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20 Tax Tips for Property Investors



WELCOME

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Property values, as history will tell us, always increase over time. Indeed, through all financial crises and economic difficulties Australia has faced, the one thing constant that continued to yield returns is property investment. If you're not investing in property, you are seriously missing out.

With proper research and smart property management, you can create a passive income and build sustainable wealth. This is why property investment is considered to be the surest way to create wealth.

Investing in property offers plenty of tax benefits, too. You can have tax deductions on your loan interest, property taxes, insurance, and more. Effective property tax planning ensures you get the full benefits and all the deductions you are entitled to. This guide will help you maximise returns from your investments by providing you with tips to minimise your taxes. But first, let's talk about other factors that affect your property investment returns.



Investment Structure

There are four basic types of Investment Structures and getting the correct structure for your property investment right from the beginning can have long-term benefits.

Individual Investment Structure

The simplest way to hold a property investment is to have it under your name. Individual investment structures are easy to set-up and manage but have no flexibility in terms of income distribution. Using an individual investment structure also makes your asset vulnerable to claims from creditors. Negatively geared property held by an individual will also attract tax liabilities when it eventually becomes positively geared.

Trust Investment Structure

An investment may be legally held in the name of a trust. The trustee determines the distribution of the income of the trust's assets to its beneficiaries.

There are four main types:

- o Discretionary
- o Unit
- o Hybrid
- o Superannuation fund

Of these four, a discretionary trust is generally the most tax effective. Depending on your circumstances, one may be more appropriate than others. If you wish to purchase assets using your

super, for example, you may choose to establish a Self Managed Superannuation Fund.

Partnership Investment Structure

A partnership investment structure is also fairly simple. For tax purposes, a partnership is not considered an entity and is therefore not subject to tax. The income, loss (if negatively geared) of a partnership flows directly to the individual members and therefore tax liabilities/benefits are attached to the income of each member/partner.

There is also a limited flexibility in terms of income distribution with partnerships. Assets are also vulnerable to claims by creditors and all partners are jointly liable to all claims.

Company Investment Structure

Though normally used for business, a company may also be used for holding investment purposes. The cost of setting up this kind of investment structure is high but it can offer asset protection for shareholders. The tax rate is generally 26%, but losses can only be offset against future income and there is no CGT discount for the sale of an asset or a property.



1. Capital Gains Tax

Capital gain is the difference between what you paid for an asset (plus fees incurred during the purchase) and what you sold it for (less fees incurred during the sale). Capital gains tax (CGT) is the tax you pay on the capital gain made from the sale of that asset.

It applies to property, shares, leases, goodwill, licences, foreign currency, contractual rights, and personal use assets purchased.

No CGT applies if the property sold is a person's main residence, i.e. their primary home.



How is capital gains tax calculated on property?

CGT is calculated based on the amount of profit you make from the sale of your property, your marginal tax rate, and the tax deductions for which you're eligible.

When a property has been held for more than 12 months, a 50 per cent discount is generally applied to the gain for Australian residents.

Exceptions to 50% discount rule

- Companies are not entitled,
- Foreign residents who purchases property after 8 May 2012,
- Self managed super funds.

However, companies are not entitled to this discount, nor foreign residents who bought their property after 8 May 2012, and self-managed super funds (SMSF) only get a discount of one third.

How you can reduce your CGT liability?

There are a number of concessions and exemptions when it comes to paying CGT. Talk to your accountant, about additional strategies to reduce your overall tax bill. We have included some of the main strategies you should consider.



Main Residence Exemption

If the property you are selling is your main residence, there is no CGT. However, this exemption may not fully apply if your residence has been used to produce income. In this case, a portion of the capital gain will be taxable.



Temporary Absence Rule

The temporary absence rule applies to a situation where you move out of your main residence. You can continue to treat the property as your main residence indefinitely, or for up to six years if you initially buy a property as your main residence and later rent it out.

If you move back into the rented property within the six years, the period is reset and can be treated as your main residence for another six years.



Investing In A SMSF

While self-managed super funds only attract a one-third discount for CGT, the standard tax rate for funds is only 15 percent, meaning the maximum CGT rate is 10 per cent. Which is lower than most people's marginal tax rate.



Timing Capital Gain

A simple strategy to reduce CGT is to consider the timing of when you make a capital gain or loss. If you know your income will be lower in the next financial year, you can choose to delay selling until then, so that your lower marginal tax rate results in you paying less CGT.



Partial Exemptions

Holding a property for more than 12 months will attract a 50 percent discount in CGT, and you can also receive a partial exemption if you move into a rental property. You are still entitled to a reduction in CGT if you use your main residence as a place of business, too.

2. What you can claim

To help make sure you claim all tax deductions you're entitled to, here's a handy list you may refer to.

The ATO does not take kindly to false claims, so before you claim any of these, make sure you incurred them or that they weren't paid by your tenant.

Tax Deductions

- Advertising for tenants
 - Bank charges
 - Body corporate fees and charges
 - Cleaning
 - Council rates
 - Electricity and gas (annual power guarantee fees)
 - Gardening and lawn mowing
 - In-house audio and video service charges
 - Insurance
 - ✓ Building
 - ✓ Contents
 - ✓ Public liability
 - Interest on loans
 - Land tax
 - Lease document expenses
 - ✓ Preparation
 - ✓ Registration
 - ✓ Stamp duty
 - Legal expenses
 - Mortgage discharge expenses
 - Pest control
 - Property agent's fees and commissions
- (including prior to the property being available to rent)
- Quantity surveyor's fees
 - Costs incurred in relocating tenants into temporary accommodation if the property is unfit to occupy for a period of time
 - Repairs and maintenance
 - Secretarial and bookkeeping fees
 - Security patrol fees
 - Servicing costs, for example, servicing a water heater
 - Stationery and postage
 - Telephone calls
 - Tax-related expenses
 - Water charges

IMPORTANT!

If any contractor who undertakes work on your property does not have an ABN you are required to withhold 47% of payment, which must be paid to the ATO if you want to claim expenses incurred.

3. What you cannot claim

Generally, you **cannot** claim tax deductions for the cost of owning a property that does not generate a rental income. You can only include costs of ownership to the property's cost base to reduce your CGT when you sell it.

This is different from rental properties with no tenants. Expenses from rental properties without tenants, unless the property is NOT genuinely available for rent, are still tax deductible.

To be eligible to claim the expenses associated with property rental, you must be genuinely looking for tenants and have advertised the property at a realistic rental price.

Loan Related Expenses – Non Deductible

- A.** Borrowing expenses are amortised over 5 years, even though we cannot claim immediate deduction for borrowing expenses.
- B.** Stamp duty charged by your state/territory government on the transfer (purchase) of the property title (this is a capital expense)
- C.** Legal expenses including solicitors' and conveyancers' fees for the purchase of the property (this is a capital expense)
- D.** Stamp duty you incur when you acquire a leasehold interest in property such as an Australian Capital Territory 99-year crown lease (you may be able to claim this as a lease document expense)
- E.** Insurance premiums where, under the policy, your loan will be paid out in the event that you die, become disabled or unemployed (this is a private expense)
- F.** Borrowing expenses on any portion of the loan you use for private purposes (for example, money you use to buy a car).

G. Travel expenses relating to inspecting, maintaining or collecting rent for a residential rental property is not tax deductible since 1 July 2017. Travel expenses can also not be added to the cost base for CGT purpose.

H. Depreciating assets in a residential rental property purchased on or after 7.30pm (AEST) on 9 May 2017.

I. Depreciating assets in a home turned into a residential rental property on or after 1 July 2017. You can only claim depreciation for new assets acquired.

TAX FACT!

You can't claim the total cost of repairs and maintenance on your rental property immediately if they are not caused by wear and tear **or not** caused by a damage resulting to your renting out the property.

Existing damages at the time of the purchase of the property are considered as capital in nature. Capital improvements or capital works are not immediate deductions and may only be written off for 40 years—the average life the government deems an asset to have.

4. Keep accurate records of expenses to maximise deduction

Needless to say, the ATO will require evidence of your expenses. Verbal assurances, nor pictures of newly mown lawns to prove that you have indeed incurred expenses for lawn mowing, for example, will not fly.

Keep your receipts, contracts and other supporting documents to claim all your deductions without problems. All records pertaining to your property maintenance must be kept for at least five years.

If you decide to dispose of your property investment, insurance, rates notices, settlement letters, stamp duty receipts, legal costs receipts, purchase contract, and all other expenses incurred right from the beginning should be kept at least five years after the property was sold.





5. Prepay Interest

If your income is likely to place you in the next income tax bracket, as a result of a pay increase and you have fixed rate loans, consider paying the interest for 12 months in advance. This will allow you to claim deductions in the same income year you are lodging your tax return. You are only permitted to do this once only.

6. Re-Value property before renting it out

If you decide to rent out your primary residence and turn it into an investment property you may be able to reduce future capital gain. Have your property re-valued prior to renting it out.

The valuation should make reference to the market price and the valuation at the date the property is rented out.

The capital gain on a rental property is calculated by the difference between the final purchase price and the valuation of the property at the time it was rented out. Failure to revalue the property, before rental, will result in your CGT liability being calculated on the original purchase price.

As your investment property gains value during your period of ownership, your CGT liability increases. To reduce your future potential tax liability, you should always revalue the rental property prior to rental and disposal.

To avoid paying more than necessary, have your property revalued by a licensed valuer before you rent it out.

Example

Claiming Capital Loss on your primary residence is tricky. Technically it is your primary residence and it has 6 years exemption to avoid any CGT unless you declare another property as your home. He decided to rent it out and moved to his new primary residence.

The capital gains tax for the property is calculated as follows:

$$\begin{array}{r} \$500,000 \text{ (sale price)} \\ - \\ \$600,000 \text{ (revalued price of the} \\ \text{property before renting)} \\ \hline = -\$100,000 \end{array}$$

Antonio made a capital loss of \$100,000.

If Antonio had not had his property revalued before renting it out, he would have had a capital gain of \$250,000— that is \$500,000 (sale price) - \$250,000 (original purchase price of the property) = \$250,000. Because he had the property revalued, he made a capital loss instead of gain, and this he can offset from his current or future capital gains.

Note: Capital losses cannot be offset against normal income though net capital losses in a tax year may be carried forward indefinitely.

7. Hold for 12 months or more

When a property is sold and a capital gain is made, a 50% discount on the capital gain for individual Australian residents is allowed, so long as the property is owned for 12 months or more.

As an individual, your CGT forms part of your income tax so your personal tax rate will become a factor in your total tax liabilities. Capital gains tax is not considered as a separate tax for individuals even though it's still referred to as CGT.

Example

Liza made a capital gain of \$200,000 on the sale of a property. Liza will only have to pay capital gains tax on \$100,000 which is half of the \$200,000 after the discount.

Liza currently earns \$45,000 per year. Her taxable income in the year in which her property was sold will be assessed at \$145,000.

Tax Fact!

A company is not entitled to the 50% CGT discount.

In a company, when an asset is sold, the profit is attributed to the company. This makes the process of fund extraction and accessing the profit complicated, and usually means higher tax. You should consult your tax accountant before any sale of a property to make the transaction tax-efficient.



8. CGT - The 6 year exemption

Take advantage of the six-year CGT rule. Under this rule, a property sold within six years of being rented out could be exempt from CGT.

Your main residence is generally exempt from capital gains tax and you can continue to treat your home as your main residence for capital gains tax purposes up to six years if it is used to produce an income.

Under the six-year rule, a property can continue to be exempt from CGT if sold within six years of first being rented out, provided there is not another property nominated as a principal place of residence.

When the property is reoccupied as the main residence, the six-year exemption resets so that another six years of exemption becomes available. Any gain on sale during this period will be exempt from CGT.



9. Offset GCT gains

Offset your capital gains by reducing your taxable income. Here are some ways you can reduce it:

- **Donate to charity**

Every donation you make that is worth \$2 or more to a registered charity institution is considered tax deductible. Make sure to keep the receipt from the institution for the next time you file a tax return.

Take note that charity donations are not refunded by the ATO. Instead, the amount of your donation is deducted from your total taxable income.

- **Make personal deductible superannuation contributions**

If you make an after-tax super contribution, you can claim a tax deduction and reduce your taxable income. Personal deductible contributions are taxed at 15% rate instead of the marginal tax rate of up to a maximum of 47%.

Employed, self-employed, and individuals earning taxable income from other sources like property investments can make personal deductible contributions.

- **Use salary sacrificing**

You can also save on taxes and use what you save towards growing your investments by making a salary sacrifice arrangement with your employer. Also called “salary packaging,” salary sacrificing allows you to put some of your pre-tax income toward mortgage payments, insurance, and others, before you are taxed.

There are other ways of offsetting your gains and reducing your taxable income. Explore and take advantage of those you can use because they can ultimately help you increase your cash flow and grow wealth.



10. Avoid CGT by refinancing and investing equity in a new property

Consider refinancing your property instead of selling it to avoid a CGT event. You can refinance and buy a new property instead with your equity. This strategy means you'll be able to avoid paying CGT until you finally sell the property.

Refinance and access the equity you have in your property and use that money for a new investment.

It's best to have your property revalued first before you approach your lender. Your new loan will be based on the new value of your property and since your Loan-to-Value Ratio (LVR), or the amount of your loan compared to the value of your property would be much lower, you would be able to borrow additional money. You can use the additional money to finance a new property investment.

Not only will you have a new investment with this strategy, you'll also be able to avoid CGT. Just make sure that when you refinance, it's kept as a separate loan so you don't complicate interest deductions for each property investment.

11. Claim depreciation deductions

Claim deductions for depreciating assets and make sure you have a depreciation schedule.

Depreciation helps you make money without spending anything, yet many investors fail to claim it. It's a non-cash deduction that can be a valuable tool for investors creating wealth because it allows you to get tax deductions and claim the wear and tear of a building without spending any money.

Property normally goes up in value, which is why it's the best investment you can make. But while the total value of a property goes up, the buildings, fixtures, and fittings all lose their value as they grow older. And you can claim depreciation deductions for these even while your property is gaining value.

If you missed out on depreciation claims in previous years, you can still claim it by lodging a request at the ATO. There is wisdom in hiring professional help so you don't miss out on deductions you can claim. You lose more by worrying about payments and fees for professionals.

Good to know!

A depreciation schedule is a written report by a quantity surveyor that states the value of your buildings, fixtures, and fittings.

A depreciation schedule is what an accountant uses to work out your tax deductions.

12. Apply for PAYG

Ask the ATO for a PAYG withholding variation every year. Deductions for expenses related to owning an investment property can be received throughout the year instead of at the end of the financial year using the PAYG withholding variation.

This strategy allows you to receive and use your tax breaks earlier so you can use them for property repairs, improvements, etc. A PAYG withholding variation can be a big help for property investors to have a regular cash flow.



14. Create solid proof that your vacant rental property is available for rent

As mentioned earlier, you can still claim deductions for vacant rental property provided you can prove that the property is genuinely available for rent.

A rental advertisement may not be enough in some cases. Listing it with an agent or obtaining a document from an agency clearly stating the amount they think your property will rent and then supporting it with documents that you are advertising for such amount will quash all suspicions that you are deliberately making it impossible for people to rent your property.

13. Claim deductions on borrowing expenses

Tax deductions for borrowing expenses over \$100 are spread over five years. Tax deductions for borrowing expenses that are \$100 or less can be claimed immediately in the same income year you incurred them.

Claim tax deductions on the following borrowing expenses:

- loan establishment fees,
- lender's mortgage insurance,
- title search fees charged by your lender,
- costs/legal fees for preparing and filing, mortgage documents,
- mortgage broker fees,
- fees for a valuation required for loan approval.

Good to know!

It's important that you have a clear intention of renting out your property. If no attempt to advertise your property is made or if rental payments are set unrealistically high, the ATO may not allow your rental claims.



15. Avoid redrawing on loans for personal and private reasons

Interest on home loan redraws is not all deductible if it's for private purposes. If you have a loan with a redraw facility and you redraw on the loan for a private purpose, then the entire interest is not tax deductible. You are limited to claiming interest on the loan value before any other drawings.

If you need funds, it is better to refinance your loan instead of redrawing on it.



16. Claim tax relief for foreign investment properties

You may be able to claim taxation relief for investment properties you own outside of Australia.

Rental income from overseas properties must be declared in your tax return, and if you paid tax in another country for your income, profits and capital gains, then you're entitled to claim a foreign income tax offset in your Australian tax return. This provides relief for double taxation.

Tax offset can only be claimed after the foreign tax has been paid. If the foreign tax was paid after the relevant income was declared in your Australian tax return, you may request an assessment amendment for that income year to claim the offset. You are given four years to request assessment amendment from the date you paid the foreign income tax.

Further, all foreign income and foreign tax paid must be converted to Australian dollars. There are two ways to do this:

- use the exchange rates prevailing at specific times for monthly rent, asset purchases, and other one-off expenses
- or use an average exchange rate for expenses incurred over a period

You may also use the ATO's Foreign Income Conversion Calculator for calculation.

Tax Offset vs Tax Deduction

Tax offset directly reduces the amount of tax you need to pay, while tax deduction reduces your taxable income



18. Defer contract date when selling a property

After you have ensured that no expense was overlooked and that you have maximised the cost base of your property, when you are ready to sell, consider signing the contract after 1 July. This will defer the CGT to the next year which will give you time to recover from any constraints or save some money to pay the CGT.

This strategy will help you maximise and benefit more from your capital gain.

17. Hold a property under an individual with a lower tax rate

For couples and people in partnership or other relationships, consider purchasing the property in the name of the person with the lower tax rate.

You pay capital gains tax based on your personal tax rate. Thus, having the property held in the name of a person with a lower tax rate will effectively lower your CGT.





19. Consider negative gearing

When your investment property expenses are greater than your investment income, this is called negatively gearing your property. The net loss will be a deduction in your personal tax return against your other income, which will typically result in a refund.

Negative gearing means that your expenses are greater than your revenue so your cash flow is also negative. Negative gearing is also more beneficial to people in the higher income brackets to get a higher ongoing refund.



20. Hire a specialist property tax accountant

This cannot be stressed enough. Getting an accountant is the best decision you could make in your property investment journey. You may have all the list of deductions you can and can't claim, but when you have an accountant, you can have the assurance that you aren't missing out on any deduction and that you are maximising your tax claims in all ways possible.

It's important to have an expert on your side who knows your special circumstances and make them work for you instead of against you. Get an expert. Get a good accountant that specialises in property.



Property Builds Wealth Consistently

Property builds wealth more consistently than any other investment. Prices fluctuate but property values have always gone up, with a few exceptions historically, and there's no evidence this will change any time soon.

Whether you're investing in property with the intention of selling later on, or you're in it for the passive income it generates, property offers huge returns. And not just in terms of monetary profits. Property investment provides numerous tax benefits.

If you choose the right investment structure and implement all these tips, you're sure to succeed in whatever goals you have set for investing in property.

And as long as you're investing in property and in your future, go all out and get the best property tax accountant who can help you build your wealth in the shortest time possible. After all, if you're going to build your wealth in property, why not build it with an expert?



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