

## Negative Gearing - Positive or negative?



Creating wealth through purchasing an investment property is a well-established practice in Australia. Buy the right property in the right location and you are on the path to prosperity.

If it was only that easy!

Make no mistake, buying an investment property carries risk. It is a medium to long term investment, interest rates and property markets can be volatile and you need to be earning other income to cover the negative cash flow associated with a negatively geared property. Of course, get the selection process right and the result can be a financial windfall, however, we have also seen the strategy turn into a financial nightmare. It's only when you combine the right property in the right location acquired at the right price in the most appropriate ownership structure that the strategy delivers the best financial outcomes.

### What Are the Claimable Deductions?

While the tax benefits are certainly important, they shouldn't be the only driver behind the decision to buy an investment property. The Tax Office allows property investors to offset a number of deductions against the rental income they receive. Expenses including mortgage interest, management fees, rates, insurance and repairs and maintenance can all be claimed. Please note, you need to be careful with the distinction between a tax deductible repair and a non-deductible capital improvement for tax purposes. Investors are also entitled to a deduction

for 'non-cash' expenses like the wear and tear on the structure of the building and assets contained within the property including furniture and fittings. This deduction is known as 'depreciation'.

In addition, the ATO also allows a 'non-cash' deduction for the Building Allowance (or Capital Works Deduction) which lets property investors claim the building construction costs over a 25 to 40 year period.

Basically, you can claim a deduction if construction of the property began after 17th July 1985 and the property is used for residential accommodation to produce rental income. If the property construction commencement date is between July 18, 1985 and 15th September, 1987 the building allowance rate is 4%. If construction commenced after September 15, 1987 the rate is 2.5%. The construction costs must be calculated by a quantity surveyor.

### Compare the Pair

To illustrate the potential tax benefits of owning a negatively geared investment property, let's examine the situation of two 'average' Australian taxpayers who both earn \$80,000 per annum. As you'll see from the table below, taxpayer (A) doesn't own an investment property and pays \$18,802 in taxes (including the Medicare Levy) after he claims \$1000 of basic work-related expenses such as uniform costs and donations.

The other taxpayer (B) who earns the exact same salary of \$80,000 buys an investment property for \$500,000 and borrows the full amount from the bank at 5%. It is an interest only loan so the interest is approximately \$25,000 for the full year. The rental income on the property is \$445 per week. He claims the same work related expenses as Taxpayer A but he is also able to claim deductions for expenses involved in holding the property including the management fees, insurance, rates and repairs. These expenses for a typical two bedroom property are estimated to be around \$3,500 per annum. Taxpayer (B) also obtained a depreciation schedule which showed they could claim an extra \$8,500 in building allowance deductions.

The following table 'compares the pair' and shows their before and after tax outcomes:

Taxpayer A (no investment property)		Taxpayer B (owns an investment property)	
Gross salary	\$80,000	Gross Salary	\$80,000
Property Rental income	N/A	Property Rental income (\$445 x 52 weeks)	\$23,140
Gross Income	\$80,000	Gross Income	\$103,140
Property expenses	N/A	Property expenses (including interest)	-\$28,500
Depreciation Deductions	N/A	Depreciation and Building Allowance Deductions	-\$8,500
Work Related Expenses	-\$1,000	Work Related Expenses	-\$1,000
Total deductible expenses	-\$1,000	Total deductible expenses (work related expenses + property expenses + depreciation)	-\$38,000
Taxable income	\$79,000	Taxable income	\$65,140
Tax payable (including Medicare Levy)	\$18,802	Tax payable (including Medicare Levy)	\$14,020
Net Take Home Income	\$60,198	Net Take Home Income	\$59,620

**The depreciation deductions in Taxpayer B's scenario have been calculated using the diminishing value method and are based on the first financial year of ownership. This is an illustrative example and every person's financial and tax situation is different which is why we recommend you seek independent advice before buying an investment property.**

As you can see, Taxpayer A's net income after he pays \$18,802 in taxes (and the medicare levy) is \$60,198. Although Taxpayer B earns the same take home wage, because of the negatively geared property he only pays tax of \$14,020 and takes home \$59,620. In effect, owning the property is costing him \$578 per annum or \$11 per week.

Investors thinking of purchasing a property should always obtain expert tax advice and to maximise the depreciation deductions you will need a report prepared by a specialist Quantity Surveyor. This case study is based on a number of assumptions and investors should take professional advice before applying to their personal situations.

*This article is not intended to provide financial or taxation advice and should not be relied upon for that purpose.*

## Splitting Assets from a SMSF

A marriage breakdown and the subsequent split of assets is always complicated. If assets are held within a Self Managed Super Fund (SMSF) then there are further complications.

The SMSF sector now accounts for around a third of Australia's total superannuation savings and according to the latest Tax Office statistics, around 70% of those are two person funds. This probably means that over one million SMSF trustees in this country are husband and wife. The Bureau of Statistics estimate that around one in three marriages will end in divorce so splitting assets from a SMSF could become a major issue.



So what complications arise from the marriage breakdown of SMSF trustees? It's common for the SMSF to own the business premises and sometimes the only way to realise the value of the asset is to sell the business premises. In many cases the business may not be able to afford to purchase the property

## Splitting Assets from a SMSF *(cont)*

from the SMSF and in all likelihood, at least one of the divorcing couple will want to exit the business as well.



In other superannuation funds, the members and trustees are separate individuals, however, SMSF members will need to continue to interact with each other whether they like it or not. If both members are also trustees they will need to perform tasks such as signing cheques, preparing tax returns, financial statements and make investment decisions etc.

So whatever the personal feelings of the SMSF trustees, they must continue to act in accordance with superannuation laws and the trust deed of the fund. The SMSF regulator states that despite personal difficulties on an individual basis, “as a trustee you must continue to act in the best interests of all members at all times”.

The Tax Office has stated that SMSF trustees must (in any circumstance):

- Ensure all trustees are included in the investment decision making process

- Act upon requests to redeem assets and roll money over to another regulated complying super fund
- Make sure that actions comply with the Superannuation Industry Supervision (SIS) Act 1993 or the SMSF's trust deed.

Apart from the issue of a business premises being owned by a SMSF, there might be other types of assets held by the SMSF which would need to be valued before a divorce settlement can be agreed upon or settled in court. Where the divided assets held by the SMSF are rolled over into one or more new funds, it is important that these assets are not first sold for cash.

The cash proceeds transferred to the new fund would not retain their original cost base for Capital Gains Tax purposes and any concessions would be lost if a cash value is realised before it is rolled over. Similarly, under normal circumstances SMSF rules disallow the acquisition of assets from related parties, however, the legislation was amended specifically to allow such a transaction in the specific case of marriage breakdown (applies to assets acquired on or after 17th November, 2010).

There are steps that can be taken to minimise the impact of divorce when initially setting up the SMSF. For example, using a corporate trustee. In the case of the business premises being the major asset of the fund, if the premises had been acquired under a unit trust structure and the fund had an investment strategy utilising unit trust structures, then the fund's corporate trustee could redeem units for cash to payout the spouse.

The corporate trustee could then take out a limited recourse borrowing arrangement to acquire a beneficial interest in the same business premises.

This illustrates the importance of the structure and strategies when setting up a SMSF. If you are thinking of starting a SMSF make sure you consult with us first because prevention is always better than the cure.



## Before You Hit the Business Start-up Button

Starting a new business necessitates risk and in the digital age your marketing could be the difference between gloom and boom. There are plenty of marketing 'must haves' for a start-up business but there are also some things you should avoid including:

### ● *Failing to Plan is Planning to Fail*

Preparation is the key to any new business and failing to plan is planning to fail. Your business plan should provide an overview of your current business position, where you plan to go and how you intend to get there. Your business plan is more than just a document to satisfy your financiers. It can be

a roadmap for your business success that both business owners and staff can refer to for guidance and direction. Without a business plan you can't establish your priorities or measure your success so it's a bit like a boat without a rudder.



### ● *Forgetting to Build an Audience*

While you are busy constructing your start-up, don't forget to build your marketing plan. There's no point having the best product or service in the world if no one can find it. Plan and build your website, think about the launch and don't wait for everything to be perfect. Get your networks in place and start building a list of potential customers and clients. Don't hold off until everything is 'just right' because you might find you have wasted a valuable opportunity or missed the boat. Don't fly under the radar, get your name out there as soon as possible.



## Before You Hit the Business Start-up Button *(cont)*

### ● **Letting Perfection Stand In the Way of Progress**

In the digital age every business needs a website and everyone wants a state of the art website. Too often entrepreneurs obsess over the look of their website at the expense of the other important aspects like content marketing. Your product is what demands your attention at this time.

Dedicate your time to building a reputation and delivering quality and value. Don't let perfection get in the way of progress because your website will always be a work in progress. Perfecting your branding and website on start-up can end up a waste of valuable time and there will always be an opportunity to rebrand and relaunch your website if you so desire.

### ● **Undervalue Content**

As stated above, it is not the look of your website that is important, but you need to embrace content marketing. By creating blogs, videos and newsletters that offer insights and updates you can position yourself as an industry expert, build brand awareness and improve your search engine rankings. Optimise the content with keywords and publish it throughout your social media channels.

A beautiful website is really just an electronic brochure without remarkable content.

### ● **Networking Without A Strategy**

Time really is money, especially when you are a start-up entrepreneur, stretched-thin and stressed out. Before any event that you plan to network at, identify your goals in order to best utilise your time at the event. Create a prioritised list of who you should be talking to, where to best find them and what you hope to gain from these interactions.

Bring plenty of business cards, have a specific piece of content to give to the attendees and make sure you follow up in a timely manner to remain relevant and fresh in people's minds.

### ● **Jack of All Trades - Master of None**

Too often entrepreneurs think they are the only people who understand their business and they fail to delegate tasks. Marketing has changed dramatically in the last few years and it could be time to engage a third party to help you develop your brand, website, videos or content.

You might be a skilled technician in your trade but is marketing your strength? Focus on developing your plan and that includes delegating tasks to third parties. You could get bogged down, lose momentum and waste a lot of time trying to be the marketing manager if it's not your area of expertise.

Make no mistake, you can't do everything yourself (even if you want to) and there's no future in being the 'jack of all trades and master of none'. Your passion and drive is essential but a Jack or Jill of all trades can sabotage even the best business. Engage a marketing team to assist you, even if you start small. A word of warning, don't hand the keys to your social media accounts to your best friend's son even though they may be social network-savvy. Your commentary on these channels represents your brand and you need to make sure they are expressing your views.

### ● **Don't Obsess Over Your Competition**

It's very normal to have a sneak peek at what the competition is tweeting, their prices and their websites, however, don't constantly take your lead from them. You could find yourself permanently trying to play catch-up.

Your start-up business is your start-up operation that you control. Their techniques and tactics may or may not work for your business. Be the innovator not the imitator.

## With All the Will in the World

It is never a pleasant thought to contemplate but the truth is, we will all go one day. Have you contemplated what would happen in the unfortunate event of you dying without a valid Will (Intestate)?

Many people believe the government will take their assets if they don't have a Will, however, this could only happen if you had no living next of kin. In such a case your assets are distributed according to a legal formula which may mean your assets go to someone who you wouldn't have chosen to receive them. Each State or Territory has



its own Intestacy laws which reflect what happens to a person's estate if there is no valid Will.

Below is a table prepared by Estate Planners, Topdocs Legal Pty Ltd that may contain news of an alarming nature to some.

	Spouse			Children	
State or Territory	1 <sup>st</sup> \$	% Remainder		% Remainder	
		Portion	\$	Portion	\$
Queensland	\$150K	1/3	\$233k	2/3	\$467K
New South Wales	N/A	100%	\$850K	0	\$0
Victoria	\$100K	1/3	\$250K	2/3	\$500K
Tasmania	N/A	100%	\$850K	0	\$0
South Australia	\$100K	½	\$375K	½	\$375K
Western Australia	\$50K	1/3	\$267K	2/3	\$533K
ACT	\$200K	1/3	\$217K	2/3	\$433K
NT	\$350K	1/3	\$167K	2/3	\$333K
Based on Wife or Husband and 3 children (of the same deceased). Estate value (excluding chattels) \$850,000.					
NOTE: Chattels automatically go to the remaining spouse, as does the family home if owned in joint names.					

So, for example, if a couple had been separated for years and never formally filed for divorce, the law in the respective State would dictate the portion of the estate based on their formula (not whether a spouse had abandoned their partner and children and really didn't deserve a portion of the estate).

Blended families also present challenges because when a spouse dies, their children from a previous relationship are no longer legally considered 'step children' of the

remaining partner and may miss out on receiving anything at all under the Intestacy laws which would probably not have been the intention of the deceased.

The Important point to note is that as your life circumstances change, making a Will or reviewing and updating your current Will ensures that your wishes as to who receives the benefit of your estate is your decision, not the various State Intestacy laws.

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