

NEGATIVE GEARING

MEANING

Negative gearing occurs when you borrow to invest in an income producing asset and the cost of borrowing exceeds the returns (income) from that asset.

EXPLANATION:

Negative gearing most often occurs in rental properties, where the rental income received isn't enough to cover the interest costs on borrowings plus expenditures toward property maintenance and upkeep.

Put simply, a Negative Gearing is when:

- You borrow to acquire an investment
- The interest and other costs you incur are more than the rental income you receive from the investment (in other words you make a cash loss), and
- This cash loss is offset against income from other sources, thus reducing your taxable income, and hence the amount of tax you have to pay (compared to the tax you'd pay without the investment).

EXAMPLE:

Mr. X is a Tax payer earning \$100,000 per annum and he buys a property for \$350,000 and borrows \$330,000 for the same at an interest rate of 8%. His Tax situation would be:

Rental Income	\$24,000
Less:	
Loan Interest	\$26,400
Management Fees	\$1,600
Rates and repairs	\$2,600
Depreciation (estimate only)	\$5,000
Total Expenses	\$35,000
TAXABLE LOSS	\$11,000
CASH LOSS(Taxable loss + Depreciation)	\$6,000
Tax Savings (as per below)	\$4,235
CASH LOSS AFTER TAX SAVINGS	\$1,735

Tax Savings

Mr. X is able claim a loss of \$11,000 against his salary income. Comparison is shown below:

Particulars	Mr. X with no Investment Property	Mr. X with one property as above mentioned
Property Tax loss	-	\$(11,000)
Taxable Income	\$100,000	\$89,000
Tax + Medicare	\$26,447	\$22,212
Net Income	\$73,553	\$86,788
Tax Saving	\$73,553	\$4,235

Scenario when you sell

Suppose if Mr. X wants to sell the property after 7 years, his profit would work out in following manner,

Particulars	Amount
Sales Price	\$450,000
Less:	
Legal Expenses	\$2,000
Agent's Commission(4%)	\$18,000
Net Sales Price	\$430,000
Cost of Acquisition	\$350,000
Less: depreciation claimed	\$35,000
Net Cost Price	\$315,000
Gross Capital Gain	\$115,000
Less: 50% capital gain discount	\$57,000
Taxable CapitalGain	\$57,000

Risk Involved – BE CAREFUL

As, you must have observed, Negative gearing only becomes a profitable venture when the property is eventually sold, and a prerequisite is that property values are rising, not falling or holding steady.

There is always a big risk associated with undertaking a negative gearing strategy, and borrowing for property investment. Although the main objective of negative gearing is to increase your return on borrowed funds, if anything goes wrong, the losses can balloon quickly, into quite substantial amounts. This is why we recommended that only people with the financial allowance to cover the effect of these potential losses should negatively gear properties. In order to protect yourself from the risks of gearing, you have to be careful in these areas:

1. Firstly ensure you choose your investment property carefully. In order to avoid losses you have to purchase a property that will increase in value. This is where research comes into play, look at recent growth areas, recent areas of property price increases and the rental returns in certain areas.
2. Secondly you have to have a backup plan in case there are problems with rent coming in. You will have to have sufficient spare income available to cover the loan repayments if you have a tenant who does not pay rent on time in some months, or even if your property remains vacant in between tenancies.
3. Thirdly you can take out mortgage insurance; this would cover your payments in certain events where you could not make the payments yourself.

OUR SERVICE:

When you use Signage Accountants to mentor you through negative gearing, you will be partnered with a company that knows the ins and outs of all types of real estate investments, including the wonderful tax strategies of negative gearing.

We know that the aim of your investment strategy is to make money and this type of investing is a wonderful way to do it. With this way of investing in property, you may be able to gain a nice income and profit. However, without the right guidance, you may find yourself struggling and even losing money.

When you work with Positive Real Estate, we can provide the information and guidance you need in order to make these types of property investment. Contact us today in order to find out more information on how you can begin investing in property.



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