



The Ups and Downs of Negative Gearing

Negative Gearing is a term often heard when talking about property investing. Used properly, negative gearing leads to a reduction in your taxable income. But, like any financial commitment, along with the benefits, there are risks and traps to avoid.

What is Negative Gearing

Negative gearing is when you structure an investment (such as a rental property) so that the cost to maintain it exceeds the money you make from it. In comparison, positive gearing occurs when you borrow to invest in an income-producing asset and the returns from that asset exceed the cost of borrowing and maintaining the asset.

Tax benefits

First and foremost, negative gearing can offer tax benefits. If your costs exceed your investment income, Australian law allows you to deduct your borrowing and maintenance costs from your total income – so long as your investments are deemed to be genuine and are income producing.

In addition, investors are entitled to a capital gains tax concession of 50% if they hold onto their asset for more than twelve months before selling. Importantly, you can only get a tax benefit if you earn other taxable income in the first place. Let's look at an example;

Consider the following scenario:

- Mike buys an investment property for \$400,000 and pays \$24,000 in interest and \$12,000 on maintaining the property in any given financial year.
- The property rents at \$390 per week (\$20,280 pa)
- He has a loss before tax of \$15,720 (\$36,000-\$20,280).
- Mike earns in excess of \$180,000 per year, which places him the highest tax bracket (46.5%).
- He can now deduct this loss from his taxable income, and reduce his tax bill by \$7,310 (46.5% of \$15,720).
- There are also other potential deductions for depreciation that can lower the holding cost still further.

Risks

It is important to note that negative gearing is only beneficial if you have money left over from your regular expenses, and only if you have a reliable income. Another caveat is to avoid assuming that you'll make money from a negatively geared property as long as you hold onto it for the long-term. Although this works in times of rapidly rising prices, it does not work so well when prices are stagnant or falling. However, if you can retain your

investment property long-term and ride out any bumps, you should expect to make a profit as property prices generally trend upwards.

Interest rates

The other thing you need to consider is your outlook for interest rates. As most investment loans are interest only, you will be paying different amounts of money over the term of the loan. Investors must therefore remain astute and always know that they can afford the repayments if rates go up; otherwise you could be forced to sell in a hurry at too low a price.

Is it for you?

Negative gearing is certainly an investment strategy worth considering. However caution should always be taken when purchasing any kind of property and especially if buying when the likely outcome is to be a negative cashflow.

The team at Mortgageport is qualified to offer advice and share other statistical information with you if you are considering purchasing an investment property.