

McCLUSKEY TAYLOR

Chartered Accountants

Real estate tax guide

Recent surveys have shown that a high percentage of property purchases are by investors. Real estate has traditionally been seen as a secure form of investment and has underlined the wealth of many Australians. There is no guarantee of profits from any investment. As each property has its own characteristics and opportunities, the potential for profits and capital gains must be carefully and fully evaluated. Every investment has inherent risks that must be carefully considered.

McCluskey Taylor has provided this guide for the real estate investor to ensure that they have a better understanding of the income tax law in this area. McCluskey Taylor advises many clients in regard to the acquisition, financing and development of real estate investments.

This guide is designed to be a general overview, not a substitute for professional advice in specific instances. Its objective is to raise awareness on the part of the investor and to provide them with some of the means to maximise their tax concessions from real estate investment. The part on record keeping ensures that any audit action by the Australian Taxation Office can be quickly dealt with and give minimal risk to the investor.

If you want further or detailed real estate and property advice, please contact the following McCluskey Taylor directors who have wide experience in this area:

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Negative gearing and its benefits

What is it?

A property is described, as being negatively geared when the expenses associated with the property are more than the rent received.

How do I benefit?

- The excess of tax-deductible expenses can be used to reduce the tax payable or increase the tax refund from other income sources.
- Reduction of tax instalment deductions may be possible if negative gearing creates a sufficient tax refund. Professional advice should be sought if you believe a variation is possible. This will result in your tax benefit from negative gearing being paid during the year, rather than in a lump sum after the end of the financial year.

Important Issues

- When purchasing a property, ensure a list of furniture and fittings values is included in the contract. Depreciation of these items is a deductible expense and amounts up to \$300 can be claimed entirely in the year of purchase.
- A special system of tax deductions applies to the cost of construction of buildings used for producing rental income, where construction commenced on or after 18 July 1985. This is a valuable and often overlooked source of additional tax benefits. Determining the allowable amount is not a straightforward exercise but the benefits can be substantial, especially as it does not involve cash outlays.
- With increased audit activity by the Australian Taxation Office, the keeping of proper records is essential to document and support legitimate claims. Keep the records detailed in this guide to ensure there are fewer problems with your tax return. Also, keep full details of the purchase price, improvements over the period and settlement costs of the property

Essential

Negative gearing only makes sense if the increase in the value of the property is more than the after tax cost of owning it. If there is no increase in value, you will incur losses, you must question why keep it?

Rental income and expenditure

Records to be kept for income tax purposes

To Substantiate Income

- All agents' monthly statements and annual reconciliation statements.
- Receipt book reconciled to bank account.
- Tenants rent book.
- Bank statements for interest income.

To Substantiate Expenses

- Land tax assessment and receipt.
- Rates notices and receipts.
- Building and contents insurance invoice and receipt.
- Repairs and maintenance – invoices and receipts
 - Description of work done
 - New work or repairs and maintenance.
- Kilometres travelled for collection/inspection in logbook format.
- Cleaning/gardening receipts.
- Shop dockets and receipts for minor items appropriately annotated.
- Receipts for items of furniture, carpet and curtains etc.
- Bank statements, demands, receipts or other record of interest paid.
- Bank statement, demand or receipt of costs of raising finance.
- Listing of furniture and fittings (chattels) and values when property purchased.
- Record of chattels sold or otherwise disposed of.
- Listing for depreciation of the building and improvements therein.

This list of deductions is not exhaustive and other concessions may be available depending on the applicable property. Professional advice should be sought to maximise all legitimate entitlements.

Other tax issues

Capital Gains Tax

On sale of the rental property, capital gains tax may be payable. This is a tax on the difference between the sale price and the cost of the property, or it may be adjusted for inflation. You pay capital gains tax at the same tax rates as your other income. However, if a property is held more than 12 months, then 50% of the gain is exempt.

It is important to have a record of all costs associated with the acquisition and sale of the property. This is because the costs, which are not deductions against the rental income, will form part of the cost/sale of the property, and therefore help to reduce any capital gains tax.

Travelling to and from Property

Travel between home and the property may be deductible if bulky equipment is transported, which cannot be kept on the rental site. An example would be to transport a lawn mower to mow the lawns, where there are no suitable storage facilities on the rental property.

Travel expenses between your normal place of work and the rental property for inspections should be deductible. However, if the property is managed, then any inspection travel is harder to justify because your presence at the property is not necessary. You may need to arrange regular inspections with your property manager at the property to ensure the travel is a deduction.

Travel expenses incurred in inspecting a property for purchase would not normally be a deductible expense because the cost does not relate to any current income.

Deductible Repairs

In many cases the distinction between a tax-deductible repair and capital expenditure is difficult to determine. In these situations professional advice should be sought so that the claim can be properly assessed and documented.

Day to day maintenance and routine repairs are usually deductible. At the other extreme, the additions of rooms or adding a new concrete driveway are improvements to the property and not deductions. Such items can be amortised for tax purposes.

The investor can maximise their entitlements by deferring non-essential work immediately after purchase and properly recording the exact nature and extent of all subsequent repairs. In this way their tax adviser can properly present the investor's case.