

Spotlight on Negative Gearing: Key Issues for Property Investors

Are you relying on negative gearing? There has been a lot of negative conversation about negative gearing lately, but if you are currently negatively gearing your investment property should you be concerned?

Negative gearing is when you claim more in deductions than you earn for an income producing asset that you have purchased using debt. It is not limited to property; you can, for example, negatively gear shares, but property is the dominant negatively geared asset claimed by Australians.

The latest taxation statistics show that we claimed \$22.5 bn in rental interest deductions in 2012-13 against gross rental income of \$36.6 bn. While these statistics are not as bad as previous years because of the low cost of borrowing (\$1.6 bn less than 2011-12), it is more than the total Defence budget in 2013-14 at \$22.1 bn.

The use of these property deductions does not vary widely across income ranges - that is, it's not just those on the highest income bracket using negative gearing. The highest proportional losses were experienced by those with incomes (net of the rental loss) between \$55,001 and \$80,000, where deductions exceeded rental income by more than 28%. Negative gearing makes owning an investment property accessible to those who potentially would not invest for the long term gain in property value alone.

The Reserve Bank has stated that the 'hot' property market, particularly in Sydney, is because "investor demand continues

to drive housing and mortgage markets, with low interest rates and strong competition among lenders translating into robust growth in investor lending". In NSW lending to investors now accounts for almost half of the value of all housing loan approvals. Demand drives price.

The tax policy experts we canvassed generally held the view that negative gearing distorts the market and - in combination with the CGT discount - provides considerable and unnecessary tax advantages to those who least need them. To quote one, "[negative gearing] is a uniquely Australian phenomenon (no other country is so generous) and I would abolish it (and the CGT discount) immediately (and not be so generous as to grandfather existing owners). The suggestion that its (temporary) abolition in the early 1990s led to an increase in rent was based on spurious and incomplete evidence. More relevant research has subsequently debunked the suggestion that the spike that happened in Sydney house prices had little to do with the abolition and a lot more to do with other, unrelated market forces".

At present, the Government and property investors want to keep negative gearing. It's a lonely policy position.

The Government Tax White Paper is due out later this year and may provide a better indication of any potential risk for investment property owners. But negative gearing is not something to bank on as a long term strategy. It's just a question of which Government will have the support to remove it.

Friends, Family and Holiday Homes

If you have a rental property in a known holiday location, chances are the ATO is looking closely at what you are claiming. If you rent out your holiday home you can only claim expenses for the property based on the time the property was rented out or genuinely available for rent.

If you, your relatives or friends use the property for free or at a reduced rent it is unlikely to be genuinely available for rent, and as a result this may reduce the deductions available. It is a tricky balance particularly when you are only allowing friends or relatives to use the property in the down time when renting it out is unlikely.

A property is more likely to be considered unavailable if it is not advertised widely, is located somewhere unappealing or difficult to access and the rental conditions - price, no children clause, references for short terms stays, etc. – make it unappealing and uncompetitive.

Repairs or Maintenance?

Deductions claimed for repairs and maintenance is an area that the Tax Office is looking very closely at so it is important to understand the rules. An area of major confusion is the difference between repairs and maintenance and capital works. While repairs and maintenance can be claimed immediately, the deduction for capital works is generally spread over a number of years.

Repairs must relate directly to the wear and tear resulting from the property being rented out. This generally involves replacement or renewal of a worn out or broken part – for example, replacing damaged palings of a fence or fixing a broken toilet. The following expenses will not qualify as deductible repairs, but are capital:

- Replacement of an entire structure (for example, a complete fence, a new hot water system, oven, etc.).
- Improvements and extensions.

Also remember that any repairs and maintenance undertaken to fix problems that existed at the time the property was purchased are not deductible.

Travel Expenses to see Your Property

If you fly to inspect your rental property, stay overnight and return home the following day all of the airfares and accommodation expenses would generally be allowed as a deduction. Where travel is combined with a holiday, your travel expenses need to be apportioned. If the main purpose of the trip is to have a holiday and the inspection is incidental, a deduction for travel is not allowed. In these circumstances you can only claim a deduction for the direct costs involved in inspecting the property such as the cost of taking a taxi to see the property and a proportion of your accommodation expenses.

If you drive a car to and from your rental property to collect rent or for inspections you can claim your car expenses. Just keep in mind that you need to be able to prove that you needed to visit the property.

Redrawing on Your Loan

The interest component of your investment property loan is generally deductible. Take care if you have made redraws on your investment loan for personal purposes. A portion of the loan may be non-deductible.

Borrowing Costs

You are able to claim a deduction for borrowing costs over five years such as application fees, mortgage registration and filing, mortgage broker fees, stamp duty on mortgage, title search fee, valuation fee, mortgage insurance and legals on the loan. Life insurance to pay the loan on death is not deductible even if taking out the insurance was a requirement to get finance. If the loan is repaid early or refinanced the whole amount, including mortgage discharge expenses and penalty interest become deductible.

Tax Scams Catching Out the Unwary

Every tax time is an advantage for scammers to target the unwary.

This time around the scammers are phoning and claiming to be from the prosecutions department of the ATO. They then state that they believe you have committed fraud and the Sheriff's Office has been called. You can, of course, make this all go away by transferring cash using the details they provide or by giving your details to them. All of it is fake.

There are a number of variations to this fake arrest warrant scam. In some cases a message is left on an answering machine obliging the person to call back.

Understandably, for those with outstanding tax debt, these calls can cause concern.

If you receive a call like this, you should feel free to hang up. We can contact the ATO on your behalf to verify there are no known issues.

Or if you would like to report the scammers take as many details as possible without giving any information away (phone numbers, supposed section of the ATO, name of the person calling, etc.) and pass them onto us. Once again we will verify with the ATO and report any known details about the scam for further investigation.

If you are contacted by email by the ATO or a group purporting to represent the ATO, you can forward these emails directly to the ATO at ReportEmailFraud@ato.gov.au.

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