WRITTEN ANSWERS

EVERYTHING YOU NEED TO KNOW ABOUT PROPERTY TAX

Ep. 226 & 228 of The Property Couch

with **JULIA HARTMAN**

Founder of Ban Tacs | CA & CPA
Registered Tax Agent

WHAT'S INCLUDED IN HERE?

INTRODUCTION	2
CAPITAL GAINS TAX RELATED QUESTIONS	3
OWNERSHIP AND TRUST RELATED QUESTIONS	7
TAX DEPRECIATION RELATED QUESTIONS	9
OTHER TAX ACCOUNTANT RELATED QUESTIONS	11
ADDITIONAL RESOURCES	14
ONGOING EDUCATION	15
Books	17
DISCLAIMER	19

INTRODUCTION

Thanks for downloading this transcript! We know that tax can be a little complicated when it comes to property investing — and that's why we have released this transcript for Julia Hartman's Episodes.

If you haven't heard of Julia yet, here's a brief bio:

Julia founded the practice that has grown into the BAN TACS group back in 1992. It now operates as a cooperative of Accountants sharing their varying expertise to provide the resources of a large firm through the personal service individual practitioners provide. She has a Bachelor of Business and is a Chartered Accountant (CA), Certified Public Accountant (CPA) and a Registered Tax Agent.

Suffice to say... she's more than qualified to chat about residential property tax!!

And just a heads up: Julia shared a lot more on the episodes as well, so make sure to tune in to each of them:

> Episode 226 | Capital Gains Tax 101

> Episode 228 | Ownership Structure & Trusts

Before we start, please note that this publication by The Property Couch is for general information only and is intended to assist you in understanding the different components of the Australian Residential Property Tax. This publication is produced in **March 2019** and may not be as relevant when read in a different time period considering the regular updates on the Australian Taxation System.

The information contained in this publication is for Australian residents only.

The information does not take into account the particular investment objectives or financial situation of any potential reader. It does not constitute, and should not be relied on as, financial or investment advice or recommendations (expressed or implied) and it should not be used as an invitation to take up any investments or investment services.

No investment decision or activity should be undertaken on the basis of this information without first seeking qualified and professional advice.

Now, with that aside, let's get started!

CAPITAL GAINS TAX RELATED QUESTIONS

Alisdair H.: **Hypothetical question. I have a PPR and I decide to build an extension and use it to rent out, Airbnb or lease to a tenant. Is the deductible percentage based on square metres only? Any other considerations that should be made, such as a common garage?**

IT 2167 says:

As a general approach, apportionment should be made on a floor area basis, i.e. by reference to the floor area of the residence to which the tenant/lodger has sole occupancy together with a reasonable figure for access to the general living areas including garage and outdoor areas. If, for example, the tenant/lodger had sole occupation of one room in the residence and shared the general living areas equally with the owner/occupier, it would be appropriate to add one half of the floor area of the general living areas to the floor area of the room of sole occupancy in order to make the necessary apportionment. In some cases, access to the general living area may be restricted to the kitchen, bathroom, a laundry - it would be necessary to restrict the reasonable figure for access to general living areas to those rooms.

Will the build be able to be depreciated as a capital works deduction?

Yes, and what you are entitled to claim will reduce your cost base, this is not optional.

When I sell my PPR, it won't be without CGT, will only the same square meterage that is be subject to CGT?

Yes, and apportioned again on a days used as a rental and days not. Now, the interesting thing here is that the whole of the capital gain on the property is first calculated and then the percentage is applied. This means that expenses that relate to your share can proportionately reduce the capital gain on the taxable side.

Section 110-25(4) allows you to increase your cost base by any holding costs that have not otherwise been claimed as a tax deduction. This would include but is not limited by interest, rates, insurance, cleaning, repairs, lawn mower fuel etc that you have not claimed against the rent because they relate to your side.

Andrew O.: **When selling an investment property, how is the depreciation you have claimed on it affect how your capital gains tax is calculated?**

If you purchased the property after 13th May 1997 then any building depreciation that is claimable on the property reduces the cost base for CGT purposes. This does not include the depreciation on plant and equipment. Plant and equipment that is subject to depreciation is not included in the CGT calculation.

An example of how this would work is you reduce the purchase price by the opening balance of your plant and equipment depreciation schedule and reduce the selling price by the closing balance of your depreciation schedule, before you start the CGT calculation.

James B.: **Is stamp duty and capital gains tax effected for first home buyers when purchasing a property for the purpose of investment vs owner occupier? Also, if the property is initially purchased as an owner occupied property but later turned in to an investment property, what is the tax outcome of this both throughout the life of property ownership and when the property is sold (further down the track)?**

The key to this answer is section 118-192 ITAA 1997 which resets the cost base of a property to its market value when it is first rented out if up until that time it was 100% covered by your main residence exemption. This section is not optional if you meet the requirements.

Usually a first home owner concession will require you to move into the property in the first 12 months. A property will not be covered by your main residence exemption for CGT purposes until you first start to live there unless you do renovations first and no one else is living there during that time.

So with these two restrictions in mind, if you first rent the property out before you move in then section 118-192 will not reset the cost base. You will be entitled to cover the property with your main residence exemption once you move into it but not for the period before it. The CGT that will apply when you sell will be calculated over the whole period you owned it and apportioned for days covered by your main residence exemption and days not. This means that any stamp duty you pay will be included in the cost base and any first home owners grant you receive will reduce the cost base.

If, on the other hand, you live there first and then rent it out, section 118-192 will reset the cost base and deemed acquisition date to the market value at the date you first rented the property out. Nothing before that date is counted so stamp duty and the first home owners grant are ignored.

Karen C.: **If I move out of my PPOR and turn it into an investment, then sell it after 6 years, how is CGT calculated?**

Assuming up until the time you made the property first available for rent, it had been covered by your main residence exemption then section 118-192 will reset the cost base to market value at that date as well as the deemed acquisition date. So, CGT can only apply from that point forward.

If you choose not to cover another property with your main residence exemption during that 6 years, you do not have to make this choice until you sell, then you can use section 118-145 to continue to cover the property with your main residence exemption for up the 6 years, in your absence.

You did say after 6 years, so let's assume it was rented for 7 years before you sold. You would work out the capital gain starting from the market value when first rented out. One seventh of this would be the taxable gain but would be further reduced by the 50% CGT discount.

Josh C.: **Can I claim any ongoing CGT discounts if I move and rent out my PPOR while I move into a rental myself?**

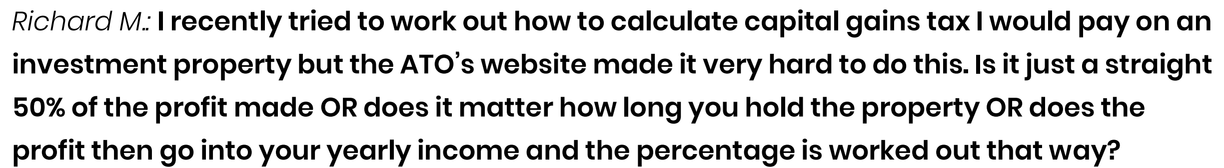
As per the example above, you could completely cover it with your main residence exemption for up to 6 years while it is rented. The catch is section 118-192.

If up until that date it has been covered by your main residence exemption then the deemed acquisition date is when it was first available for rent.

If for some reason you did not opt to cover it with your main residence exemption and sold it within less than 12 months of first renting it out then you would not qualify for the 50% CGT discount because you technically have not owned it for 12 months.

John T.: **I will be looking at losing close to $80k on an investment property that I have held onto for 12 years. Just wondering how long I can carry this capital loss over for? And how the whole offset process works.... (i.e. would a $80k profit in the future completely be offset against this loss?)**

There is no limit to the period of time you can carry over a capital loss but if you have a capital gain then you must offset. The offset happens before any 50% CGT discount is applied.



Richard M.: **I recently tried to work out how to calculate capital gains tax I would pay on an investment property but the ATO's website made it very hard to do this. Is it just a straight 50% of the profit made OR does it matter how long you hold the property OR does the profit then go into your yearly income and the percentage is worked out that way?**

Can I recommend that you buy my CGT calculator in the shopping section of www.bantacs.com.au

You need to have at least 12 months and 1 day between signing of contract to buy (or reset of cost base) and signing of contract to sell, to qualify for the 50% CGT discount. If you qualify then only half the profit is added onto your yearly income and then just taxed the same as any other income you have.

Joshua F,: **If I have purchased a block of land but choose to on sell it prior to settlement, but the new purchasers don't settle, would I be taxed on the 10% deposit the new purchaser pays in the event they don't follow through with the sale, leaving me to settle on the land?**

Yes and no — 50% CGT discount.

OWNERSHIP AND TRUST RELATED QUESTIONS

Ben A.: **When investing for the long term as a couple (with one partner's income considerably higher than the other), what are your top tax tips to consider when determining ownership and borrowing structures?**

The first thing I would consider is whether it is possible to hold the property in a SMSF, so many tax benefits but it's very hard and expensive to borrow. Make sure to talk to a qualified accountant and a qualified financial planner/SMSF Specialist to consider if a SMSF suits you.

Otherwise:

You need to do some "what if" analysis on the numbers to see how long it is likely to be negatively geared.

You would not consider a company because it does not qualify for the 50% CGT discount.

This means, if you want asset protection then perhaps consider holding the property in a trust. However, the trouble is Labor is threatening a minimum tax rate of 30% on trust distributions so it's not ideal if you are retired. So at the moment, we need to stay clear of them too.

This leaves personal names, which depends on remaining working life and how long it is negatively geared.

Borrowing:

When it comes to borrowing consider P&I if it will give you a 1% reduction in your interest rate. On a $500,000 loan dropping from 5% interest only to 4% P&I will only mean an extra $3,644 a year in repayments to have the whole $500,000 paid off in 30 years. This means you only repay $109,000 of the principal back the other $400,000 odd is paid for by the interest savings.

Remember you asked for the top tips — there are plenty more and SMSF is a complicated structure so you **must** see your Accountant before you sign anything.

Locky K.: **What is the best tax structure for being able to keep borrowing (family trust or company)? Buy, build and rent out for passive income?**

Companies don't get the 50% CGT discount. Buying under our own name is always easier to borrow.

Family discretionary trust will not allow you to negatively gear, and at the moment Labor's threatened 30% minimum tax rate is a real worry about holding anything in a trust going into retirement.

Troy W.: **Should we open a company to manage all the residential properties or a trust perhaps? If so, what are the tax benefits do we have?**

Not sure what you are trying to achieve here. Maybe to claim travel to the rental properties? However, this would have to be market rates, arm's length etc. Something the ATO hate, but your company or trust can technically charge you for work.

Hypothetically saying, company would be better if you were going to leave the profits in there, paying 30% tax. However, you'd consider Trust if you want flexibility to distribute profits. But the most important thing is, you would need to consider whether you would get caught by the personal services income provisions. That is, if you do all the work then the company or trust has to distribute all the profits to you anyway.

Assuming you own the properties, you will probably achieve not much more than a lot of extra Accounting fees.

Alistair Boyd: **How to transfer property between entities (company to trust or company to personal name). Investigate how the family law act interprets this.**

Family law is always going to look through any entity. Even if you go as far as a blood line, trust and successfully keep the family law court locked out, they are just going to award the spouse the rest of the matrimonial assets to compensate anyway. A pre-nuptial agreement is a better chance.

Bear in mind that any transfer is going to trigger stamp duty and CGT. It is the sale of a property.

John F.: **If 5 family members own 1 investment property, can the income be all directed to 1 person or must it be 20% each?**

The income must be apportioned in line with ownership. Though one owner can rent their share to another owner.

TAX DEPRECIATION RELATED QUESTIONS

NOTE: For tax depreciation related questions, Bradley Beer, CEO of BMT Tax Depreciation was on The Property Couch back in Episode 117 (Everything You Need To Know About Depreciation Changes) and Episode 151 (What are the Final Budget Changes on Tax Depreciation?). Make sure to tune in if you'd like to learn more on this topic.

Damien R.: **Is there any point in getting a tax depreciation schedule anymore for existing fixtures (since recent changes)?**

Not for plant and equipment unless the property has been held by you as a continuous rental since May 2017. Building depreciation will still be applicable if the property was built or improved after 16th September 1987.

Paul J.: **Any point getting a depreciation schedule done on a brand-new build investment property, considering I can just give my accountant the exact costings of the build to depreciate?**

As long as you can dissect the cost between the building and the plant and equipment. If you Google ATO rental property guide you will find at the back a list of most items explaining whether they are plant and equipment or qualify for building depreciation.

You could ask the builder to break this down for you.

Pete M.: **I want to know: am I able to claim tax deductions if I rent out 1 or 2 bedrooms in my home? If I rent out 2 bedrooms in my 3 bedroom home, am I able to claim two thirds or my rates, Strata, etc?**

Yes, but you will also have to pay CGT on 2/3rds of the capital gain. If until that point in time you had always fully covered the property with your main residence exemption then the whole cost base is reset to market value at the date you first advertise it to rent.

Mathew D.: **When renovating an investment property to what level must you renovate the investment property so that it can be classed as a "Substantial Renovation" in order to allow you to claim it as a depreciating asset?**

Due to the reference to an investment property, I am going to assume you are not renovating to sell. In that case the only time you need to worry about substantial renovation is if the builder buys the plant and equipment. If the builder does and the renovation is not substantial then when the P&E is on sold to you it is considered second hand so no depreciation is available. Simply pay for the P&E directly yourself.

As for the renovations that are not P&E, it does not matter if the renovation is substantial you can still depreciation them at 2.5%.

A substantial renovation is defined in GSTR 2003/3. It needs to affect every room in the house and be substantial so just a coat of paint in every room along with a kitchen and bathroom renovation will not be substantial. Even doubling the size of the house may not be substantial if none of the original house is affected.

Brendan Gale: **What is the threshold between claiming all renovations / maintenance in one year, vs having to stagger it over "X" years?**

It is not a threshold or a choice for that matter.

The only relevant threshold would be if you buy plant and equipment — for example, a range hood or curtains that costs less than $300. Like items are added together to measure against the threshold. Plant and equipment over $300 needs to be depreciated over its effective life.

With non-plant and equipment it is going to be over 40 years unless it is a repair that did not need doing when you purchased the property.

You may be interested in our renovators booklet in the library section of our website.

OTHER TAX ACCOUNTANT RELATED QUESTIONS

Andrew M.: **Would love to know if we have any further clarification on the possible negative gearing changes from labour. Are we able to still offset our income with interest down to 0 but not claim it as a loss i.e. negative gearing, or is there plans to take away claiming the interest charges at all so all income is classed as income?**

At the time we recorded this podcast, there is no plan to take away claiming interest completely.

First of all, these provisions are grandfathered so if you already own the house you will be alright.

Secondly, it is not specific to interest. If you were to buy a property after the start date for this legislation then you would only be able to claim expenses up to the total rent received, any excess would just be included in the cost base for CGT purposes. That is what it says on the ALP website but I have received contradicting views from Chris Bowen's office as to whether they reduce the cost base or can be carried forward to offset again future profitable years.

There is unlikely to have any solid decisions until they have passed on the legislation and as always, one should not be investing in property purely for tax purposes.

Nick W.: **How do I transition my investment property at retirement with minimal tax impact?**

Retirement will not trigger any tax consequences, what will trigger tax is when you sell the property and that is better done after retirement assuming you will be in a lower tax bracket.

But speak to your accountant and ask if it would be appropriate for you to consider doing it before you are 65 so you can contribute to superannuation to offset some of the gain.

Alternatively sell your home tax free because of the main residence exemption and move into the rental property.

Kosta D.: **What implications must we consider if we go down the short-let Airbnb route?**

If it is just using your rental property as an Airbnb then it's very much the same, just more expenses such as soap and linens. It is when you use your home partially for Airbnb that the problems begin.

There is a detailed blog on this in the library section of www.bantacs.com.au. Most importantly, keep records for the property from now until you sell it.

If it is your own home then you need to keep records for even the holding costs associated with your use of it as well. Not just relating the Airbnb part but the whole property as capital gains tax will apply when you sell it and you can increase the cost base by any expenses you haven't claimed a tax deduction for. This will be your share of the interest, rates etc that you haven't claimed against the Airbnb rent. It even includes maintenance, for example cleaning materials. So keeping receipts is the key.

Next important record is the days it was used to produce rent. This includes days it was listed with Airbnb even though it was not actually rented. Then of course, it will be the floor area used. This will measure your CGT exposure but note that the ATO gets the best of both worlds. You can't claim expenses while it is listed but not occupied if you are using it for private purposes during that time.

If the property you are Airbnb-ing is negatively geared, the ATO will argue you are not trying hard enough to rent it so not really a commercial venture so can only claim expenses up to the amount of rent you receive. They will question you for not having it listed on various sites even though there are several good reasons why you should only list with Airbnb. They might also challenge that your spiel about the property is not good enough or you are charging too high a rent so you really don't want to rent it at all, you are just trying to get a tax deduction!

Sandy S.: **How do you choose/ find a quality property investment savvy tax accountant?**

Of course, you need one that has had investment properties to understand the ups and downs, tenant pain etc. But please remember that a good Accountant should be able to get a better return by investing in their practice than in property so don't be impressed by claims of a large property portfolio.

Sineth W.: **How to differentiate investment savvy/specialist tax agent and general Tax agent? What outcome Investment savvy tax accountant can bring in to table?**

It is important that they have had an investment property to understand the dramas but don't expect them to have a heap because a good accountant can get a better return by reinvesting in their practice.

The most important thing they can bring to the table is helping you with the buy decision, crunching the numbers, explaining how best to set up the loan, whose name to buy it in etc.

If they stumble with this then you will know right from the start.

Iain H.: **What sort of benefits could one expect from a property investment savvy/specialist tax agent over a generalist or doing it yourself?**

At the moment doing it yourself, really? How are you going to keep up with all the changes? Are you able to differentiate between a repair and an improvement and how they are treated for tax purposes?

Replacements in their entirety are a good example. Firstly, you need to communicate with your Accountant before you do things. Say, for example, you say to your Accountant, "I am going to replace the fence.". A good Accountant is going to say, "Don't do that all at once. Replace it a bit at a time over a few years. Then each time you are only replacing part of it so you will qualify for an immediate tax deduction as a repair. Replace it all in one go and the deductions is spread over 40 years!"

ADDITIONAL RESOURCES

As you can probably already grasp, Julia is very generous on sharing her knowledge and this time it's no different! Here are some additional resources that she would like to share with The Property Couch community as well:

The Tax and Record Keeping Consequences of Holiday Rentals Such as Airbnb

Obviously, you have to declare the income you receive and are entitled to claim expenses but the long-term consequences of a property earning income is capital gains tax (CGT), which means keeping records for the rest of the time you own it. This will even apply to your home in most circumstances. Read more here >>

Renovators' Booklet

This is certainly no substitute for advice from your Accountant on your particular circumstances but our experience is that your Accountant is generally the last person you tell. After reading this you will understand why they should be the first person you talk to and identify the important topics for your discussions. It is important that you visit your Accountant before you sign a contract. Read more here >>

Got more questions on Tax?

Send them in to Julia! She does charge a small fee to answer your questions but it's tax deductible. And you can expect straight answers from her on a variety of tax topics too. No Appointment Necessary. Simply lodge your tax question and you should have an answer within 2 working days. Ask your Question here >>

Simply want to learn more from Julia?

Then subscribe to her blog! Her comments are both educational and entertaining. If you think tax is boring then you'll be proven wrong.

Don't believe us? Check out Julia's Blog here >>

ONGOING EDUCATION

How To Videos

With more than 130 videos, our How to Videos provide a wealth of information on property investment, superannuation, market trends, and more.

These videos are free for everyone, including new investors and experienced investors alike.

See them all ***here.***

Special mentions:

- 3 Handy Tips to Invest in a Changing Market.
  Watch here.
- Who is the One Person a Buy and Hold Investor Needs to Impress and Why?
  Watch here.
- Have you taken this critical step to reducing debt?
  Watch here.

Case Studies & Success Stories

Success leaves clues! If you're interested to see how other investors built their portfolio, learn what compromises they've made, and discover their dreams and their plans, we've shared a few stories on our website. You can **see them all here** but a few of the case studies that we've done are:

- Late 20s couple, self-employed. ***Watch here.***
- Mid 40s couple with 2 kids. ***Watch here.***
- Professional couple in their Late 50s. ***Watch here.***

Australia's #1 Property Podcast

The Property Couch

is now on...

Our podcast **The Property Couch** consists of everything you need to know about property, finance and money management EXCEPT all of the jargon designed by Property Spruikers to keep you confused.

The Property Couch's sole purpose is to stop Australians from making bad property investment decisions.

At the time of writing, it has been downloaded over 4.4 million times and with 1,200+ five-star reviews on iTunes, The Property Couch is Australia's Best Rated Business Podcast!

Tune in to all episodes here.

Special mentions:

If you are new to the podcast, we always suggest you start from **Episode 1** so you get all of the critical, foundational knowledge. As a starting point, you should aim to listen to the First 20 Episodes.

Don't have time for it? No worries! Just **download our Binge Guide here** where we summarise it all for you! 😉

Books

Our Best-Selling books include...

Building a Property Portfolio:

The Armchair Guide to Property Investing

This is a comprehensive guide to the fundamentals of money management, risk assessment, asset selection tips, location research, the buyer's decision quadrant for success and picking a winning property, this book gives readers a full toolkit to be a successful property investor.

We'll share 18 investment strategies that in our vast experience have worked for hundreds of our clients — and ourselves— over the years. There are also insightful case studies where you'll discover how six very different investors — a young single, a couple who started investing early, a couple who left it a bit late, a single parent and a couple with no kids — built portfolios that will deliver $2,000 a week in retirement income!

CLICK HERE to Get The Armchair Guide to Property Investing

Money Management:

Make Money Simple Again

A prequel to the first book, this book offers a simple, proven approach that will make money simple again, helping you to spend less than you earn so that you can save and invest for your financial future.

Unlike *The Armchair Guide to Property investing*, this prequel book takes a deep dive on our highly effective Money SMARTS system and the 7 steps to achieve financial peace.

We'll show you exactly how to...

- Know where your money goes
- Take control of your spending
- Trap your cash flow surplus each month

- Pay off your debt sooner
- Ensure you don't leave any "money on the table"
- Make every dollar work harder for you
- Pay for holidays, kids' education, property and other big-ticket items
- Achieve total control of your money in this new age and invest for your financial future
- Stop leaving "money on the table"!

CLICK HERE to Get Make Money Simple Again

OR Save Money and Get them Both…

Bundle offer

Yep, it's the ultimate for a property investor's toolkit!

Plus, you get to put the elements of money management straight into action with a bundle discount ☺

DISCLAIMER

As mentioned at the top of this publication, we cannot emphasize enough that this is for general information only and is intended to assist you in understanding the different components of Residential Property Tax. The information contained in this publication is for Australian residents only. The information does not take into account the particular investment objectives or financial situation of any potential reader. It does not constitute, and should not be relied on as, financial or investment advice or recommendations (expressed or implied) and it should not be used as an invitation to take up any investments or investment services.

No investment decision or activity should be undertaken on the basis of this information without first seeking qualified and professional advice.

The Property Couch and The Empower Wealth Group of Advisory Companies, its employees or contractors do not represent or guarantee that the information is accurate or free from errors or omissions and therefore provide no warrantees or guarantees.

The Empower Wealth Group of Advisory Companies disclaims any and all duty of care in relation to the information and liability for any reliance on investment decisions, claiming the use or guidance of this publication or information contained within it. Empower Wealth Group of Advisory Companies: Empower Wealth is the trading name of Integrated Pathways Pty Ltd ATF Integrated Pathways Unit Trust ABN: 13 653 728 295. This publication is copyrighted and should not be distributed or copied without prior written agreement with Empower Wealth.