<u>Negative gearing and investment properties</u>

Negative gearing describes the situation where you borrow to buy an investment and the interest and other costs you incur to maintain the investment exceed the annual income you receive from the investment.

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 tax benefits should not be the primary consideration behind the investment decision

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.

The 13 steps to negative gearing of property

<u>Step 1 – Consult with your accountant</u>

Your accountant is in a unique position to advise you regarding the purchase of an investment property. We understand your tax affairs and can help you by:

- Preparing a forecast including the calculation of the weekly net cash outflows required for maintaining the property
- Assist with determining ownership structure
- Prepare a profit and loss schedule for your annual return
- Assist with creating a Capital Gains Tax register of costs

<u>Step 2 – Finding the right property</u>

It's all about location, location, location. Planning, research and patience are all important.

<u>Step 3 – Pre-purchase inspection</u>

Before purchasing a property it is essential that you are aware of any serious faults or defects.

A pre-purchase inspection from a licensed professional provides peace of mind and confidence in your investment decision. Before signing a contract, the buyer should consider enlisting the services of a qualified building inspector or surveyor to provide a professional condition report.

The report will point 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 unauthorised renovations or extensions.

<u>Step 4 – Stamp duty and land transfer costs</u>

Stamp Duty rates vary depending on the value of the property. The stamp duty is less where the property is going to be your principle place of residence.

The Land Transfer fee is levied by the state Land Titles Office. Both of these costs are not tax deductible but rather added to the cost base of the property for capital gain tax purposes.

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 undertaken by a solicitor or registered conveyancer.

Step 6 – Finance

Finance is one of the most important considerations when acquiring a property.

Most mortgage brokers are willing to give you some indication as to the likely success of your loan application and the associated costs. We recommend that you get your finance pre-approved, especially if you are planning to purchase at auction.

The loan establishment costs such as bank valuation and application fees, mortgage insurance, mortgage registration etc. are all tax deductible over a period of 5 years.

Step 7 – Cashflow analysis

A negatively geared property implies a net cash outflow that you will need to fund from other income sources. It is important that you budget for the extra cashflow commitment associated with the newly acquired property.

Step 8 – Sign the contract

Once you have found the property that you want to purchase, now is the time to engage a solicitor or conveyancer to assist with all of the legal aspects.

Step 9 – Insurance

Now that you have purchased your property it is time to consider the type of insurance you require.

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.

Step 11 – Prepare property for rent

Undertake the necessary steps to maximise the rental income and during this preparatory stage it may include doing some renovations.

Step 12 – Find a tenant

Decide whether to engage a real estate agent or find a tenant yourself. A real estate agent will charge commissions at around 7% of the rent, plus incidental charges for items such as postage, annual statements etc. Real estate agents will also charge a letting fee plus any advertising costs to find the first tenant and will charge the same fees when changing tenants later down the track.

Whilst you are able to manage the property yourself, it is a lot less time consuming and stressful to engage a real estate agent to act on your behalf.

Step 13 – Back to your accountant

Prepare a PAYG variation – Given the anticipated tax loss on the property, investors who are subject to normal 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 application and the ATO will instruct your employer to vary the amount of tax withheld from your regular pay. This means that you receive more net pay per pay period and less of a refund when you prepare your Income Tax Return.

Prepare annual rental profit & loss - we will prepare a rental profit & loss statement in conjunction with the preparation of your annual Income Tax Return so that you can see the actual loss made for a financial year.