Chan & Naylor
Our People. Your Advantage.

20 Tax Tips for Property Investors

WELCOME

CONTENTS

Warning: This e-book contains general advice or information only. The information in this e-book is general information only and has been prepared without taking into account your personal objectives, financial situation or needs. You should consider any advice in this e-book in light of your personal objectives, financial situation or needs before acting on it.

It is recommended to seek advice from a qualified professional relevant to your particular needs or interests. (For instance, Tax Advice from a Tax Agent, Financial Advice from a Licensed Financial Adviser and so on and so forth).

Chan & Naylor and its related parties (direct or indirect) disclaim all and any guarantees, undertakings and warranties, expressed or implied, and shall not be liable for any loss or damage whatsoever (including human or computer error, negligent or otherwise, or incidental or consequential loss or damage) arising out of or in connection with any use or reliance on the information or advice in this ebook.

Introduction

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.

> "The cost of establishing the correct structure, getting the right advice and self-education are all, to some extent, an investment where the return can be quantified in the amount of tax saved over the long term."
>
> – Ed Chan

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 structure 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 subjected 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.

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 30 %, but losses can only be offset against future income and there is no CGT discount for the sale of an asset or a property.

Top 20
Tax Tips

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 for more than $10,000.

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

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 you 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.

Meanwhile, investing in affordable housing can attract a 60 percent reduction in CGT – so long as the housing meets certain criteria and the rent is charged at a discounted rate.

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 property 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.

- Stamp duty charged by your state/ territory government on the transfer (purchase) of the property title (this is a capital expense)
- Legal expenses including solicitors' and conveyancers' fees for the purchase of the property (this is a capital expense)
- 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)
- 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)
- Borrowing expenses on any portion of the loan you use for private purposes (for example, money you use to buy a car).

B. 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.

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

D. 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 a 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

Minimise future capital gains by having your property revalued before renting it out to include not just the final sale price, but also the cost of the property at the time it was rented.

The capital gains tax of a rental property is calculated by the difference between the final purchase price and the value of the property at the time it was rented. So if you don't revalue your property before renting it out, the value of the property will still be based on the original purchase price.

This means that if your property gains value during your ownership and you have not readjusted the value before renting it out and then disposing of it, you will be liable for a higher capital gains tax and the lower the adjusted basis is, the higher your capital gains tax will be.

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

Example

Antonio bought his home for $250,000 in 2005. In 2015, he decided to rent it out and had it revalued at $600,000. In 2017, he disposed of the property and sold it for $500,000.

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

$500,000 (sale price)

-

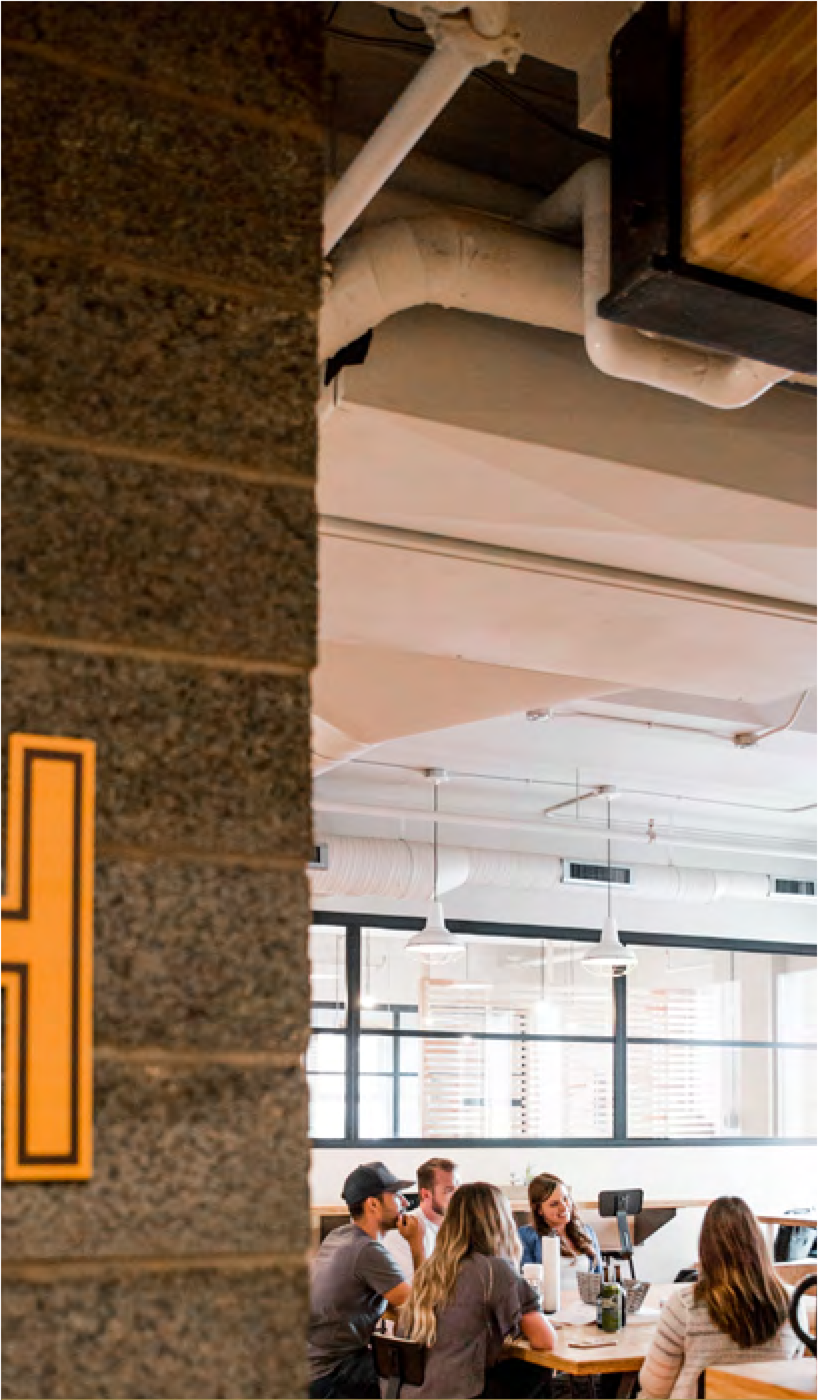
$600,000 (revalued price of the property before renting

= **-$100,000**

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 that 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 no other property is 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 CGT 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.

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.

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.

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

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.

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 tax 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 and because Australia has a progressive tax system. Negative gearing is also more beneficial to people in the higher income brackets to get a higher ongoing refund.

"You never invest or willingly lose money just to get a tax deduction. Never."

– Ed Chan

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?

***Disclaimer**

Before acting on any information you may have received during a strategic financial consultation, or read about on our websites, email communications, guides including our newsletters, you should consider the appropriateness of the advice, having regard to your own objectives, financial situation and needs.

If any products are discussed, you should obtain a Product Disclosure Statement relating to the products and consider its contents before making any decisions.

It is recommended to seek advice from a qualified pr ofessional relevant to your particular needs or interests. (For instance, Tax Advice from a Tax Agent, Financial Advice from a Licensed Financial Adviser and so on and so forth).

Chan & Naylor and its related parties (direct or indirect) disclaim all and any guarantees, undertakings and warranties, expressed or implied, and shall not be liable for any loss or damage whatsoever (including human or computer error, negligent or otherwise, or incidental or consequential loss or damage) arising out of or in connection with any use or reliance on the information or advice in this communication.

Peter Locandro

Managing Partner,
Chan & Naylor Melbourne,
Moonee Ponds & Wheelers Hill

Peter is an accountant who is about more than just the numbers. He has been a small business owner for more than 25 years, a keen property investor, a public speaker, a radio host, blogger and a small business mentor to many. Peter has been the Managing Partner of Chan & Naylor Melbourne from the 1st July 2019. Before this, he was the Founder & CEO of Financially Sorted since April 2017. Prior to that, he spent 20 years at ZJL Partners, the last 17 years as the Managing Partner. Peter also spent some time at various public practices learning the craft of accounting, taxation and leadership. Helping team members perform to the best of their ability is what puts a smile on his face.

Peter, CPA qualified, with over 25 years public practice experience is based in Melbourne, Australia. It is humble beginnings from the days growing up on a dairy farm in the country to Italian migrants whom sent him off to boarding school at age 11 to get an education and get him off the farm.

Peter became a business owner at age 26.

He teaches his clients to make decisions, to take action and not sit on the fence. His ideal client is someone that is keen to listen, keen to learn and keen to succeed. He has helped many achieve things that they thought were not previously possible through his guidance and teachings. He is also about setting up the right tax structures – for both asset protection and legal tax minimization reasons. His accountancy qualifications go a long way towards achieving this objective.

Peter is an Essendon supporter and has 1 dog, 3 children, and 1 wife. In his free time, you can find him following the kids basketball journey's around the world or enjoying a nice Japanese Whiskey.

CONTACT US

Chan & Naylor | Melbourne
Level 5
85 William Street
Melbourne VIC 3000
Ph: 03 9370 4800

Chan & Naylor | Moonee Ponds
Level 1 Suite 2
38 Margaret Street
Moonee Ponds VIC 3039
Ph: 03 9370 4800

Chan & Naylor | Wheelers Hill
Level 2 Suite 10
622 Ferntree Gully Rd
Wheelers Hill VIC 3150
Ph: 03 9888 3175

Email: melb@chan-naylor.com.au
W: chan-naylormelbourne.com.au