives and taxation position. We are not your average accounting firm that just keeps the score. Rather, we want to work with you in conjunction with your financial planner to develop tax effective strategies that will help secure your financial future.

Regards

# The History of Negative Gearing

The Australian Government introduced negative gearing in the early 1980's to encourage taxpayers to purchase investment properties to increase the availability of rental properties. By supplying housing for people who were not in a position to purchase their own home it would save millions of dollars in funding plus huge administration and infrastructure costs. With a growing number of the population renting, an under supply of rental properties would not only push rents up (giving rise to inflationary pressure and unhappy electorates), it would also put further pressure on the government housing supply. The initiative was also designed to stimulate the economy because so many industries in this country heavily rely on building, construction and development.

A quarter of a century later the landscape has changed.

Statistically speaking, Australians are living longer and having fewer children. The Australian Bureau of Statistics suggests that currently 84% of retirees have a family income of less than \$21,000. At the same time, the 'baby boomer' generation is approaching retirement age and most of them will lean on the social security system. Unfortunately compulsory employer funded superannuation didn't start until 1991 when the first wave of baby boomers were mid-way through their working lives. Initially contributions were only 3% of their wage, growing to the current level of 9% by 1998. Courtesy of this planning initiative and some prosperous years in the new millennium, the outlook was positive until the 2008 share market 'crash' wiped out around 25-50% of their superannuation fund balances.

The global credit crisis and rising unemployment will mean we can expect to have many under-funded retirees and as a consequence, the Government continues to encourage self-funded retirement strategies including superannuation and negative gearing. However, history tells us that Governments (and change of Governments) can also mean policy changes and the tax concessions are not set in stone.

## Negative Gearing Overview

Negative Gearing describes the situation where you borrow to buy an investment (most commonly property or shares) and the interest and other costs you incur to maintain the investment exceed the annual income you receive from the investment. This booklet specifically relates to the negative gearing of *residential property*.

A negatively geared property is where the interest and expenses to maintain the property (including depreciation, building construction write off etc.) exceed the rental income. The ultimate aim for most property investors is to build a portfolio of positively geared properties (where the rental income exceeds any running costs) that grow in value at a much higher rate than inflation. It is through negative gearing and the associated tax benefits that investors are able to purchase and accumulate real estate.

When buying a negatively geared property you need to understand some key principles including:

- A Tax Deduction is available because you are making a 'loss' on your investment. This implies a net cash outflow that you will need to fund from other sources
- Negative Gearing is attractive because of its tax advantages; however, the taxation benefits should not be the primary consideration behind the investment decision
- Capital Growth is the most important ingredient in successful property investing. You accept the losses in the belief that the future capital gain on sale will more than compensate you for those financial losses
- Promises of high rental returns are attractive but remember, the rent helps fund the loss but the capital growth is what builds equity
- Buying the right type of proper~ in the right location is the key to long term capital growth
- When is the best time to buy? property experts suggest you buy the best possible quality property you can afford, when you can afford it. 'Time in the market' not 'timing the market' is what really matters

The net result of a negatively geared property is a tax deductible loss. The tax benefit of the loss will then depend on the ownership structure and an individual, the owner's marginal tax rate. Theoretically, the tax

loss reduces your taxable income and your total tax payable. Obviously, the higher your marginal tax rate the larger the tax saving and the smaller the after tax holding cost each week.

Deciding who should own the property is a very important decision and you need to consider a number of issues including asset protection, estate planning and income tax. For example, individuals can claim a tax deduction for the full amount of the loss and offset it against their other income (i.e. salary, wages, business or investment income). This is not necessarily the case for other types of structures.

With any tax planning strategy you should 'start with the end in mind' and factor capital gains tax in the equation. The incorrect structure can prove very costly and could mean forfeiting concessions such as the 50% capital gains tax discount or paying stamp duty to transfer ownership.

Tax minimization is often part of the motivation to negatively gear a property. As you will read in this booklet, the tax benefits are very important but they should not be the main reason behind the investment.

## Negative Gearing and How It Works

To illustrate how negative gearing works for taxation purposes and to give you some feel for the associated costs we will use a case study example that flows all the way through this booklet.

The basic assumptions for this sample property include:

- You personally sign a contract on 1<sup>st</sup> April 2017 to purchase an investment property in Victoria for \$400,000 with a settlement date of 1<sup>st</sup> July 2018
- You finance 100% of the property (\$421,865), including the stamp duty (\$19,070), bank loan fees (\$600), conveyancing (\$550), sundry legal fees (\$450), land transfer fee (\$1,100) and mortgage registration (\$95)
- The mortgage loan is interest only and the interest rate is 7.87%
- The rental return is 4.5% of the cost of the property being \$18,000 per annum or \$346.15 per week
- You engage a quantity surveyor who advises that the construction of the building was completed on 1st January 2018 at a cost of \$150,000 providing an annual building construction deduction of \$3750 which remains available for the next 35 years
- The Fittings and Equipment in the property totaled \$10,000 and we have used a depreciation rate of 15% in this example
- The Rental Income and Expenses will increase by 5% per annum
- The Property will grow in value by 7% per annum

### Profit & Loss Projection

Gross Rent Received (52 weeks @\$346.15pw)	\$18000
<b>Expenses</b>	
Advertising	300
Agent's Commission (7% of Rent + Outgoings + GST)	1440
Bank Charges and Fees	120
Body Corporate Fees	1500
Borrowing Costs (see page 30)	139
Building Construction Write Off	3750
Cleaning	100
Depreciation \$10,000 @ 15%	1500
Gardening & Lawns	200
Insurance - Landlord	500
Insurance - Building '~ as Body Corporate)	0
Interest \$421,865 @ 7.87%	33154
Letting Fee —2 Weeks Rental plus GST	770
Postage and Stationery	20
Rates - Water & Council	1400
Repairs	500
Telephone	30
Travel to Inspect and Miscellaneous	100
<b>Total Expenses</b>	<b><u>\$45523</u></b>

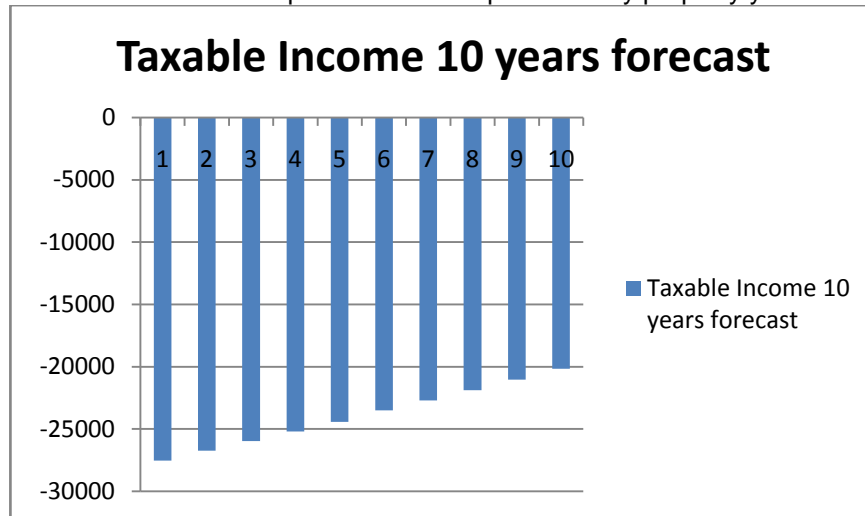
NET TAXABLE LOSS

\$27523

## Tax Deductible Loss

The attached graph and table provide a forecast of the next 10 years tax deductible loss on the sample property.

The analysis assumes interest rates remain constant over that period and you will notice the loss diminishes each year (mainly due to the reduced depreciation claim in the property's plant and equipment). As accountants we can produce these reports for any property you are looking to purchase.



Year	1	2	3	4	5	6	7	8	9	10
Rental Income	17992	18892	19837	20829	21870	22964	24112	25318	26584	27913
Interest on Loan	33146	33146	33146	33146	33146	33146	33146	33146	33146	33146
Annual Running Expenses	6980	7329	7695	8080	8484	8908	9353	9821	10312	10828
Depreciation	1500	1275	1084	921	783	666	566	481	409	347
Special Building Allowance	3750	3750	3750	3750	3750	3750	3750	3750	3750	3750
Borrowing Costs	139	139	139	139	139	0	0	0	0	0
<i>Total Deductions</i>	<i>45515</i>	<i>45639</i>	<i>45814</i>	<i>46036</i>	<i>46302</i>	<i>46470</i>	<i>46815</i>	<i>47198</i>	<i>47617</i>	<i>48071</i>
<b>Net Taxable Income</b>	<b>-27523</b>	<b>-26747</b>	<b>-25977</b>	<b>-25207</b>	<b>-24432</b>	<b>-23506</b>	<b>-22703</b>	<b>-21880</b>	<b>-21033</b>	<b>-20158</b>

### Tax Benefit of \$27,523 Tax Loss at 2017/2018 Tax Rates

Assuming you purchase the property in your own name, the tax benefit of the \$27,523 loss will depend on your other income and marginal tax rate.

The attached table indicates the maximum tax benefit you would receive based on your level of income using the 2017/2018 tax rates.

Taxable Income	Tax Rate	Maximum Tax Benefit
Below \$18,200	NIL	0
\$18,201-\$37,000	\$0.190	\$ 5,229.37
\$37,001-\$87,000	\$0.325	\$ 8,944.98
\$87,001-\$180,000	\$0.370	\$ 10,183.51
Over \$180,000	\$0.450	\$ 12,385.35

## Affordability – The After Tax Cost

It is important to understand that the loss for taxation purposes is not the same as your actual cash outflow.

This is because of the tax deductibility of 'non-cash' items such as depreciation and the building construction write off that are explained later in the booklet To determine the affordability of the property we have converted the tax loss of \$27,523 to a weekly, net out of pocket cost (after tax). As the table illustrates, the actual after tax cost varies between \$180 per week and \$426 per week depending on your marginal tax rate.

### CASH FLOW YEAR 1

Marginal Tax Rate	0.00%	19.00%	32.50%	37.00%	45.00%
Net Tax Loss	\$ 27,523	\$ 27,523	\$ 27,523	\$ 27,523	\$ 27,523
Add: Loan Repayments	\$ 33,154	\$ 33,154	\$ 33,154	\$ 33,154	\$ 33,154
	\$ 60,677	\$ 60,677	\$ 60,677	\$ 60,677	\$ 60,677
Less: Non-Cash Items					
Depreciation	\$ 1,500	\$ 1,500	\$ 1,500	\$ 1,500	\$ 1,500
Building Construction Write Off	\$ 3,750	\$ 3,750	\$ 3,750	\$ 3,750	\$ 3,750
Interest	\$ 33,154	\$ 33,154	\$ 33,154	\$ 33,154	\$ 33,154
Borrowing Costs	\$ 139	\$ 139	\$ 139	\$ 139	\$ 139
	\$ 38,543	\$ 38,543	\$ 38,543	\$ 38,543	\$ 38,543
Cash Outlay Before Tax Savings	\$ 22,134	\$ 22,134	\$ 22,134	\$ 22,134	\$ 22,134
Less: Tax Savings	\$ -	\$ 5,229	\$ 8,945	\$ 10,184	\$ 12,385
Net Cash Outlay After Tax Savings	\$ 22,134	\$ 16,905	\$ 13,189	\$ 11,950	\$ 9,749
Net Cost Per Week	\$ 426	\$ 325	\$ 254	\$ 230	\$ 187

## Ownership Structure

Which entity or person should own the investment property and take advantage of the tax deductible loss?

This is a very important decision you need to make during the pre-purchase planning phase. There are a number of factors to consider including asset protection, estate planning, income tax and future capital gains tax. You should consider the long term - repercussions of owning a property with a partner or family member including the impact on your borrowing capacity, the timing of a property sale being to your disadvantage, relationship breakdowns, changes in financial goals, job redundancies and possibly becoming a single income family when children arrive etc.

The Taxation Office treat the property as being owned by the person(s) named on the title and ignore who has funded the purchase or any other written or verbal agreement between interested parties. Buying in the wrong entity can be financially catastrophic because transferring ownership of a property at a later date can be a very expensive exercise with stamp duty costs (see page 16) and potential capital gains tax. Also

remember, the 50% discount on capital gains for properties held for more than 12 months is not afforded to all entities.

One of the most important considerations regarding ownership is the marginal tax rate of the property owner. As previously mentioned on page 5, a negatively geared property will generally create a tax deductible loss for a number of years and the tax relief will depend on the owner's marginal tax rate. A common mistake is buying the property in the name of both husband and wife who are both gainfully employed. However, shortly afterwards they start a family and one of the owners have no other sources of income. The losses accumulate and can be offset against future income but the tax benefits are deferred. On the flip side, there may be capital gains tax savings if the property is sold and one of the owners have no other income.

### **DIVIDING INCOME AND EXPENSES ACCORDING TO LEGAL INTEREST**

Co-owner who are not carrying on a rental property business (few people would qualify) must divide the income and expenses for the rental property in line with their legal interest in the property.

If they own the property as:

- Joint tenants, they each hold an equal interest in the property
- Tenants in common, they may hold unequal interest in the property. For example, one may hold a 20% interest and the other an 80% interest.

You should consult with your Solicitor regarding the legal implications of this structure but from a taxation point of view the rental income and expenses must be attribute to each co-owner according to their legal interest in the property. This is despite any separate agreement between co-owners (either oral or in writing) stating otherwise.

NOTE: Interest on funds borrowed by only one of the co-owners which is exclusively used to acquire that person's interest in the rental property does not need to be divided between all the co-owners.

### **OWNED INDIVIDUALLY OR JOINTLY**

This type of structure can be effective for a taxpayer who:

- Is in the top marginal tax rate
- Has no adult children for income splitting
- Intends negatively gearing and/or prepaying interest on loans at the year end
- Asset protection is not a primary concern

<b>Taxable Income</b>	<b>Tax Rate</b>	<b>Net Cash Outlay Per Week After Tax Savings</b>
Below \$18,200	NIL	\$ 426.00
\$18,201-\$37,000	\$0.190	\$ 325.00
\$37,001-\$87,000	\$0.325	\$ 254.00
\$87,001-\$180,000	\$0.370	\$ 230.00
Over \$180,000	\$0.450	\$ 187.00

Any capital gain on the sale of an investment property (held for more than 12 months) is eligible for the 50% capital gains tax discount and is shared with your partner (where owned jointly).

**TAX TIP:** If you are gearing heavily then purchase the property in the name of the person who is likely to be in the higher tax bracket over the long term. The weekly after tax cash outlay is less. In the above example, an investor on a lower rate of tax of 32.5% (including Medicare levy) would be out of pocket \$426 per week compared to \$187 per week for someone earning over \$180,000 and in the top marginal tax bracket. However, time the property sale to be when that person's income has fallen, due to retirement, etc



## COMPANY

Companies are not eligible for the 50% capital gains tax discount (where assets have been owned for more than 12 months) so they are not generally recommended for investment property ownership. Also, if the property is negatively geared and the Company tax rate is a flat 30% then the tax benefit of the loss is limited to a maximum of 30%. Another negative is that any loss is quarantined in the Company and carried forward where the company does not have sufficient income to offset the loss.

## FAMILY TRUST

Family Discretionary Trusts are popular vehicles for holding investments because they can offer asset protection plus the ability to distribute income to children and other family members. They provide flexibility through annual discretion with the distribution of income which can help minimize the total tax payable. Trusts are eligible for the 50% Capital Gains Tax discount where the property is owned for more than 12 months.

A disadvantage with Trusts is that negative gearing losses are 'locked' in the Trust where they have no other income to offset the loss. They can be carried forward but you lose the immediate tax benefit of the loss. Franking credits are also 'lost' where a Trust is negatively gearing a share portfolio and incurs an overall loss.

Structure	Description	Tax Implication
<b>Personal Name</b>	<ul style="list-style-type: none"> <li>the property is purchased in your own name</li> <li>personally entitled to all profits/losses and capital growth</li> </ul>	<ul style="list-style-type: none"> <li>owner does not complete a separate tax return for the rental property and the rental profit or loss is added to your other income to determine your taxable income</li> <li>your personal TFN is used for income tax purposes and set up costs are negligible</li> <li>access to 50% Capital Gains Tax Discount on sale</li> </ul>
<b>Partnership (Joint Tenants and Tenants in Common)</b>	<ul style="list-style-type: none"> <li>two or more people purchase a property and share the costs, profit or loss and capital growth</li> <li>liability is to the extent of the borrowings and could extend to the personal assets of the partners</li> <li>to avoid future disputes between partners, a formal "partnership Agreement" can be drawn up by a solicitor</li> </ul>	<ul style="list-style-type: none"> <li>a partnership is not a separate legal entity and does not pay income tax. Each partner pays tax on their taxable income including their share of the partnership profit or loss</li> <li>a separate tax return is not needed for this type of partnership "rental statements" is required which details each partner's share of the profit or loss per the ownership title</li> <li>access to 50% Capital Gains Tax Discount on sale</li> <li>set-up costs are minimal</li> </ul>
<b>Limited Liability Company</b>	<ul style="list-style-type: none"> <li>shareholders own the company and directors are appointed to run the company</li> <li>shareholders can also be directors and employees, as in a family business</li> <li>allows you to distance yourself financially from the rental property and limits the liability for debts to the property-not your personal assets</li> <li>director(s) have legal and financial reporting obligations</li> </ul>	<ul style="list-style-type: none"> <li>separate legal entity with its own Tax File Number and pays income tax on its profits at the Company tax rate of 30%</li> <li>annual compliance costs are relatively high with record keeping requirements including a separate Income Tax Return</li> <li>set-up costs are upwards of \$1,500</li> <li>no access to the 50% Capital Gains Discount on sale</li> <li>negative gearing Losses can only be offset against other company income so they may be "trapped" unless there is other income</li> </ul>
<b>Trust</b>	<ul style="list-style-type: none"> <li>The property is transferred to a third party (trustee) who has legal control and duty to run the investments for the benefit of</li> </ul>	<ul style="list-style-type: none"> <li>Lodges its own Tax Return and has its own Tax File Number but tax is paid by the beneficiaries on</li> </ul>

	<p>the beneficiaries</p> <ul style="list-style-type: none"> <li>• Holds property (capital) for specified beneficiaries</li> <li>• Trust Deed sets out the Trust's powers, beneficiaries and formalizes its administration</li> <li>• Can be difficult to dismantle</li> <li>• allows you to distance yourself financially from the rental property and limits the liability for debts to the property-not your personal assets</li> </ul>	<p>their trust distributions in their personal income tax returns</p> <ul style="list-style-type: none"> <li>• Flexibility of income distributions each year to minimize tax</li> <li>• Access to <b>50%</b> Capital Gains Tax Discount on sale</li> <li>• Negative Gearing Losses can only be offset against other trust income so they may be "trapped" if there is no other income generating activities or investments</li> <li>• Annual compliance costs are high and record keeping is onerous with set-up costs of a Trust being upwards of \$1,000</li> </ul>
--	---	---

## Where To Buy – The Importance of Capital Growth

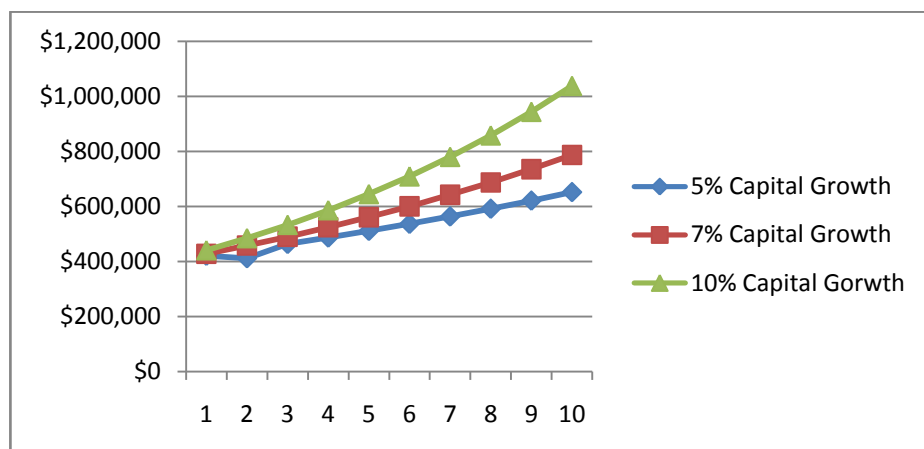
Clearly we are not real estate agents or property experts but we have seen clients achieve wonderful financial results from property investment and at the other end of the scale we have also seen some financial disasters. The importance of capital growth cannot be understated. While the rental income helps you fund the annual outgoings, capital growth builds your equity in the property and overall wealth.

To illustrate this point let's assume you buy a \$400,000 property.

The graph and table below compare the property value after ten years with different rates of compound growth — 5%, 7% and 10%. If the property grew at a compound rate of 5% per annum the value at year 10 would be \$651,558. A 7% growth rate produces a projected value of \$786,860 (\$135,302 more) while a 10% compound growth rate over a 10 year period produces a value of \$1,037,497 (\$385,939 more).

To further highlight the importance of capital growth versus rental income let's assume you are comparing several similar properties but one is offering \$30 more in rent per week. That is \$1,560 more per annum and over 10 years it equates to \$15,600 (ignoring inflation). Compare that figure to the \$135,302 or the \$385,939 difference in capital growth rate and the choice of property to buy is a 'no brainer'.

PROPERTY VALUES AT THE END OF EACH YEAR			
YEAR	5% CAPITAL GROWTH	7% CAPITAL GROWTH	10% CAPITAL GROWTH
1	\$420,000	\$428,000	\$440,000
2	\$411,000	\$457,960	\$484,000
3	\$463,050	\$490,017	\$532,400
4	\$486,203	\$524,318	\$585,640
5	\$510,513	\$561,021	\$644,204
6	\$536,038	\$600,292	\$708,624
7	\$562,840	\$642,313	\$779,487
8	\$590,982	\$687,274	\$857,436
9	\$620,531	\$735,384	\$943,179
10	\$651,558	\$786,860	\$1,037,497



If you believe the media the three most important ingredients when buying an investment property are location, location and location. According to property experts like Richard and Monique Wakelin in their book, *Streets Ahead—How to make money from residential property*, the characteristics of quality rental properties include:

1. High Capital Growth Potential in the Long Term
2. Competitive and Sustainable Rental
3. Close Proximity to the CBD and Amenities
4. Architectural Timelessness and/or Conformity
5. Logical Floor Plan and Structural Soundness

They also suggest the inner suburbs of capital cities tend to be the most consistent performers but obviously this is all subject to affordability. The table of median house prices in capital cities for the last 10 years highlights the fact that growth rates vary from state to state. Not only that, experience tells us that growth **rates vary** suburb to suburb and even street to street.

CAPITAL CITY MEDIAN HOUSE PRICES		
CITY	MEDIAN HOUSE PRICE	10 YEAR GROWTH P.A
ADELAIDE	\$ 522,815	11.20%
BRISBANE	\$ 548,918	11.40%
CANBERRA	\$ 753,516	11.50%
DARWIN	\$ 565,696	11.80%
HOBART	\$ 443,521	13.00%
MELBOURNE	\$ 903,859	10.80%
PERTH	\$ 557,567	13.60%
SYDNEY	\$ 1,179,519	8.10%

Source: 1 RP Dab July2008, REIT DEC 2017

2 Average Annual Price Growth Over The Past 10 Years.

As a guide, property experts suggest quality properties double in value at least every 7-10 years and grow on average by 7% or 8% per annum above the rate of inflation.

Remember, the only way that you make money (other than when the property becomes positively geared) is when you sell the property and realize the capital gain. Location and capital appreciation underpin the whole negative gearing strategy and you need to spend time researching the market. Beware of properties marketed on the back of rental guarantees, stamp duty savings, immediate positive cash flows and building depreciation allowances. Ultimately the real test is capital growth.

For time poor investors we strongly recommend you engage the services of a professional buyer's advocate. They can save you hours of research and due diligence in sourcing and acquiring your investment property. They offer independent, expert property advice and can help you secure a property

that matches your budget and investment objectives. Their fee for the service is around 2-3 percent of the cost of the property which is not tax deductible and is added to the cost base of the property for capital gains tax purposes.

## SELF HELP RESOURCES

There is a plethora of books on the subject of where to buy but for potential investors who want to do some reading I strongly recommend you read Richard and Monique Wakelin's book, *Streets Ahead — How to Make Money from Residential Property*. It is an excellent publication for first time property investors and reinforces the importance of capital growth with numerous tips and supporting financial statistics.

*Top Australian Suburbs* by Peter Koulizos (released 2008) makes recommendations on 107 suburbs across Australia that he believes have the best capital growth potential over the next 20 years. He examines the type and style of houses in each suburb, the local and state government plans for improving the suburb and even lists the street names in what he believes are the under valued suburbs. It is interesting reading but only an opinion and as we stated earlier, there is no substitute for professional advice.

According to property expert and best-selling author Margaret Lomas, the key to successful property investing is asking the right questions before you buy a property. In her 8th book, *20 Must Ask Questions For Every Property Investor*, she shares the 20 questions she has formulated over her many years of investing in property to create lasting wealth through successful property investment.

A sample of her questions includes:

1. What is the demographic make up of the area I am considering investing in?

Many investors don't know the answer to this question so they are at risk of buying a three-bedroom house on a large block in a community of up and coming young professionals who all want to rent a neat little apartment. Alternatively, they purchase a two storey town house a long way from public transport, when 80% of the local population are over 55

2. What are the local council's plans for future development?

Property is a long term investment so you want to know what the council has in mind for the area. Are they building schools and kindergartens to attract new young families? Is there a train route to the city to encourage more young professionals? Smart investors identify the likely changes that will have a positive impact on property values.

The magazine, *Your Investment Property* consistently features articles on where to buy and is obviously current, being a monthly publication.

## When to Buy?

Property experts suggest you buy the best possible quality property you can afford, when you can afford it. 'Time in the market' not 'timing the market' is what really matters.

To illustrate this point let's look at the numbers. Using the same \$400,000 property example, if you deferred buying the property for 7 years the lost opportunity is significant because of the compounding effect. We all know property operates in cycles but assuming consistent average annual growth of 5%, the value after 10 years is \$651,558. If you wait 7 years before investing your \$400,000 investment it is only worth \$463,050 at year 10 - a difference of \$188,508. If the growth rate is 7% the difference in delaying the purchase by 7 years is \$296,843 (\$786,860 - \$490,017). At 10% growth rates the lost opportunity is \$505,097 (\$1,037,497 - \$532,400).

The moral of the story is that procrastination can be costly and trying to pick the bottom of the market is nearly impossible. It is often said that the past is not a good guide to the future but let's have a look at the 'investment clock' to identify the historical economic cycles.

## The Investment Clock

History tells us that financial and property markets follow a cycle that has been tabled in the attached 'Investment Clock'. This clock was first published in London's Evening Standard in 1937 and while not flawless, it often provides a useful guide for making investment decisions. Importantly, unlike a real timepiece, the investment clock does not always divide time evenly.

Property runs its own cycle but is largely linked to the economic cycle. The economic cycle runs through four main stages on about a 7 to 10 year cycle. It goes 'boom', 'stagnant' (slow down), 'bust' (recession), recovery then repeats.

There's all sorts of economic indicators and the media are always trying to 'tell the time'. Investors who try and pick the peaks and troughs invariably get it wrong and miss the surge in prices at the start of the stage.

Because of the long term nature of property investment, may we remind you that it is 'time in the market' not 'timing the market' that really counts?

## The Risks

It is important to understand that property investment does have its share of risks. While gearing can amplify your gains, it can also magnify your losses. Unlike shares and other investments, property is illiquid and can't be converted into cash overnight. It is quite a process to sell a property with a marketing campaign of around 30 days followed by a 60 or 90 day settlement. Let's look at some of the risks and how you can avoid them.

**Financial Over-Commitment** - Property investment can be very rewarding, however, many first time buyers have soured their experience by financially over-extending themselves. What if you or your partner's income drops because of sickness, injury, retrenchment or you start a family? Planning is important and one of the best safeguards is to take out income protection insurance (sickness and accident) so you continue to receive income to service the loan in the event you become sick or suffer an injury.

**Interest Rate Increases** - Rates can be extremely volatile and increases can cause major problems. As the graph below indicates, rates have varied between 6% and 17% in the last twenty years. It may be suitable to fund the purchase with an interest only fixed rate loan where you simply repay interest and no principal. A fixed rate loan can provide you with peace of mind because you know your repayments won't rise in the given period. Alternatively, you may choose to take a variable loan and then fix the loan should interest rates start to rise.

**Vacancies and Tenant Damage** - The highest vacancy rate in Australia in the past 20 years has been 9%.

In other words 9% of properties were vacant but importantly, 91% were occupied. To guard against this situation you can take out landlord insurance to cover periods of vacancy or tenants damaging the property.

This form of insurance is discussed later in this booklet.

**Wrong Location** - As previously mentioned, the three most important ingredients when buying property are location, location and location. The only way that you make money is when you sell the property and realize a capital gain. Location and capital appreciation are the secret to success. Excuse the pun but buying a 'lemon' can certainly sour the experience.

**Speculation** - Many new investors are attracted by the thought of speculating in property but it is important to remember that speculation is short term and high risk, while property investment is a medium to long term outlook. The successful speculator usually works full time in property, buying improving and then reselling.

**Falling Values** - Property prices can fall and the US sub-prime crisis is a classic example. According to Moody's Economy.com in 2008 "About 75.5 million U.S. households own the homes they live in. After a housing slump that has pushed the values down 30% in some areas, roughly 12 million households, or 16%, owe more than their homes are worth". The Real Estate Institute of Victoria's property price report showed that the Melbourne median house price declined by 3.3 per cent in the September 2008 quarter alone.

Just a few other things that can go wrong:

1. An economic downturn can mean property values fall.
2. White ants are discovered (An initial property inspection could prevent this)
3. Government may legislate to reduce the benefits of negative gearing.

This is by no means an exhaustive list of the risks and we can help you to make the right decision on your path to gaining financial security through property investment. Suffice to say, most of these traps can be avoided with adequate preparation and planning.

## Getting Finance

Obtaining the right loan can nearly be as important as choosing the right property because a poorly structured loan can reduce an investor's flexibility, increase their risk profile and create reporting and taxation nightmares.

The devil is often in the detail with mortgage loans. It may seem illogical but you need to understand that the loan with the 'cheapest' interest rate is not necessarily the best loan for your circumstances. You need to consider the features that come with the loan, the ongoing fees and any potential early payout penalties. Be wary of discounted 'honeymoon' type rates and gimmicks used by lenders to get your business. Get it wrong and the early payout penalties (deferred establishment fees) associated with refinancing could waste thousands of dollars.

Before you buy a property you need to know how much you can borrow and all the associated costs. We strongly recommend you get your finance pre-approved so you know your financial limits before you start researching suitable properties. When you apply for a loan, the lender will ask a number of questions to fully assess your borrowing capacity. You should also have a list of questions prepared for the lender. In addition, you should ensure you have the following paperwork:

- photocopies of current bank statements
- proof of share holdings and other assets
- details of any second income, bonuses, allowances or benefits
- pay-slips or a letter from your employer outlining the length of employment and salary
- if self-employed, income tax returns
- if self-employed, profit and loss statements certified by an accountant
- if also selling a home, copies of exchanged contracts or a solicitor's letter confirming a firm buyer
- if paying out an existing mortgage and starting a new home loan, a letter from your present lender stating the amount owing and proof of past repayments
- a photocopy of the front page of the contract of sale, if you have already decided on a property.

### Steps to Successfully Financing an Investment Property:

- Prepare a realistic budget with at least a 2% allowance for potential interest rate rises. This will ensure that you have sufficient income to meet any likely increases in repayments. In the last twenty five years interest rates have been as low as 5% and as high as 17%.
- Try and stick to the budget in the months prior to purchasing the property so you know it is sustainable.
- Obtain pre-approval for the finance so you know your purchase limit including stamp duty and legal costs
- Cancel credit care; that are not being used and reduce credit card limits as they reduce your borrowing capacity. You might consider putting the credit card into a low income, non-borrowing partner's name.
- Ideally, stay with the same employer for several months in a full-time or permanent part-time role (rather than as a casual) before lodging the loan application
- If you are self-employed the lender will generally use an average of your last 2 years profit. Ensure that your Accountant has prepared up to date financials and tax returns to avoid delays in getting the approval
- Research property values before applying for a loan so that you have a good idea of your portfolio's worth before the bank valuation is performed. A bank valuation is usually less than 90% of the current market so if you need to borrow more than 80% of the property's value apply for 100% funding of the purchase and on-costs and adjust the loan down once approved

There are many things to consider when searching for the right loan and the interest rate is only one factor. With literally hundreds of different loan products available, finding the right loan can be challenging and time consuming. Our affiliated mortgage brokers can compare a range of loans and will liaise with us to ensure the loan is correctly structured for maximum tax effect. Simply call our office if you would like to utilize their services.

- As a guide the following points should be discussed with your banker or mortgage broker:
- Type of Loan - Principal and Interest or Interest Only?
- Type of Loan — Fixed Interest Rate, Basic Variable or Standard Variable Rate or a combination?
- Type of Loan - Discounted Variable (Honeymoon rate that reverts to a much higher rate after a period of time which can prove very costly over the life of the loan)
- Should I use a Line of Credit (not usually for an investment property) or Mortgage Offset?

- What is the total of all borrowing costs including loan establishment fees?
- Can I have a split loan so that one is tax deductible and one is for private purposes?
- How much deposit is generally needed?
- Will mortgage insurance be required and how much will it cost?
- Which security to use to avoid cross securitization if possible?
- Is there a maximum amount that banks will generally loan as a percentage of my income?
- What loan term should I select and what are the monthly loan repayments?
- Are there redraw facilities and at what is the cost? (Should you need access to funds at a later date to renovate or purchase another property)
- Can I make extra lump sum repayments or extra regular repayments?
- What are the ongoing monthly fees charged by the lender?
- What penalties are payable on early termination of the loan should you sell the property in the first few years, buy another property or refinance?
- Consider the future in terms of when you may be looking at selling a property, changing the usage of the investment property to your personal home, future renovations or repairs, development, etc.

Let's expand on a few of them in more detail:

## Fixed Versus Variable Rate

This is an important question particularly in a volatile economic climate.

Variable rate loans, where the interest rate varies throughout the life of the loan, are the most common type of home loan available. The lender will adjust the rate, according to the economic climate and the official interest rate set by the Reserve Bank of Australia. Most lenders will offer several types of variable loans, with different rates and added extras. Generally, the loans with the lower interest rates have less flexibility in terms of conditions and fewer or no added extras. Those with higher rates may offer extras such as a redraw facility, which allows the borrower to draw on money already paid into the loan. They will also have more flexible conditions such as no restrictions on making extra payments or paying off the loan early.

A fixed rate loan is where the interest rate is fixed for a set period (usually 1 to 5 years) and as a very general guide, if the loan is going to stretch you to your financial limit then fixing at least part of the loan will provide some protection against rate rises. Stiff penalties may apply for breaking the loan contractor paying off the loan early. Most fixed loans have a restriction on extra repayments and offer limited extra features. Borrowers do not benefit from a drop in current interest rates.

Many lenders will allow the borrower the option of 'splitting' a loan into a partly fixed rate and a partly variable rate. For example, an 80% fixed rate with a 20% variable rate. This allows the borrower to customize the loan and combine the security of fixed loan with some of the flexibility of the variable loan.

## Principal and Interest or Interest Only

If you have other personal loans (such as a home loan) that are not tax deductible, you should establish a separate loan for the rental property and potentially make it an interest only loan. In this instance your personal home loan will be principal and interest, so that any spare funds or lump sum amounts can be used to pay off the non-deductible home loan rather than the investment property loan where the interest is fully tax deductible.

Separate loans will also avoid the time consuming task of calculating the percentage of interest that is tax deductible if the loan relates to multiple properties or purposes. If you make draw downs on a multi-purpose loan, the percentage of private usage must be recalculated each time you make a draw down.

Also, imagine how frustrating it would be to have a \$200,000 loan where 50% relates to the rental property and the balance is for your private home. You inherit \$100,000 with the intention of paying off the private portion of the loan leaving just the tax deductible investment loan. Where you have a consolidated loan, the Taxation Office deems that you have paid off half the private home loan so you can only claim 50% of the interest on the remaining \$100,000 loan. If you had separate loans this would not have been an issue.

Most 'variable interest only' loans allow unlimited extra repayments of principal so you can elect to then



swap to principal and interest once the non-deductible home loan is paid off. This way you have the best of both worlds with the option to repay interest only or have a principal and interest loan.

## Loan Features and Fees

To give you some indication of what features and fees are generally associated with the various types of loans we have included this table.

	Discount Variable	Basic Variable	Line of Credit	Fixed Rate	Offset	Standard Variable
Ongoing Fees	NO	YES	YES	NO	YES	NO
Extra Payments	YES	YES	YES	NO	YES	YES
Redraw	YES	YES	YES	YES	YES	YES
Interest Only	YES	YES	YES	YES	YES	YES

### Mortgage Offset

This allows interest on savings held by a borrower to be credited against interest charges on the mortgage. This in turn helps reduce the term of the loan by paying off the interest earlier. Carefully check the terms and conditions as hidden fees and charges may apply.

### Honeymoon Loans

This type of loan offers discounted rates for the first six to twelve months. After this period the loan reverts to a standard variable rate and the repayments increase. At the end of the honeymoon period there may be 'switch costs' depending on the type of loan you choose.

### Cross Securities/Collateral

This is where one loan is secured by the title to more than one property. Typically it may be an investment loan secured by both your primary residential home and the investment property as follows:

Property	Value	Current Loan	Secured By
Residential Home	\$500,000	\$200,000	Home
Investment Property	\$400,000	\$421,865	Home & Investment Property

This situation reduces your future lending flexibility because it ties you to one lender and may block access to the equity you have created in the properties to use for investment purchases. If the bank increases their rates then you are hamstrung unless you refinance the entire debt. Should you want to purchase other investments such as another property or shares you have no option but refinance both loans which can be very costly.

Another potential issue is that you could be offering lenders excessive security and a poorly structured loan portfolio may not adequately separate the deductible and non-deductible expenditure.

The implications of having a poorly structured loan portfolio may not be evident from the outset but they will surface. The costs, including extra valuation fees and potential interest penalties (particularly with fixed rate loans), can be substantial and erode the equity you worked so hard to build. Not only that, you may not be able to access the best loan deal available going forward because you are locked in with a specific lender.

As we keep emphasizing, planning is the key to successful property investing. Consulting with a professional mortgage broker regarding the type and structure of the loan is very important.

# The 13 Steps to Negative Gearing of Property

## Step 1: Consult with Your Accountant

Your Accountant is in a unique position to advise you regarding the purchase of an investment property. They understand your tax affairs and have access to software to help evaluate a property and:

- Prepare a Cash flow Forecast including the Calculation of the Weekly Net Cash Outflow
- Assist with Determining Ownership Structure to Maximize the Tax Savings and Protect your Investment
- Assist with Advice on the Tax Deductibility of Expenditure
- Prepare a Profit and Loss Schedule for your Annual Tax Return
- If required, prepare an Annual PAYG Variation for Employees to claim the Tax Savings in your regular pay rather than waiting until the lodgment of your Tax Return
- Assist with creating a Capital Gains Tax Register of Costs
- Determine Capital Gains and provide Tax Planning Advice
- Liaise with Financiers to obtain the Right Loan, Correctly Structured for Maximum Tax Effect
- Assist with Referrals to Insurance Brokers, Solicitors, Buyers Advocate etc.

## Step 2: Finding the Right Property

As previously mentioned on pages 9 and 10, it's all about location, location, location. Planning, research and patience are all important. For time poor investors we strongly recommend you engage the services of a professional buyer's advocate. They offer independent, expert property advice and can help you secure a property that matches your budget and investment objectives. They can save you hours of research and due diligence in sourcing and acquiring your investment property.

## Step 3: Pre-Purchase Inspection Report

Before spending hundreds of thousands of dollars buying a house, unit or flat it is essential that you are aware of any serious faults or defects. It is estimated that 15 to 20 per cent of properties require substantial and costly remedial work. Knowledge is power and this information could influence your decision to buy or might help you negotiate a lower purchase price.

A pre-purchase inspection from a licensed professional provides peace of mind and confidence in your investment decision. Too often people buy a property only to find that there are major structural faults that can cost thousands of dollars to repair. Not only that, they could be deemed "initial repairs" (see page 29) and not tax deductible. Before signing a contract, a buyer should consider enlisting the services of a qualified building inspector, a surveyor or architect to provide a professional condition report. A qualified inspector will know exactly what to look for and will see through any cosmetic improvements covering up faults that may be missed by the untrained eye. The inspector will provide a written condition report, pointing out faults in the property, whether they can be repaired and how much these repairs are likely to cost. The report will also highlight any unsafe or unauthorized renovations and extensions.

## Step 4: Stamp Duty and Land Transfer Costs

Stamp Duty rates vary from state to state and the Victorian rates are quoted below. The stamp duty is less where the property is going to be your principal place of residence at the time of purchase (as opposed to being an investment property). Please contact your local State Revenue Office to calculate the exact amount of stamp duty payable in your circumstances. Stamp duty adds to the 'cost base' of the property for capital gains tax purposes so remember to keep these records.

<b>VICTORIAN STAMP DUTY RATES FOR PURCHASE OF A RENTAL PROPERTY ON OR AFTER 6 MAY 2008</b>	
<b>Dutiable Value Range</b>	<b>Rate</b>
\$0 - \$25,000	1.4% of the dutiable value of the property
\$25,001 - \$130,000	\$350 plus 2.4% of the dutiable value in excess of \$25,000
\$130,001 - \$960,000	\$2870 plus 6% of dutiable value in excess of \$130,000
More than \$960,000	5.5% of dutiable value of the property



In our \$400,000 purchase example the following stamp duty would be payable in Victoria:

- Purchased as a rental property:  $\$2870 + 6\% \text{ of } (\$400,000 - \$130,000) = \$19,070$
- Purchased initially as your Main Residence  $\$2870 + 5\% \text{ of } (\$400,000 - \$130,000) = \$16,370$

The *Land Transfer Fee* is levied by the state Lands Title Office so please check with your mortgage broker or solicitor as to the likely cost, It is also a cost that is not tax deductible but is added to the capital cost of the property for capital gains tax purposes.

In Victoria the land transfer fee (effective from 1/7/08) is \$115.90 plus \$2.26 for every whole \$1000 of the purchase price to a maximum of \$1346 if the application is lodged by paper. There is a \$20 saving to lodge it electronically. In our \$400,000 case study example we are lodging by paper so the fee would be \$115.90 plus  $\$2.26 \times 400 = \$1099.90$  (rounded up to \$1,100).

### **Step 5: Conveyancing Costs**

Conveyancing is the transfer of the property title from one person to another, or the granting of an encumbrance such as a mortgage.

A buyer of real property must ensure that they obtain a good and marketable 'title' to the land, that the seller is the owner, has the right to sell the property and there is no factor which would impede a mortgage or resale. Conveyancing is usually completed by a solicitor or a licensed conveyancer. There are also kits available if the buyer wishes to complete the process themselves, but due to the complexity of varying state and council laws, it's not recommended.

A common conveyance by a solicitor or licensed conveyancer usually takes 4—6 weeks. Most firms offer fixed price services (allow \$1000) which includes costs of searches, legal advice and other outlays. A typical conveyance includes, but is not bound or limited to, the following:

- Title searches
- Checking for encumbrances and restrictions on the property
- Ensuring any special conditions mentioned in the contract are met
- Making sure rates and water consumption charges are paid by the appropriate party
- Arranging for the payment of Fees and charges
- Preparation of legal documents.

### **Step 6: Finance**

Finance is one of the most important considerations when acquiring a property and we can help you identify the best loan product for your circumstances in conjunction with a mortgage broker (Refer Pages 13 to 15 for more details).

Most mortgage brokers are willing to give you some indication as to the likely success of your loan application and the associated costs. Obviously the amount you are borrowing, the term of the loan, fixed versus variable, interest only versus principal and interest are all variables you need to consider that we briefly discuss in this booklet.

We often recommend that clients get their finance pre-approved, especially if you plan to purchase at auction, as there is no 3 day cooling off period.

The loan establishment costs such as bank valuation and application fees, mortgage insurance, mortgage registration, etc. are all tax deductible over a maximum of 5 years and we discuss these later in this booklet.

Detailed notes regarding the tax deductibility of mortgage interest is included in this booklet but due to the complexity of this area we suggest you discuss this with your mortgage broker and accountant.

### **Step 7: Cash Flow Analysis**

As previously mentioned, a negatively geared property implies a net cash outflow that you will need to fund

from other income sources. It is vitally important that you budget for the extra cash flow commitment associated with your newly acquired property.

A cash flow statement for our sample property is on page 6 of this booklet and note that we have assumed that there are no vacancies during the year when preparing the analysis.

### Step 8: Sign the Contract

You have done all your homework and found the property so you are ready to buy. Now it's time to engage the conveyancer or solicitor to help with all the legal aspects.

Things you need to discuss with them could include:

- Making the contract subject to finance in case there are any issues with the loan
- Possibly making the purchaser a 'nominee' so that ownership can be changed before settlement if you are still undecided
- Inserting a separate schedule of Fixtures and Fittings or Plant & Equipment with each item separately listed and cost to assist with depreciation claims
- Obtaining any Building Construction costing from the vendor so that a quantity surveyor is not needed for the building construction write off calculations making the purchaser a 'nominee' so that ownership can be changed before settlement if you are still undecided
- If purchasing jointly, understand the difference between "Tenants In Common" as opposed to "Joint Tenants" as this has different asset protection and legal implications

### Step 9: Insurance

When purchasing a rental property there are several types of insurance you need to consider. We recommend you discuss them with an insurance broker and the common types of insurance include:

**Building & Contents Insurance Plus Public Liability** - The moment the contract is signed you may need to get building insurance as some contracts state that the property is at your risk from the time of signing. Also not all of the house cost is covered on the building insurance policy so you may need contents insurance as well. If you have bought a unit, the building and public liability insurances are usually covered in the body corporate fees but check the policy.

**Landlord Insurance** - Apart from insuring the house and contents you should consider 'landlord's insurance'. This will pay for damage done by tenants and provide income during periods of vacancy etc.

**Life Insurance** - Buying a negatively geared rental property implies taking on additional debt which is a compelling reason to review your level of life insurance. This form of insurance pays a lump sum to your beneficiaries (or your estate) when you die and typically the proceeds are used to eliminate debt or generate replacement income

**Income Protection Insurance provides** a monthly payment when you're unable to work because of injury or illness. Payments can be up to 75% of your current income and may be paid for the duration of your incapacity or for a specified period. The proceeds can then be used to meet your loan repayments

**Lender's Mortgage Insurance** - Under the Consumer Credit Code a lender can demand you to take out Mortgage Insurance if you are borrowing more than 80% of the purchase price of the property. Typically this is a one-off premium paid at the time of settlement and can cost between 1 and 3 per cent of the amount borrowed. This can be a substantial sum if you are borrowing a large amount of money. Mortgage insurance does not protect you, it protects the lender in the event that you default on the loan and the amount still owing on the loan is greater than the sale proceeds. It is important to note that if you default and the mortgage insurance is paid out, the insurance company will pursue you to repay the balance of the debt.

Should you need a referral to insurance broker for this purpose please don't hesitate to contact us.

### Step 10: Wills and Power of Attorney

The purchase of an investment property is a significant financial event. As such, it may warrant the review of your Will. It is important that your Will reflects your current wishes and distributes your estate in the most beneficial and tax effective manner. You might also consider preparing an Enduring Power of Attorney

should you be medically unfit, overseas or inaccessible to make financial decisions.

Should you require a referral to a Solicitor for this purpose please don't hesitate to contact this office.

### **Step 11: Prepare Property For Rental**

Undertake the necessary steps to maximize the rental income and this preparatory stage may include some renovations. Again, be very mindful of the 'initial repairs' warning on page 29. Generally the tenant in a residential property will be signing a 1 year lease and their lease will offer them 'quiet enjoyment' of the property which will restrict your access to complete major repairs.

It is critical that you keep all receipts as most of these costs are probably not going to attract an immediate tax deduction but will impact on your building construction costs and cost base for capital gains tax purposes.

### **Step 12: Find A Tenant**

Decide whether to engage a real estate agent or find a tenant yourself. A real estate agent will charge around 7% of the rent (plus GST) and other costs such as postage. In addition, they will charge a letting fee that is commonly equal to the first 2 weeks rent to find a new tenant plus any additional advertising costs.

If you do not engage an agent you can download an Australian Tenancy kit that will provide guidelines on lodging a rental bond, doing a condition report and preparing a rental agreement. The process is lengthy and tenants and landlords both have many rights and obligations, refer to [www.rentalagreementsdiy.com.au](http://www.rentalagreementsdiy.com.au), We recommend that a real estate agent is used.

There is also assistance from your state Consumer Affairs Office. In Victoria you need to supply a tenant with a publication called 'Renting a Home A Guide For Tenants and Landlords' by Consumer Affairs Victoria on or before the day they move in or you face a \$500 fine. Refer to [www.consumer.vic.gov.au](http://www.consumer.vic.gov.au) for more information.

### **Step 13: Back to Your Accountant**

**Prepare a PAYG Variation** - Given the anticipated tax loss on the property, investors who are subject to normal Pay As You Go (PAYG) withholding tax from their salaries have two options:

1. Pay the normal withholding tax from your regular pay and receive a larger tax refund when you lodge your annual income tax return, or
2. Lodge a PAYG Income Tax Withholding Variation (ITWV) application and the Australian Taxation Office will instruct your employer to vary the amount of tax withheld from your regular pay. Effectively it brings forward the annual tax benefit of the loss to help your cash flow.

An ITWV is an annual application made to the ATO to vary the amount of tax withheld from your salary each pay period by your employer. The variation is valid for the whole of the financial year and can be lodged at any time during the year. Once an ITWV is processed, the ATO will notify your employer of the 'varied' amount of tax to be withheld from your pay each pay period. The ATO processes most ITWV applications within 10 working days. Each year we recommend applications be lodged at least 2 weeks prior to the expiration of the existing variation so we recommend you contact us early in June.

**Prepare Annual Rental Profit and Loss** - The 'Keeping Records' section of this booklet includes a segment on the annual records to be kept plus a checklist of information needed to prepare the first tax return after purchase.

**Assist in Setting Up Records for Capital Gains Tax** - These records are vital as they need to be kept for 5 years after the property is sold. Please refer to the 'Capital Gains Tax' and 'Record Keeping' sections of this booklet regarding the information needed to maintain a cost base register.

We recommend you computerize the record keeping and Rent Manager is a simple program that lets you record the rental income, expenses, cost base, travel to the property for repairs and inspections plus

mortgage interest and repayments. A demonstration copy of the program is attached to the inside back cover of this booklet.



## Keeping Records

Keeping records for a rental property can be sorted into 2 categories

### a) Records that impact Capital Gains Tax

- These must be kept for 5 years after the property is sold and include:
- All details relating to the purchase such as the contract of purchase, vendors' settlement statement or statement of adjustments, stamp duty on purchase, conveyancing costs, etc.
- Quantity Surveyors report or details of the amount allocated to plant and equipment and building construction at the date of purchase
- All receipts of new plant and equipment purchased or building construction undertaken since purchase which would also include 'initial repairs' done to the property
- The amount claimed for depreciation and building construction write off in every year since the property was rented

### b) Records related to Annual Income and Expenses

- The receipts, invoices and statements verifying annual income and costs need to be kept for 5 years after the tax return has been lodged and assessed and include:
- The annual or monthly real estate agents' statements of rental income and expenses (including any invoices for expenses)
- Where property is self managed, a receipt book or rent book confirming the rental income
- All receipts and invoices for expenses incurred such as council and water rates, body corporate fees, repairs, insurance, mortgage loan statements, etc.
- Details of kilometers travelled by car for inspections or repairs and the make, model and engine capacity of the vehicle

### Checklist of Records To Prepare if First Tax Return

- The Statement detailing adjustments for rates etc
- A separate list of all plant and equipment and their written down depreciation values either written into the contract as a schedule if a past rental property or from a vendor's depreciation schedule, If none are available then obtain a quantity surveyor's report, unless the property is pre 18/7/85 with no new structural improvements or major renovations and minimal depreciation values. Quantity surveyors charge approximately \$600 which is tax deductible
- Loan contracts specifying loan establishment fees, mortgage insurance, valuation fees, stamp duty etc
- All mortgage statements for the year, from the first draw down to the 30th June
- The Annual Summary of income and expenses from the real estate agent or all monthly rental statements
- Details all expenses incurred such as rates, insurance, body corporate, repairs, travel etc
- Latest pay slip if PAYG withholding variation is to be lodged

## Rent Manager

### Keep excellent records for your investment property

If you own an investment property Rent Manager is the perfect tool to manage your property, makes completing your tax returns easy and gives you peace of mind that you have the capital gains tax information you need when you finally come to sell the property.

Rent Manager keeps your purchase and sale records for Capital Gains Tax purposes plus all the information you need to prepare your annual tax returns. It also allows you to analyze potential investment property purchases through the 'property analysis' module.

A demonstration version of Rent Manager is included on the inside back cover of this booklet. The trial version is fully operational for 30 days before you will need to purchase and unlock the program.

Rent Manager includes the following features:

- Record property purchase, sale and improvement details so you don't get caught when you need this 'cost base' information for Capital Gains calculations
- Record the rental income and expenditure for your investment property
- Record information from the real estate agent monthly rental summaries
- Keep track of any mortgages including interest and bank charges
- Keep a log of your car travel for collecting rent and conducting property inspections
- The Annual Summary provides all the information for completing your annual tax return
- Keep records for multiple properties
- Calculate Depreciation of Furniture & Fittings
- Calculate Tax Deductible Building Allowances
- Easy to follow manual and online help
- Print all the key reports that your accountant needs to complete your tax returns
- Full 90 day money back guarantee

### Rent Manager CD-Rom Specifications

- PC with Pentium 233 or higher processor
- 32MBRAM
- 50 MB Hard Drive Space
- Windows 98, 2000, NT14, ME or XP
- CD-Rom Drive
- VGA or Higher Resolution
- Rent Manager is compatible with Windows Vista

## Common Mistakes in Tax Returns

- Claiming property improvements as repairs when they are actually capital costs, like remodeling a bathroom or replacing a stove. Note, you may still be able to claim a capital works deduction over 40 years.
- Claiming a 100% tax deduction on conveyancing costs on the purchase and sale of a property when they form part of the cost base for capital gains tax purposes.
- Not splitting the Income and Expenses as per the legal interests noted on the property title.
- Claiming the full cost of travel to inspect a property where the main purpose of the trip was to have a holiday and the inspection was incidental.
- Not apportioning expenses for private use such as loans used partially to fund private purchases such as a car.
- Making incorrect claims for a property that is not genuinely available for rent, or where a property has been available for rent for only part of the year.
- Not apportioning borrowing costs that exceed \$100 over 5 years or the length of the loan if a shorter period.
- Claiming 'initial' repairs that are not deductible (refer to page 29)

## **Goods and Services Tax (GST)**

In this booklet we have assumed that you are not carrying on the business of property investment and that you are also not a property developer as they have special rules and GST obligations. Generally, residential property is 'input taxed' which means that you do not charge GST on the rent or sale of the property. Similarly you can't claim any GST credits on the rental expenses or purchase costs.

Generally GST only applies to the purchase of new homes but not to established homes. Do not sign the contract without checking whether GST applies. If uncertain, seek professional legal advice. If GST applies to a sale, it must be clearly specified in the contract whether the price is inclusive or exclusive of GST and how the GST will be calculated.

### **Initial Purchase**

There is no GST payable on the purchase of an 'existing' residential property but you will pay GST on the purchase of a 'new' property. An existing property means that it has been sold at least once in the five year period after initial construction. A 'new' property has not previously been sold and is subject to GST as the builder or developer must be registered for GST as they are carrying on a business. The GST payable on a 'new' property can be complex as a special scheme called the 'margin scheme', which assigns a pre 1st July 2000 value to the property, may apply. You are best to get your solicitor to check the purchase contract before signing to ensure you have a complete understanding of the amount you are paying for the property including GST if it is a new property.

### **Rental Income and Expenses**

You do not charge GST on properties rented to households but likewise you are not able to claim back the GST you pay on rental expenses. Not all expenses that you incur are subject to GST as water, sewerage and council rates are GST free. Financial institutions are also input-taxed so that interest and most loan costs are also GST free. Repairs, real estate commissions, insurance, advertising and the like, are all subject to GST.

# Time To Sell

## Selling Costs and Considerations:

### Real Estate Agent's Fees

These are usually a set percentage of the sale price of the property with extra costs for marketing, auctions, etc. Prices can vary between agents and in different suburbs and price brackets, so it is best to negotiate them with your agent. These costs form part of the 'cost base' for capital gains tax purposes and effectively reduce the capital gain on sale. In our case study we have used 2.5% of the sale price as the fee.

### Conveyancing Costs on Sale

These also have an impact on your cost base and capital gains calculation. The cost will vary as to whether you use a conveyancing company or a solicitor.

### Settlement Statement of Adjustments

Just like when you purchased the property there will also be a statement of adjustments on sale. The vendor and purchaser are compensated for any rates or fees that are paid in advance or unpaid at the date of settlement. These include body corporate fees, water rates and council rates. These adjustments all impact on the profit and loss statement for the property.

### Penalty for Early Mortgage Payout and Mortgage Discharge Fee

Any fees levied to discharge the mortgage are claimable in the annual rental profit and loss statement including the mortgage discharge fee.

### Repairs Done Before Sale

If the tenant vacates the property and you undertake repairs before sale to rectify defects caused by the tenants these are tax deductible PROVIDED you received some rental income in the financial year the repairs were done. Otherwise they will be capital items added to the cost base that will only help reduce the capital gain. Clearly, from a tax planning perspective, it is best to get the repairs done in the same year that rent was last received.

### Unclaimed Borrowing Costs

If you have financed or refinance-I the rental property loan within the last 5 years at a cost exceeding \$100 you will be able to claim the remainder of the unclaimed borrowing costs in the final profit and loss statement.

### Plant & Equipment

Generally the sale price for plant and equipment is not stipulated in the sale agreement and therefore it is assumed that you sell these items at their 'written down value' at the date of sale. This means that there is no profit or loss on sale. Depreciation on these items is claimed up until the date of sale provided the property is still being rented or available for rent. The depreciation claimed is then used in the calculation of the capital gain (\$3,231 as per our case study).

### Building Construction

If the property was acquired after 13th May 1997 then any claim that has been made for the capital works deductions or building construction must be taken off the cost price of the property to calculate the reduced cost base for capital gains tax purposes. Remember the capital gain is halved if the property was held over 12 months (provided it was not owned by a company) or there are other capital gains tax losses to be offset first.

You can still claim the expense right up to the date of sale (provided it is still tenanted or available for rent) with a 100% tax deduction but only 50% of the claim is effectively written back if you qualify for the capital gains tax discount concession.

If the building was acquired before 13<sup>th</sup> May, 1997 but after 18<sup>th</sup> July, 1985 then there is no building construction cost adjustment for capital gains tax purposes.

## Capital Gains Tax

Capital Gains Tax is very complex and we strongly recommend you consult with us regarding the implications of selling. In summary, there are 4 key points that you should be aware of including:

1. Capital Gains Tax is calculated on the date that contracts are signed as unconditional and not the settlement date.
2. You must hold the property for over 12 months to be eligible for the 50% discount that effectively means that only half of the gain is taxable. However, any gain is reduced by prior year capital losses or current year capital losses from other investments before the 50% discount is applied. Note also that not every type of ownership structure is eligible for the discount.
3. You must keep adequate records of all the cost base items associated with the property for capital gains tax purposes. These records must be kept for 5 years after you dispose of the property.
4. Capital gains are generally taxed at your marginal tax rate so the lower your income in the year of sale the better because the gain is added to your other income and taxed accordingly.

The net capital gain is calculated as:

- Your Total Capital Gains for the year less
- Your Total Capital Losses (including any net capital losses from previous years) less
- Any CGT Discount and CGT Small Business Concessions to which you are entitled.

**SAMPLE PROPERTY - CAPITAL GAINS TAX WORKSHEET**

<b>DATE</b>	<b>DESCRIPTION</b>			
1/04/2017	Property Cost		\$ 400,000	
	<b>Purchase &amp; Holding Cost</b>			
1/07/2017	Stamp Duty on Property	\$ 19,070		
1/07/2017	Legal Fees on Purchase	\$ 1,000		
1/07/2017	Land Transfer Registration	\$ 1,100	\$ 21,170	
	<b>Additions After Purchase</b>			
	Improvements after Purchase	\$ -		
	<b>Selling Costs</b>			
1/12/2018	Legal Fees on Sale	\$ 1,000		
1/12/2018	Real Estate Agents Fees on Sale	\$ 11,850	\$ 12,850	
			\$ 434,020	
	<b>Less Adjustments</b>			
	Depreciation Claimed (see note)	-\$ 3,231		
	Building Construction Claimed - bought after 13/05/97 (see note)	-\$ 9,678	-\$ 12,909	
	<b>Total Cost</b>			\$ 421,111.00
1/10/2018	Proceeds on Sale			\$ 474,000.00
	Net Gain Before Discounting			\$ 52,889.00
	50% Discount - owned over 12mths and no other losses			\$ 26,444.50
	Tax at Marginal Rate of 32.5% (2017/2018 income between \$37,001 and \$87,000)			\$ 8,594.46

**Assumptions:**

- Property Growth of 7% over the 2 years Holding Period
- Building construction write off reduction on cost base only relates to assets bought after 13/05/97
- The property was never used as a principal place of residence
- The furniture sold at WDV and therefore no assessable or deductible amount.

YEAR	DEPRECIATION & LOSS ON DISPOSAL	BUILDING CONSTRUCTION WRITE OFF	COMMENTS
2016	\$1,500	\$3,750	
2017	\$1,275	\$3,750	
2018	\$456	\$2,178	Pro-rata in year of sale
TOTALS	\$3,231	\$9,678	

This is the correct method to calculate capital gains on property and should be used where you have all the information including details of every improvement and plant acquisition that has been made while you held the property. If you are using the 'indexation' method to calculate the capital gain then the dates of any improvements are factored into the calculation (acquisitions prior to 30/9/1999 are indexed to quarterly inflation rates). The indexation method is generally only used where you have other capital losses to offset against a gain before the 50% discount is applied.

There is another calculation method which can only be used where you have no other losses to offset and you are not using the indexation method. It only requires knowledge of the original price that was allocated for furniture and fittings and building construction costs for depreciation and building construction purposes. You adjust the purchase price down accordingly. When you sell the property you adjust the sale price by deducting the written down value of all plant and equipment and the unclaimed construction costs at that date.

The difference will be equal to the cost of all improvements and additions less depreciation and construction cost adjustments over the period that you held the property. Sometimes we find that all the information concerning the property has not been kept especially when it has been held over a number of years and tax returns with depreciation amounts have been discarded. Don't let this happen to you!

## Some Capital Gains Tax Complications

### You lived in the property first

The stamp duty on purchase will be less if you initially purchased the property as you're principal or main residence. Your capital gain will also be reduced for the period that you used it as your principal place of residence. Interest and rates while you lived in the house may also have a bearing on the calculation.

### The property was first used for income producing activities after 20/8/1996

This happens when you acquire the property and live in it solely as your principal place of residence with no income producing activities (i.e. no place of business from home or rental from boarders), and then you move out and rent the property. In this case the cost is NOT the cost you paid for the property but rather the market value at the time it is rented out. The good news is that you do not need to have kept all the records of the renovations you did while you lived in the house and you are not paying capital gains tax on the property's appreciation while you lived in it as your principal place of residence.

**TAX TIP** If you first used the house as your principal place of residence and then rented it out after 20/8/1996; get a valuation done at the time you move out. It is not necessary to get a certified valuation but simply a written valuation by a licensed real estate agent.

### Six Year Main Residence Exemption

There is a very useful exemption available where you initially lived in the property as your principal place of residence and then rent it out while you have no other principal place of residence (i.e. you travel overseas or move interstate for work purposes and rent). Under Section 118-145 a taxpayer can elect to continue to treat the residence as their principal place of residence for up to 6 years after they ceased living there. You could even live there for a year to get the first home owners grant, move back to the family home for 6 years to save money and travel, then move back in for a few more months and get another 6 year exemption. Obviously the Taxation Office will want proof that you lived in it (such as your address change on the electoral role), but it represents an excellent strategy to minimize capital gains tax! -

**TAX TIP** You must first live in the property without boarders etc. to qualify for the full six year exemption with no other principal place of residence in that period. Whilst there is no set minimum period we suggest at least 3 months and at least 12 months if you received the new home owners grant.

#### Example: Principal place of residence first rented after 20/8/1996

Let's assume you bought a property for \$200,000 on the 1/1/1995 and live in it as your main residence until 1/1/1997, then rent it out while you move back to your parent's house and then travel overseas. You sell it 1/1/2005 and decide that it's time to move out of your parent's house and buy a larger place of your own. The market value of the house at 1/1/1997 was \$250,000 and you sell it for \$450,000.

If you did not make the six year main residence election your capital gain (before the 50% discount) would have been \$450,000 less \$250,000 (market value and not the price is used) being \$200,000 multiplied by 8years/10years which equals \$160,000. You do not pay Capital Gains Tax on the first 2 years when the property was your main residence.

By making the election (a form you sign and keep), the capital gain before the 50% discount becomes: \$450,000 less \$250,000 = \$200,000 multiplied by 2 years/10years which equals \$40,000.

You are only assessed on the gain for 2 years out of the 10 you owned the property. The 2 years you lived in it plus the 6 year exemption under the Section 118-192 election are tax free periods.

#### Example: Principal place of residence first rented before 20/8/1996

Let's assume the same facts as the above example but you rent it out from the 1/1/1996 so that the original cost of the property and not the market value at the date of income production is used.

- The capital gain (before the 50% discount) would be \$450,000 - \$200,000 = \$250,000 x 9years/10years being \$225,000 where no election is made.
- Where the election is made the capital gain (before the 50% discount) is \$450,000 - \$200,000 = \$250,000 x 3years/10years being \$75,000.

### You reside in the property with Boarders

This is a particularly common option for young people to help them fund the purchase of their first home but it can be dangerous. Firstly, you can jeopardize the first home owner's grant which can vary in amount depending on when you purchase the cost of the house, whether it is a newly constructed dwelling, the state it is located in and even if it is in a rural location. Please check the conditions attached to the grant with both the Federal Government and the State Revenue Office in your state. The Federal First Home Owner Grant was boosted between 14th October, 2008 to 30th June, 2009 to \$14,000 for existing properties and \$21,000 for newly built properties. Victoria also offers (subject to eligibility) a \$3,000 or \$5,000 First Home Bonus plus an additional regional bonus of up to \$3000 (subject to eligibility).

The next warning is that you are not able to claim the full capital gains tax 'principal place of residence exemption' or the 6 year exemption mentioned above. However, you are able to claim the negative gearing loss in your tax return as the rent from the boarders is income and the costs such as interest; rates etc. are then claimable on a pro-rata floor area basis.



Let's say you buy a three bedroom property on 1/1/2017 for \$240,000 and you rent out the other 2 bedrooms from day one. You have a larger bedroom complete with ensuite and a small TV room. There is also a common dining room, lounge room and kitchen that you all share while the boarders have their own separate bathroom. On a floor area basis the boarders use 55% of the house.

You sell the house on 1/1/2018 for \$440,000. The capital gain (before the 50% discount) would be:  
 $\$440,000 \text{ less } \$240,000 = \$200,000 \times 55\% = \$110,000.$

The capital gain may seem high but should be weighed up against the cash flow advantage derived from the boarder's rental income and the potential tax saving from the negative gearing strategy.

### **Holiday Houses or Property available for Part-Year Rental Only**

The private use will also impact on the capital gains tax calculation as the non-deductible portion of holding costs such as rates and interest can be added to the cost base where the property was bought after 21st August 1991.

## **Types of Rental Property Expenses**

There are three categories of rental property expenses, those that are:

1. Fully Tax Deductible Expenses
2. Non-Tax Deductible Expenses
3. Expenses Deductible Over Time

Each of these categories is discussed separately below.

### **Fully Tax Deductible Expenses**

Expenses for which you may be entitled to an immediate tax deduction in the financial year you incur the expense include:

- Advertising for Tenants
- Agent's Fees and Commission
- Bank Charges
- Body Corporate Fees and Charges\*
- Cleaning
- Council Rates
- Electricity and Gas
- Gardening and Lawn Mowing
- In-House Audio/Video Service Charges
- Insurance - Building, Contents, Public Liability
- Interest on Loans\*
- Land Tax\*
- Lease Document Expenses\* - Preparation, Registration, Stamp duty
- Legal Expenses\* (excluding acquisition costs and borrowing costs)
- Letting Fees
- Mortgage Discharge Expenses\*
- Pest Control
- Postage
- Quantity Surveyor's Fees
- Repairs and Maintenance\*
- Secretarial and Bookkeeping Fees
- Security Patrol Fees
- Servicing Costs – e.g.: Air conditioner
- Stationery
- Telephone calls and Line Rental

- Water Rates and Charges

\*You can claim a deduction for these expenses only if you actually incur them. Deductions marked with an asterisk(\*) are discussed in more details in our A-Z section of rental costs in the rear of this booklet.

## Non Tax Deductible Expenses

Expenses for which you are not able to claim deductions include:

- Property acquisition and disposal costs including initial repairs
- Expenses not actually incurred by you (i.e. water or electricity charges borne by your tenants) and
- Expenses that are not related to the rental of a property (i.e. expenses connected to your own use of a holiday home that you rent out for only part of the year).

### Property Acquisition and Disposal Costs

You cannot claim a tax deduction for the costs of acquiring or disposing of your rental property. These include the actual cost of the property, conveyancing costs and stamp duty on the transfer of the property. However, these costs will form part of the cost base of the property for Capital Gains Tax purposes.

In our example the purchase price of the rental property was \$400,000, conveyancing and legal search fees totaled \$1000 including the cost of a bank cheque, stamp duty was \$19,070 and land transfer registration was \$1,100. None of these acquisition costs are tax deductible but are added to the 'cost base' of the property for capital gains tax purposes. As such the cost base would be \$421,170 before any adjustment for the allocation of the purchase price for Fixtures and Fittings and the Building Construction Write Off.

To illustrate how the acquisition costs are treated we have produced this table of costs and broken them up into the appropriate categories.

	Total Expenditure	Not Deductible	100% Deductible	Claim Over Time
<b>Source: Legal Invoice</b>				
purchase price	400000	400000		
stamp duty on transfer	19070	19070		
land transfer registration	1100	1100		
legal out of pocket & title searches	260	260		
loan application fee	600			600
mortgage insurance (nil as met 80% equity)	N/A			N/A
bank cheque fee	40	40		
conveyancing costs	700	700		
<b>Source: Legal Settlement Statement</b>				
council rates on settlement	524		524	
body corporate fees on settlement	120		120	
water rates on settlement	54		54	
<b>Source: Mortgage Statements</b>				
mortgage registration	95			95
valuation fee - bank waived in our sample	N/A			N/A
<b>Total Initial Purchase Costs</b>	<b>422563</b>	<b>421170</b>	<b>698</b>	<b>695</b>

### **Initial Repairs**

'Initial' repairs you make in remedying defects, damage or deterioration that existed at the date you acquired the property are not tax deductible. Even if you are unaware that the fault existed at the time of purchase the repair is still not tax deductible.

Taxation Ruling TR 97/23 published by the Australian Taxation Office on repairs covers many different scenarios and highlights the complexity of this area. It can be viewed on the Taxation Office website at [www.ato.gov.au](http://www.ato.gov.au) by entering TR 97/23 in the 'search for' section of the home page.

Some examples of initial repairs include painting the property, repairing fencing, replacing guttering or retiling the bathroom all prior to tenants moving in.

However, repairs to rectify damage caused by tenants after the property is rented out are generally tax deductible provided that the repair is not an improvement. We discuss repairs in more depth on page 37 of this booklet.

**TAX TIP:** From a tax planning perspective it may be advantageous to defer expenditure such as internal painting for a year or so after acquiring the property as the tenant may cause some damage that necessitates a repaint. Deferring the expense will protect the tax deduction.

**Example:** Repairs Prior to Renting Out the Property

You do some repairs to your newly acquired rental property before the first tenant move in. You repaint dirty walls, replace broken light fittings and repair doors on two bedrooms. You also discover white ants in some of the floorboards that require replacement. These expenses were incurred to make the property suitable for rental and did not arise from your use of the property to generate assessable rental income. The expenses are capital in nature and you will not be able to claim an immediate deduction for them.

### **Holiday Houses or Property Available for Part-Year Rental**

If your property is used for both private and assessable income-producing purposes, you can not claim a tax deduction for the portion of the expenditure that relates to your private use. Examples would include holiday homes and time-share units.

In such cases you can not claim a tax deduction or any expenditure incurred in the periods when the home or unit was used by you, your relatives or your friends for private or non-income producing purposes. Apportionment of expense claims is usually on a time basis according to how long it was used for private purposes as opposed to assessable income-producing purposes. Any period that the property was available for rent may also be included in the tax deductible portion providing that it can be shown that you were actively engaged in seeking a tenant during that time.

### **You Reside in the Property with Boarders**

You are able to claim the negative gearing loss as the income from the boarders is assessable rental income and the costs such as interest, rates etc. are then allowable on a pro-rata basis (calculated on a floor area basis). Before you take in a boarder, please refer to the Capital Gains Tax section of this booklet at page 26 regarding the ramifications on the New Home Owners Grant and main residence exemption for capital gains tax. It could be a costly decision.

Expenses will be partially non-deductible where:

- The property is available for rent for only part of the year
- Only part of the property is used to earn rent
- You rent your property at non-commercial rates

## Expenses Deductible Over Time

There are three types of expenses you may incur for your rental property that may be claimed over a number of income years:

- a) Borrowing expenses
- b) Capital works deductions
- c) Amounts for decline in value of depreciating assets

Each of these categories are discussed in detail below.

### A) Borrowing Costs

You can claim all of the following as borrowing expenses:

- stamp duty charged on the mortgage
- loan establishment fees
- title search fees charged by your lender
- costs (including solicitors' fees) for preparing and filing mortgage documents
- mortgage broker fees
- fees for a valuation required for loan approval
- lender's mortgage insurance, which is insurance taken out by the lender and billed to you.

If your total borrowing expenses are more than \$100, the tax deduction is apportioned over five years or the term of the loan, whichever is less. If the total deductible borrowing expenses are \$100 or less, they are fully deductible in the income year they are incurred. If you repay the loan early and in less than five years, you can claim a deduction for the unclaimed balance of the borrowing expenses in the year of repayment. If you obtained the loan part way through the income year, the deduction for the first year will be apportioned according to the number of days in the year that you had the loan.

A loan used partially for private purposes will have the borrowing cost deduction limited to the extent of the business percentage. In our case study we have assumed that the loan was used exclusively to finance the cost of the new rental property and the associated additional costs (stamp duty, etc).

Example: Apportionment of Borrowing Costs

In order to purchase your rental property you -borrow \$421,865 over 30 years which includes a \$600 bank application fee and a \$95 mortgage --registration fee. There is no longer any mortgage stamp duty in Victoria and you have enough equity in your residential home so the bank did not require a separate valuation or mortgage insurance.

The loan was obtained on the 1 July, 2017 so the calculation would result in an annual deduction of \$139 (\$695 divided by 5 years). Remember that in the first year the claim is usually pro-rated but in our case study we have conveniently used the settlement date of 1st July, 2018 providing a full 365 day claim.

### B) Capital Works or Building Construction Write-Off

Capital or construction costs are the cost to build, extend or renovate a building. They do not include the cost of the land, the initial costs to clear the land or soft landscaping such as trees or woodchip. No value is attributable to your own personal labour if, for example, you painted the building yourself. It does, however, include architect fees, foundation excavation, payments to carpenters and other tradesmen and construction of retaining walls, fences and even in-ground swimming pools.

Rates of depreciation are determined by the type of construction and the year in which it was built. Generally speaking any residential investment property built after 18th July, 1985 can be depreciated at 2.5% (or 4.0% in some cases if construction falls within certain dates). Where ownership changes, the right to claim any undeducted construction expenditure for capital works passes to the new owner. The new owner must confirm that the building was constructed in the appropriate period when a claim is available and must use it for income producing purposes. Deductions can apply to capital works such as:

- A building or an extension
- Alterations — kitchen or bathroom
- Other structural improvements — paving, pergola, driveway, retaining wall or fence.

### **Estimating Construction Costs**

If you can't determine the precise construction costs only the following qualified people can make the assessment:

- Clerk of works, such as a project organizer for a major building project
- Supervising architect who approves progress payments
- A builder experienced in construction estimates of similar buildings
- A quantity surveyor

Valuers, real estate agents, accountants and solicitors generally do not have the relevant qualifications. When you sell the property the amount you have claimed for the building construction write off costs will reduce your cost base for capital gains tax purposes if you bought the property after 13th May, 1997.

Example: Capital Works Deduction

You sign a contract 1st April, 2008 to purchase an investment property in Victoria for \$400,000 with a settlement on 1st July, 2008. You engage a quantity surveyor who advises that the construction of the building was started on the 1st May, 2003 and completed on 1st August, 2003 a cost of \$150,000. Thereby an annual deduction of \$3750 ( $\$150,000 \times 2.5\%$ ) is still available until it ceases the 31st July, 2043.

The first year will usually be pro-rated but we conveniently settled on 1st July so a full year claim is available.

The Written Down Value of the Construction Costs when you acquire the property was \$131,558 as \$3442 would have been the claim in the 2004 tax year and then \$3750 for Years 2005 to 2008 inclusive.

**TAX TIP:** It is well worth engaging a quantity surveyor as the annual tax deduction can be substantial and ongoing for a number of years.

## **C) Depreciation or Decline in Value Deduction**

'Plant and equipment' is a term encompassing items such as curtains, kitchen stove and oven, carpet and vinyl floor coverings and where applicable, loose furniture such as beds, tables or chairs.

Depreciation on items of plant and equipment is based on the effective life of the asset. Generally speaking, the effective life of any depreciable asset is the length of time (in years) the asset can be used to produce income.

### ***What's the difference between capital costs, fixtures & fittings and repairs?***

As detailed above, capital costs (also known as construction costs) are the building itself and the fixtures that form part of the building. Fixtures and fittings (also known as plant, equipment or articles) are generally removable items sitting in the building that if removed would not drastically change the make up of the building or render the building incomplete.

Repairs and maintenance have always been a contentious issue for taxation purposes and you need to be very careful to distinguish a repair from an improvement to the property. You also need to determine whether or not you have repaired an item to bring it back to its original condition (or working order) or have you improved the item beyond its original condition. For example, replacing a rotted piece of timber on your pergola is a repair but knocking down the pergola and replacing the entire structure is an improvement and as such is considered a capital expense and must be depreciated over time. As previously discussed, 'initial repairs' are not tax deductible and form part of the cost base for Capital Gains Tax purposes.

### **Effective Life**

This is the estimated life of a depreciating asset from when it is first purchased having regard to wear and tear, etc. It is generally determined by the Taxation Office unless you wish to self assess a different rate due to special circumstances. The sort of information needed to make an estimate of the effective life is available from the Australian Taxation Office. On page 33 of this booklet is a table of the effective life of some of the more common items (as at 31st October, 2008) for your reference.

What rate do I use? There are a few different ways to claim depreciation on plant and equipment and we can help you determine which is the most appropriate.

### **Immediate Deduction for an Asset Costing \$300 Or Less**

This is a great concession as you get a 100% tax deduction in the year you acquire the asset providing it is used solely for income production when purchased. Even better is the fact that it is \$300 per owner, so if you and your partner own the property jointly, then you can claim 100% tax deduction if it costs \$600 or less. Note, it must not be part of a set or number of identical assets that total over \$300 such as 4 chairs at \$200 each.

### **Diminishing Value Method**

This method assumes that the decline in value each year is a constant portion of the remaining value. As such, it gives you a higher tax deduction in the early years and a progressively smaller deduction thereafter. On the 10th May, 2006 the Government altered the formulae for this method so that the tax deduction is higher as all depreciation rates increased.

In our example below the depreciation on the Hot Water Service acquired 1st August, 2017 would be as follows:

2017 Tax Year: Cost \$500 x 16.67% (Refer Rate Table) < 334/365 days = \$76.

The carry forward Written Down Value is \$424.

2018 Tax Year: WDV \$424 x 16.67% x 365/365 days = \$71

The carry forward Written Down Value is \$353.

### **Prime cost Method**

This assumes that the value of the asset decreases uniformly over its effective life so that the depreciation claim is the same amount each year. In our example below the depreciation on the Hot Water Service acquired

1st August, 2008 would be as follows:

2017 Tax Year: Cost \$500 x 8.33% (Refer Rate Table) x 334/365 days = \$38.

The carry forward Written Down Value is \$462.

2018 Tax Year: Cost \$500 x 8.33% x 365/365 days = \$42.

The carry forward Written Down Value is \$420

This \$42 would be the annual tax deduction each year for the 12 year life with the first and final years pro-rated.

### **Low-Value Pool**

You can also accelerate your claim by allocating assets that cost more than \$300 but less than \$1000 to a special 'low value pool'. Once you have allocated an asset to the pool it stays in the pool. The decline in value is worked out at 18.75% in the first year and then 37.5% of the diminishing value thereafter. However, only the taxable use percentage is allocated to the pool.

The low value pool is complex and best left to us to calculate when we are preparing your year end tax return.

### **Estimating Plant & Equipment Values**

Where you buy a rental property from an unrelated party, one way of establishing the cost of depreciating

assets is to have their value specified separately in the sale agreement. If separate values are not included then you may be required to demonstrate the basis of your valuation.

### **Second-hand depreciating assets**

From 1 July 2017, used and second-hand depreciating assets in residential rental properties may not be deductible.

**Table 1 Depreciation deductions you can claim under the new legislation**

<b>Date of purchase</b>	<b>New assets</b>	<b>Second-hand or used assets</b>
<b>Property purchased for rental purposes before 7.30pm on 9 May 2017</b>	<b>Yes</b>	<b>Yes</b>
<b>Depreciating assets in a brand new or substantially renovated rental property purchased at or after 7.30pm on 9 May 2017</b>	<b>Yes</b>	<b>No</b>
<b>Depreciating assets in an existing rental property purchased at or after 7.30pm on 9 May 2017</b>	<b>Yes</b>	<b>No</b>
<b>Depreciating asset purchased before 7.30pm on 9 May 2017</b>	<b>Yes</b>	<b>Yes</b>
<b>Depreciating asset was purchased at or after 7.30pm on 9 May 2017</b>	<b>Yes</b>	<b>No</b>

### **Depreciating assets in a rental property purchased before 9 May 2017**

If you owned a rental property, or entered into a contract to purchase your rental property before 7.30pm on 9 May 2017, you can continue to claim deductions for decline in value of the depreciating assets that were in the rental property before that date.

It doesn't matter whether the depreciating asset installed in the property was new or used, or whether the property was new or not.

The decline in value of a depreciating asset starts when you first use it, or install it ready for use. This is known as the depreciating asset's start time. For example, if you purchased an asset halfway through the financial year (eg, on 1 January) - and used it only for a taxable purpose - you can claim half of the first income year's decline in value, as long as the asset has remaining effective life.

Your deduction needs to be reduced for any personal use of the asset.

For assets costing \$300 or less, you can claim an immediate deduction for the entire cost (to the extent you use it for a rental property). You can't do this if the asset is one of a set of assets that together cost more than \$300 - for example, if you buy four dining chairs each costing \$250, you can't treat them as separate assets to claim an immediate deduction.

### Methods of calculating depreciation deductions

To work out your deduction for depreciation, use either the:

prime cost method - this means the value of the depreciating asset decreases uniformly over its effective life, or

diminishing cost method - this means the decline in value each year is a constant proportion of the remaining value; so it diminishes over time.



To save on paperwork, depreciating assets valued at less than \$1,000 can be grouped in a low-value asset pool and depreciated together.

You can work it out using the Decline in value calculator.

### **Example**

Sharon owns a residential property she has been renting out since September 2015. In March 2017, Sharon bought a second-hand fridge to replace the fridge that had broken down.

Because Sharon bought the second-hand fridge for her rental property before 7.30pm on 9 May 2017, she can still claim depreciation deductions for any remaining life of the asset.

### **Depreciating assets in a brand new or substantially renovated rental property purchased at or after 7.30pm on 9 May 2017**

If you buy a newly built property, or buy a property that has been substantially renovated, you will be entitled to claim depreciation deductions for decline in value of the new depreciating assets if:

- no one previously claimed any depreciation deductions on the asset, and;
  - either no one lived in the property when you acquired it, or;
  - if anyone lived in the property after it was built or renovated, you acquired it within six months (of the property being built or renovated).

### Substantial renovations

Substantial renovations of a rental property are renovations in which all, or substantially all, of a building is removed or is replaced. This could include the removal or replacement of foundations, external walls, interior supporting walls, floors, roof or staircases.

For renovations to be substantial, they must directly affect most rooms in a building. The removal and replacement of the exterior walls, the removal of some internal walls, and the replacement of the flooring and the kitchen in a house are considered collectively to amount to substantial renovations.

### Example

Jake bought a four bedroom residential property in October 2017 with the intent of it being a rental property. Three months before selling, the previous owners had removed a wall between two bedrooms and turned the space into a large bedroom with an ensuite. They also repainted and recarpeted the room.

Even though Jake acquired the property within six months of the renovations being completed, the renovations only impacted a part of the house, and aren't classified as being substantial renovations. In this case, Jake can't claim depreciation deductions for the decline in value of the depreciating assets in the property. However, if Jake buys any brand new depreciating assets for the property, he will be able to claim depreciation deductions for its decline in value.

### **Depreciating assets in an existing rental property purchased at or after 7.30pm on 9 May 2017**

If you purchased your rental property at or after 7.30pm on 9 May 2017, you may be impacted by the changes to legislation for depreciating assets. These changes apply from 1 July 2017.

You can no longer claim deductions for second-hand or used depreciating assets, whether they are bought with the property or separately. You also can't claim depreciation deductions if you have used the asset for private purposes before installing it in your rental property.

You can claim deductions for new depreciating assets.

### Example

At the start of 2016, Marty bought a home that he's been living in as his main place of residence. In August 2017, Marty decided to move out and rent out the property fully furnished, which included the furniture and fittings he had been using while living there.

Since the property was made available for rent after 7.30pm on 9 May 2017, Marty is not able to claim depreciation deductions for any remaining life of the used depreciating assets.

This is because, even though Marty owned the property before 9 May 2017, it had not been rented out and

the assets are considered used at the point he commenced renting the property.

### **Depreciating assets purchased for a rental property**

The date you purchase the depreciating assets (either separately or bought with the property) impacts whether you are entitled to claim deductions for their decline in value.

#### Depreciating assets purchased brand new

Depreciation deductions for new assets have not changed. You are still entitled to claim depreciation for new assets you purchase for your rental property. This also includes new assets installed as part of property developments or with building packages.

See also:

- [methods of calculating depreciation deductions](#)

#### Example

Kerrie purchases two apartments from a developer – one off-the-plan and the other four months after completion. At the time of purchasing the off-the-plan apartment, it is already rented out by the developer.

Both of the apartments incorporate depreciating assets such as curtains and furniture prior to settlement and the transfer of title to Kerrie. The developer also provided shared areas in the apartments' complex.

The shared areas have a range of new depreciating assets that are joint property of all the apartment owners.

For off-the-plan apartment and its shared areas, Kerrie is entitled to claim deductions for decline in value of the depreciating assets.

For the tenanted apartment and its shared areas, Kerrie is still entitled to claim deductions for decline in value of the depreciating assets (although they have been used for four months) because:

- no one claimed any deductions for decline in value of the depreciating assets, and
- the apartment was supplied to Kerrie within six months of being built.

Note that Kerrie can only deduct her share of the depreciating assets installed in the shared areas of the apartment complex.

### **Depreciation Example**

Description	Cost	Base Value	Days-Held	Diminishing Rate	Decline in Value	Adjusted Closing
-------------	------	------------	-----------	------------------	------------------	------------------

						<b>Value</b>
Hot water Service Electric	500	500	334/365	16.67%	76	424
Carpets	2000	2000	334/365	20%	366	1634
Stove	300	300	Below \$300	100%	300	0
Curtains	1000	1000	334/365	33.33%	305	395
<b>Totals</b>	<b>3800</b>	<b>3800</b>			<b>1047</b>	<b>2753</b>

Let's say you purchased a property on the 1st August, 2018 and the purchase contract specifies separate asset values being hot water service \$500, carpets \$2000, stove \$300 and curtains \$1000. The property was very run down and assets were defined in the contract and \$3800 appeared reasonable. We have used the below \$300 tax advantage and diminishing value method (instead of prime cost) but we could have also used the low value pool on the Hot Water Service to get an even higher claim. Calculations are complex and always consult with your Accountant.

## Additional Notes - The A-Z Taxation Guide to Rental Property Expenditure

### 1. Body Corporate Fees and Charges

Body corporate fees and charges designed to cover the cost of day-to-day administration and maintenance are generally tax deductible. They usually incorporate building and public liability insurance of your unit and the common area. However, if the body corporate requires you to make payments to a '*special purpose fund*' to pay for specific capital expenditure these levies are not deductible. Similarly, if the body corporate levies a special contribution for major capital expenses to be paid out of the 'general purpose sinking fund', you will not be entitled to a tax deduction for this special contribution amount. This is because payments to cover the cost of capital improvements or capital repairs are not deductible.

A *general purpose sinking fund* is one established to cover a variety of unspecified expenses (some of which may be capital expenses) that are likely to be incurred by the body corporate in maintaining the common property. For example, painting of the common property (e.g. stair well) or repairing or replacing fixtures and fittings of the common property. A *special purpose fund* is one that is established to cover a specified capital improvement to the common property which is likely to be a significant expense that can not be covered by ongoing contributions to a general purpose sinking fund.

### 2. Interest on Loans

To claim the mortgage interest, the property must be rented or available for rent in the income year you are claiming a deduction. You can no longer claim the interest you incur after you cease using the property for income producing purposes.

While the property is rented, or available for rent, you can also claim interest charged on loans taken out:

- to purchase depreciating assets
- for repairs
- for renovations.

Similarly, if you take out a loan to purchase land on which to build a rental property or to finance renovations to a property you intend to rent out, the interest on the loan will be deductible from the time you took out the loan. However, if your intention changes — for example, you decide to use the property for private purposes and you no longer intend to use it to produce rent or other income — you can't claim the interest after your intention changes.

### **TAX WARNINGS: Things that can effect the tax deductibility of mortgage interest and other expenses include:**

You use the property for private purposes for a period of time

- You use the money borrowed to buy a new home to live in and rent out your old home
- You have one loan which is partially for the property and partially for private use.
- You make no payments at all on the rental property loan because all loan payments are made against the private part of the loan. The Taxation Office advises that the interest claim must be reduced on these split loan arrangements to assume that at least interest is paid and not capitalized
- You rent the property to a relative or friend at below market value
- You share your home with Boarders

These can all be complicated scenarios and we strongly recommend you consult with us to discuss the tax consequences.

Banks and other lending institutions offer a range of financial products which can be used to acquire a rental property. Many of these products permit flexible repayment and redraw facilities. As a consequence, a loan might be obtained to purchase both a rental property and a private car. In such a case, the interest on the loan must be apportioned between the deductible and non-deductible parts according to the amounts borrowed for each purpose. A simple example of the calculation is shown below.

Let's assume you decide to take out a loan for \$200,000 from which \$170,000 is used to buy a rental property and \$30,000 is used to purchase a private car. If the loan interest rate is 8.75% per annum and assuming that the property is rented from 1 July:

Total Interest for Year 1 = \$200,000 X 8.75% = \$17,500  
 Deductible Portion \$170,000/\$200,000 x \$17,500 = \$14,875

If you prepay interest it may not be completely deductible in the current year and we recommend you seek advice from your Accountant.

Loans that are used for both private purposes and for the rental property may have a fluctuating balance due to a variety of deposits and withdrawals. You must keep accurate records of the movement so you can calculate the interest that applies to the rental property portion of the loan. This calculation can get very messy and complex so we always recommend you have a separate or dedicated loan for the rental property.

Some rental property owners borrow money to buy a new home and then let out their previous home. If there is an outstanding loan on the old home and the property is used to produce income, the interest outstanding on the loan, or part of the interest, will be deductible. However, an interest deduction can not be claimed on the loan used to buy the new home because it is not used to produce assessable income. This is the case whether or not the loan for the new home is secured against the former home.

### 3. Land Tax

This is an annual cost imposed by your State Revenue Office so please contact them for the likely fee payable. Your principal place of residence is excluded and in Victoria you only pay it if you own land with a total taxable value (previously known as 'unimproved value') of \$225,000 or more (excluding exempt land).

In the above example the taxable land value on a property costing \$400,000 would generally be below the \$250,000 threshold as that is the value excluding the house construction. Therefore, there would be no land tax payable as this is the purchase of our first rental property and our main residence is excluded from calculations. The land tax rates for property held in trusts is higher and you should contact your State Revenue Office for these rates.

#### Victorian Tax and Duty Rates as at 31<sup>st</sup> October 2018

2018 Land Tax General Rates (Excluding Trusts) Total Taxable Value of Landholdings	Land Tax Payable
<\$250,000	NIL
\$250,000 to < \$600,000	\$275 plus 0.2% of amount >\$250,000
\$600,000 to < \$1,000,000	\$975 plus 0.5% of amount >\$600,000
\$1,000,000 to < \$1,800,000	\$2,975 plus 0.8% of amount >\$1,000,000
\$1,800,000 to < \$3,000,000	\$9,375 plus 1.3% of amount >\$1,800,000
\$3,000,000 and over	\$24,975 plus 2.25% of amount >\$3,000,000

### 4. Lease Document Expenses

The costs of preparing and registering a lease and the cost of stamp duty on a lease are deductible to the extent that you have used, or will use, the property to produce income. This includes any costs associated with an assignment or surrender of a lease.

## 5. Legal Expenses

Some legal expenses incurred in producing your rental income are deductible. For example, the cost of evicting a non-paying tenant. However, most legal expenses are of a capital nature and not deductible including costs of:

- Purchasing or selling your property
- Resisting land resumption
- Defending your title to the property.

Non-deductible legal expenses may, however, form part of the cost base of your property for capital gains tax purposes.

## 6. Mortgage Discharge Expenses

Mortgage discharge expenses are the costs involved in discharging a mortgage other than payments of principal and interest. These costs are deductible in the year they are incurred to the extent that the mortgage was to produce assessable income. For example, if you used a property to produce rental income for half the time you held it as a holiday house for the other half of the time, 50% of the costs of discharging the mortgage are deductible.

Mortgage discharge expenses may also include penalty interest payments charged by a financier due to early repayment of a loan. Penalty interest payments associated with a rental property are deductible:

- if the money borrowed is secured by a mortgage over the property and the payment effects the discharge of the mortgage, or
- if payment is made in order to rid the taxpayer of a recurring obligation to pay interest on the loan.

## 7. Repairs and Maintenance

Expenditure for repairs you make to the property may be deductible. However, the repairs must directly relate to wear and tear or other damage that occurred as a result of you renting the property. Repairs generally involve a replacement or renewal of a worn out or broken part. For example, replacing some guttering damaged in a storm or part of a fence that was damaged by a falling tree.

However, the following expenses are capital, or of a capital nature, and are not tax deductible:

- replacement of an entire structure or unit of property (such as a complete fence or building, a stove, kitchen cupboards or refrigerator)
- improvements, renovations, extensions and alterations, and
- initial repairs — for example, in remedying defects, damage or deterioration that existed at the date you acquired the property.

You may be able to claim capital works deductions for these expenses —for more information, see Capital Works Deductions. Expenses of a capital nature may also form part of the cost base of the property for capital gains tax purposes.

Repairs to a rental property will generally be deductible if:

- the property continues to be rented on an ongoing basis, or
- the property remains available for rental but there is a short period when the property is unoccupied — for example, where unseasonable weather causes cancellations of bookings or advertising is unsuccessful in attracting tenants.

Example: Repairs when the property is no longer rented out

After the last tenants moved out you discover that the stove didn't work, kitchen tiles were cracked and the toilet window was broken. You also discover a hole in a bedroom wall that had been covered with a poster. You pay for this damage to be repaired so you can sell the property.

As the tenants were no longer in the property, you were not using the property to produce assessable income. However, you could still claim a deduction for repairs to the property because the repairs related to the period when the tenants were living in the property and the repairs were completed before the end of the income year in which the property ceased to be used to produce income.

Examples of repairs for which you can claim deductions are:

- replacing broken windows
- maintaining plumbing
- repairing electrical appliances.

Examples of improvements for which you can not claim deductions are:

- landscaping
- insulating the house
- adding on another room

### **8. Travel and Car Expenses**

From 1 July 2017, travel expenses relating to a residential investment property are not deductible.

A residential premise (property) is land or a building that is:

- occupied as a residence or for residential accommodation
- intended to be occupied, and is capable of being occupied, as a residence or for residential accommodation.

Under the new legislation, you are no longer able to claim any deductions for the cost of travel you incur relating to a residential rental property unless you are carrying on a [business of property investing](#) or are an [excluded entity](#).

As with prior years, the travel expenditure cannot be included in the cost base for calculating your capital gain or capital loss when you sell the property.

Example: An individual with residential investment property in 2017–18

Sarah rented out her residential rental property 2017–18. She travelled to the property to repair damages caused by tenants during the year.

As the investment is a residential property, Sarah cannot claim travel expense.

## Worksheet – Sample Property – A

ADDRESS \_\_\_\_\_ POSTCODE \_\_\_\_\_

PURCHASE PRICE \$ \_\_\_\_\_ DEPRECIABLE ITEMS \$ \_\_\_\_\_  
 BORROWING \$ \_\_\_\_\_ BUILDING CONSTRUCTION COST \$ \_\_\_\_\_  
 INTEREST RATE \_\_\_\_\_ % CURRENT TAXABLE INCOME \$ \_\_\_\_\_  
 WEEKLY RENTAL \$ \_\_\_\_\_

PROJECTED PROFIT & LOSS STATEMENT	\$	\$
Gross Rent Received (52 weeks @ \$ _____)		
<b>EXPENSES</b>		
Advertising		
Agent's commission (7% of Rent + Outgoings +GST)		
Bank Charges and Fees		
Body Corporate Fees		
Borrowing Costs Year 1 Claim ( see below*)		
Building Construction Write Off \$ _____ @ _____ %		
Cleaning		
Depreciation \$ _____ @ _____ %		
Gardening & Lawns		
Insurance - Landlord		
Insurance - Building		
Interest \$ _____ @ _____ %		
Letting Fees - 2 Weeks Rental plus GST		
Postage and Stationery		
Rates - Water & Council		
Repairs		
Telephone		
<b>Total Expenses</b>		
<b>NET TAXABLE LOSS</b>		

### BORROWING COSTS

Claimable over 5 years if over \$100 in total and the loan term is 5 years or more

Loan Establishment Fee \$ \_\_\_\_\_  
 Loan Valuation Fee \$ \_\_\_\_\_  
 Finance Brokers Fees \$ \_\_\_\_\_  
 Mortgage Registration \$ \_\_\_\_\_  
 Mortgage Insurance \$ \_\_\_\_\_  
 Other Borrowing Costs \$ \_\_\_\_\_  
 Total Borrowing Costs \$ \_\_\_\_\_ Divided by 5 = Annual Claim \$ \_\_\_\_\_  
 First Year Claim is Pro-rated \$ \_\_\_\_\_ x \_\_\_\_\_ days / 365 days = \$ \_\_\_\_\_

## Worksheet – Sample Property – B

ADDRESS \_\_\_\_\_ POSTCODE \_\_\_\_\_



PURCHASE PRICE	\$ _____	DEPRECIABLE ITEMS	\$ _____
BORROWING	\$ _____	BUILDING CONSTRUCTION COST	\$ _____
INTEREST RATE	_____ %	CURRENT TAXABLE INCOME	\$ _____
WEEKLY RENTAL	\$ _____		

PROJECTED PROFIT & LOSS STATEMENT		\$	\$
Gross Rent Received (52 weeks @ \$ _____)			
<b>EXPENSES</b>			
Advertising			
Agent's commission (7% of Rent + Outgoings +GST)			
Bank Charges and Fees			
Body Corporate Fees			
Borrowing Costs Year 1 Claim ( see below*)			
Building Construction Write Off \$ _____ @ _____ %			
Cleaning			
Depreciation \$ _____ @ _____ %			
Gardening & Lawns			
Insurance - Landlord			
Insurance - Building			
Interest \$ _____ @ _____ %			
Letting Fees - 2 Weeks Rental plus GST			
Postage and Stationery			
Rates - Water & Council			
Repairs			
Telephone			
<b>Total Expenses</b>			
<b>NET TAXABLE LOSS</b>			

### BORROWING COSTS

Claimable over 5 years if over \$100 in total and the loan term is 5 years or more

Loan Establishment Fee	\$ _____
Loan Valuation Fee	\$ _____
Finance Brokers Fees	\$ _____
Mortgage Registration	\$ _____
Mortgage Insurance	\$ _____
Other Borrowing Costs	\$ _____
Total Borrowing Costs	\$ _____ Divided by 5 = Annual Claim \$ _____
First Year Claim is Pro-rated	\$ _____ x _____ days / 365 days = \$ _____

## Notes From Meeting