LOOKING AT BUYING A RENTAL PROPERTY?

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What are the tax benefits of having a rental property?

This is quite a difficult question to answer as it really depends on your individual circumstances.

Rental properties are popular as they can save you tax now and the capital growth (increase in sale price) can help increase your wealth in the future.

The tax benefits of having a rental property really depend on:

- Your marginal tax rate
- Amount borrowed
- Interest rate on your property loan
- Rental return
- Age and condition of the building
- Property market value increases

The term “negatively geared” refers to where your tax deductions exceed your rental income. This is a good tax position for a high income earner, but generally means that there is more money going out each week to pay for the property than you receive in rent. This negative cash flow is not ideal if your budget is tight. It may not be a great choice for families with young children.

As your tax deduction can be increased for building write-offs, you are often better tax-wise to buy a dwelling under say 20 years. Capital improvements are generally claimed at 2.5% pa which means that you get an extra tax deduction for the notional wear and tear on the building even though you haven’t spent anything to repair it.

Joint Tenant or Tenant’s in Common?

If buying the rental property as a couple, you have the option of buying as Tenants in Common rather than Joint Tenants.

This means that, if Mr A is a high income earner & Mrs A only a medium income earner, for immediate tax benefits they could purchase the property say 75:25. Mr A would then receive 75% of the tax deduction for the negatively geared property and Mrs A only 25%. While this can provide an immediate tax saving, any capital gain on the sale of the property will be split on the same basis. The tax benefits are definitely something you need to talk to us about before buying the property.

What about land tax?

You should also remember that Land Tax can apply to your rental property.

For NSW, the Land Tax threshold is currently $549,000. While your principal home and primary production land is generally exempt, you will pay Land Tax on other land you own where the land value exceeds the annual threshold.

We recommend that our rental property clients register for Land Tax with the Office of State Revenue even if their land value is less than the threshold.

Common Misconceptions

A common misconception we come across is the difference between loan repayments, interest charges and the tax deduction which applies. Only the interest and bank charges are generally tax deductible. Principal repayments are never tax deductible.

The tax treatment of initial repairs is also commonly misunderstood. For tax purposes, a repair is something which restores the asset to the condition it was originally in when you acquired it. It does not make it better than the original. For example, if you purchased your rental property and immediately repainted it, then this is a capital improvement and you receive no immediate write-off. However, if you repainted in say 2 years due to tenant damage, the cost would be a repair and you could claim an immediate write-off. Definitely something to consider.

If replacing assets in the home, there is a difference between building and depreciable assets. Generally if something is attached to the building, it is written off at 2.5% pa. If freestanding or mechanical, it is subject to depreciation.

Items costing under $300 per owner that would normally be subject to depreciation are immediately tax deductible. For example, a new kitchen would be a building improvement – 2.5% write-off only. A hot water service is a depreciable item – you would generally claim the cost as a tax deduction over 15 years for a solar system. If replacing curtains or blinds, and the cost of each set is less than $300 per owner, you can claim an immediate tax deduction.

The 2017 Budget has resulted in a number of changes to the treatment of Rental Property expenses. Our example explains some of these changes.

Example

Peter is is looking to purchase a solely owned rental property and wishes to know what his likely rental property deductions would be for. With the recent changes announced in the budget, this will depend on whether the property is purchased before 9 May 2017.

If Peter purchased the rental property before 9 May 2017 what would be the likely tax deduction?

Peter would be able to claim:

- Building write-off of 2.5% pa on the construction cost of the house if construction commenced after 18 July 1985. Renovations can also be written off.
- Depreciation on existing plant, equipment and furnishing items including in the house when he purchased it. This depreciation is at a higher write-off than the 2.5% building deduction.
- Interest on his mortgage.
- Ownership costs such as council rates, insurance, lawn mowing and gardening.
- Repairs for tenant damage.
- Real estate agents fees.
- Travel to inspect the property BUT only until 30/06/2017.

Peter would not be able to claim the following as a tax deduction:

- Principal repayments of his loan.
- Initial repairs to the property like painting.
- Improvements to the property such as adding a new deck or replacing the kitchen. These may qualify for a 2.5% pa write-off rather than a 100% immediate tax deduction.

What if Peter purchased the rental property after 9 May 2017?

The budget changes announced will affect the depreciation of plant, equipment and furnishing items included in the purchase price of the house. Now that the proposed legislation has been passed, these items will be depreciated as part of the building cost. This will mean a lower tax deduction for Peter.

Travel to inspect the property or collect rent will no longer be allowable from 1 July 2017.

Have more questions? Contact us at:

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