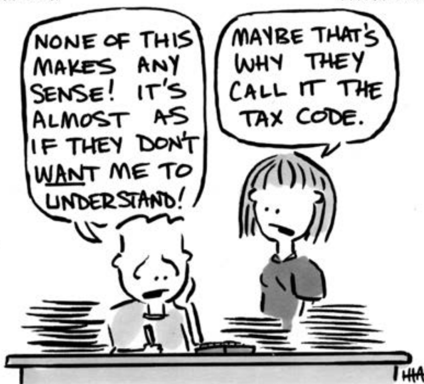
How To Pay Low Tax on Australian Property Investments, as an Overseas Based Investor

Many overseas investors and even Aussie expats believe that tax is "high" in Australia, and may put off investing for that reason. But, you will be amazed at the "real" rates of low tax you pay in Australia when investing in property. Not too far off the rates in Singapore and Hong Kong. **Little known and understood.**

Some expatriates living overseas then are worried about possible *"world-wide"* tax on their overseas income if they invest back home. Again, a needless worry.

Very few overseas investors and even expatriates know the correct information, or even realise **how the correct tax planning could benefit them hugely in the future by both reducing any potential income tax, tax on rental or Capital Gains (profits) tax.**



What Tax do Non-Residents Pay?

Non-residents of Australia pay tax differently from residents. Here is a summary of what you will pay.

As a non-resident (no matter what nationality)you will:

Pay tax **only** on all income earned in Australia. USUALLY AS A NON-RESIDENT THIS MEANS *YOUR RENTAL INCOME on any Australian property investments.*

It is important to note that if you **have no other** AUSTRALIAN INCOME,OR SALARY,YOU WILL ONLY PAY TAX AT **THE LOWEST RATES**. And even better, he whole construction

Tax File Number

Once you have acquired a property with the intention of earning income from rent, you must register with the Australian Taxation Office and obtain a tax file number. If you have not already done so, you will need to complete a Tax File Number Application in full, accompanied by the required proof of identity documents.

Original documents are required and will be returned. Alternatively, copies certified by the Australian Consulate can be provided.

Income Tax Return

Australia's financial year is from 1 July to 30 June. The laws require every person or corporation to lodge an income tax return if any income has been earned or any expense incurred within that period in Australia.

The return is due for lodgement 31 October following the year of income.

The return must state the gross income received f**rom all sources within Australia** and a claim may be made for any expenses relating to that income.

Income tax is then levied on your Taxable Income **not** total income.

Taxable Income is calculated as your gross rental income (from all properties owned) **less** any **allowable deductions** incurred in earning that income.

If a surplus of income results, tax is levied at the prevailing non-resident rate of tax.

Later in this Report, we look at what is Capital Gains Tax, and also examine "negative gearing."

And also provide a checklist of legal tax deductions you can claim.

Some of the more common deductions you usually will be able to claim include:

- advertising for tenants
- agents commission for managing the property
- gardening and maintenance
- insurance - property and contents
- interest on loans used to finance the property
- lease preparation costs, council and waterrates and land tax
- telephone, facsimile and postage
- attending property investment seminars

Australian Income Tax Legislation requires that in order to claim any deductions, you must have documentary evidence to substantiate the claim. These records must be kept for five years after lodging the return to which they relate. Failure to do so may result in your claim being disallowed and penalties being charged.

The Australian Government also **provides incentives for property investors** in the form of *additional* tax deductions. These include:

- Depreciation - on furniture, fittings and equipment used in the rental property.
- Building Write-Off - 2.5% per annum of construction cost of new buildings.
- Borrowing Expenses - amortisation over five years for the full cost of establishing a loan.

It is important to note that if your expenses (including paper expenses such as Depreciation) exceed your rental income then no income tax is levied. As a non- resident investor, this ***annual loss may be carried forward indefinitely to offset future Australian rental income or capital gains taxes.***

This is an important benefit, not available to residents living in Australia who must use these losses in the year incurred against personal income.

As the Australian taxation system is federal based, any loss made on one property can **offset the income or capital gain** of another property regardless of the property's location in Australia.

Capital Gains Tax

In Australia, Capital Gains Tax is levied on profits made on the sale or transfer of assets. When you sell your property, the excess of the sale price over the purchase price is a capital gain.

When determining how much of the capital gain is taxable, allowance is made for any buying and selling costs and improvements.

Should a capital loss be incurred, then no tax is applicable and the amount of the loss is available to be carried forward indefinitely to offset future capital gains. More details below.

WHAT IS "NEGATIVE GEARING?"

When you borrow money to purchase a property and the rental income you receive from the property (minus other expenses) is **more than the interest on the loan in a given period,** then the property is said to be "positively geared." It follows then that when the rental income is less than the interest and expenses, the property is "negatively geared." It's that simple.

Yet many people **still seem to think** it is very complicated!

It's also easy to see that the size of the loan you take out as a proportion of the selling price, will determine whether your purchase is positively or negatively geared. This is because the larger the loan, obviously, the higher the interest you must pay; and after a certain point, the interest (plus other expenses) will exceed the rental income.

The following realistic, numerical example will help us to see the benefits that negative gearing can bring: -

	Purchase A positively geared	**Purchase B negatively geared**
Purchasing price	500,000	500,000
Cash paid as deposit	40% — 200,000	25% — 150,000
Interest-only loan	60% — 300,000	75% — 375,000
p/a interest on loan @6.0%	(18,000)	(22,500)
Other property expenses	(6,250)	(6,250)
Rental income @5%	25,000	25,000
Annual surplus/(shortfall)	750	(3,750)
After five years:		
Value of property		
(capital gain @5% pa)	638,000	638,000
Gain	138,000	138,000
Plus surplus/(shortfall)	(5yrs x 750)	(5yrs x 3,750)
Return on original cash investment	(3,750) 83,709	(18,750) 119,250
	48.1% or	79.5% or
	8.17% pa compound	12.41% pa compound

'Negative gearing' is one of the most frequently discussed concepts amongst investors in Australian Property, but how many of them actually understand it? Knowing how and when to use negative gearing **can open the door to some huge advantages,** especially for offshore investors.

The first of these benefits is that **a negatively geared property can produce higher percentage returns** on the money you invest as shown above.

At first sight, purchase A in the example would appear to be the more attractive option.

But on closer inspection, things look different. We can see that purchase A uses a 60% interest-only loan and after five years of taking a modest profit on his rental income and enjoying a 5% capital gain on the value of the property he comes away with a 8.17% pa compound return before tax on the AUD200,000 he originally invested.

Purchaser B, however, **took a larger loan** on which he paid more interest, giving him a shortfall, after five years he comes away with compound growth on the AUD150,000 he originally invested of 12.41% - at more than 4% pa higher than purchaser A, a **significantly better return.**

Note also that the negatively geared purchase involved a AUD50,000 **lower initial outlay** and so the investor would be free to invest the other AUD50,000 elsewhere.

This is a simplified example, of course. In practice, expenses or interest payments may vary, and the crucial capital gain rate may be lower or much higher than 5%.

The second reason for negative gearing being advantageous is the taxation benefits that it brings. **As an incentive for investors** to buy rental property, the Australian government has allowed the shortfall or loss from a rental property to be **offset against other income** such as salaries.

For an overseas investor with **no other Australia-sourced income,** these shortfalls can be accumulated and offset in future years against increased rental income, realized capital gains, or other investment income. Purchaser B above generates AUD18,750 in tax losses by taking a shortfall of AUD3,750 for each of five years, and this amount, plus another amount for depreciation, (which could be as much as AUD50,000- 60,000) can be **offset against the gains** he makes when his rental income becomes higher than his interest expenses, for example.

Alternatively, **an expatriate Australian** returning to Australia to work in a few years' time could **use the accumulated tax losses** against the salary he would earn on his return to Australia. In this way, personal income tax in Australia can be reduced to less than 15%, often for many years.

Negative gearing, then, i**s an invaluable investment tool** in the right circumstances. However, the fundamental secret to successful property investment in Australia remains acquiring at a reasonable price a prime property in an excellent location, and taking a mid to long term view in order to maximize the benefits.

Capital Gains Tax Explained: Simplified

Capital Gains Tax is a tax charged on any **capital gain arising from the sale** of any asset acquired after the 19th of August, 1985.

You are liable for Capital Gains Tax if your capital gain exceeds your capital loss in any financial year. Any capital gain must be reflected in your tax return for that year.

All investment properties are subject to the Capital Gains Tax when sold.

One big misconception with Capital Gains Tax is that it is paid at the top marginal tax rate. This is incorrect. Any capital gain made is added to your other income to give you your

taxable income and then taxed at your marginal rate which may not necessarily be the top tax rate.

Another misconception is that in the event a loss is made, that loss can help reduce your taxable income as a **negatively geared property** would. This is also incorrect. **A capital loss can only be offset against a capital gain.**

When determining a capital gain or loss it is important to keep all documentation relating to the purchase or sale of the property and all expenses associated with the purchase or sale as these may form part of your cost base reducing any capital gain.

If buying off the plan, it is important to note that in calculating a capital gain the date of acquisition and sale is that on the purchase and sale contract **not the date of settlement**.

Tax Deduction Checklist - Rental Property

(This list is not exhaustive)

Item	**Deductible**	**Non- Deductible**
Accounting Fees	Yes	
Advertising	Yes	
Agent Fees & Commissions	Yes	
Bad Debts	Yes	
Boarder’s Costs	Yes	
Body Corporate Fees	Yes	
Borrowing Expenses	Yes	
Building & Structural Improvements	Yes	
Cleaning	Yes	
Commissions & Management Fees	Yes	
Depreciation	Yes	
Early Termination of Lease Payments		No
Electricity & Connection Costs	Yes	
Eviction proceedings against tenants		No
Bank Charges	Yes	
Gardening	Yes	
Gas	Yes	
Head Rental*	Yes	
Insurance	Yes	
Interest	Yes	
Land Tax	Yes	
Lease Incentives	Yes	
Lease Premium		No
Lease Surrender Payments		No
Legal Fees not associated with eviction	Yes	

Mortgage Insurance	Yes	
Municipal Rates & Taxes	Yes	
Office Supplies	Yes	
Postage	Yes	
Repairs excluding initial repairs	Yes	
Security	Yes	
Solicitor Disbursements	Yes	
Telephone	Yes	
Travel		No
Water	Yes	
Prepurchase travel expenses for properties not purchased		No

** Where landlord is lessee rather than owner and is sub-leasing the property to another rent-paying tenant.*

Whilst this tax has concerned some overseas investors, there is *no need to be overly concerned*, as Australia has always had different taxes, and Capital Gains tax has been around a long time.

In fact for over 30 years.

Even with all the different changes over the years, it has **not ever stopped people investing**, nor has it stopped *outstanding returns* from being achieved.

In any event, with the *extensive tax deductions* available on new property, some simple computer modelling shows that **generally there is under 15% of the gain** to be paid, assuming a typical new property, with around 5% per annum capital growth and an reasonable mortgage.

Obviously if you **make windfall profits,** you will be paying a higher tax.

However, *before you pay tax* you have to make a gain!

What to Provide your Accountant at Tax Time

When you are getting ready for the preparation of your Tax return it is essential that you provide your Accountant with everything they may require to maximise your **tax refund** or minimise your tax liability.

It is imperative that you supply your Accountant with detailed lists of all your income from the property and expenses, whether they be cash or non-cash expenses.

Cash expenses are expenses that are paid for in cash throughout the year like management fees and repairs.

Non-cash Expenses are items which you can legally depreciate such as the actual building and fit out of the building.

Following is a list of the things you will need to collect and keep throughout the financial year to give to your Accountant at tax time.

For each investment property you own you will need to keep a separate folder to collate all your records.

- The address of the property
- The date of purchase of the property (preferably a copy of the contract)
- A copy of the depreciation schedule
- The purchase price of the property
- The total income of the property (rental income)
- The total expenses incurred with all receipts
- A copy of your bank statement so your accountant can calculate the interest cost
- A list of any questions you may have for your Accountant

Without supplying all this detailed information to your Accountant they will not be able to *maximise your return at the end of the financial year,* and unless you do this you are inhibiting the rate at which you can reinvest.

Building Construction Costs include:

- Engineering
- Drafting
- Architects fees
- Surveyor fees
- Foundation and excavation costs
- Building fees *(cost associated with obtaining the necessary approvals from relevant authorities)*

Building Construction costs exclude:

- Expenditure on acquiring land
- Expenditure on demolishing existing structure
- Expenditure on clearing, leveling, filling, draining, or otherwise preparing the construction site prior to carrying out excavation works
- Expenditure on landscaping
- Expenditure on plant
- Profit by the builder

Where a new owner is unable to determine the construction cost associated with the building, an estimate provided by a qualified person may be used.

Appropriate qualified people include:

- A clerk of works, such as a project organizer for major building projects
- A supervising architect who approves payments at stages of projects
- A builder who is experienced in estimating construction costs of similar building projects
- A quantity surveyor - the most common

Structural Improvements

These include extensions, alterations and improvements constructed after 26 February 1992. Other examples of these include:

- Sealed roads
- Driveways
- Car parks
- Retaining walls
- Fences and gates

How much to borrow when buying investment property?

As a general rule, borrowing to maximise taxation benefits should be in the order of 60% to 80% of the purchase price. As mentioned previously, care should be taken to select the correct finance package.

At this level of debt, the ***rental will normally offset the interest*** expenses.

But *all other expenses* relating to the property would then be allowed to be tax deductions, including items such as travel and hotel costs during regular inspection trips down under. Your professional tax adviser will give you the full list, which is substantial.

A paper or "tax" loss is created so it is possible to have a break even cash position, whilst creating a substantial tax losses, which can be used in the future.

Whilst you are living overseas, whether you are a foreign investor or an Australian citizen working overseas, it is likely you will have *no other taxable income* in Australia. Normally, if you were living in Australia, **this tax loss for your property** would be used as a tax deduction against your personal income-tax.

This can greatly reduce an individual's tax rate in Australia, and also helps explain why a property always has been and will **continue to be a popular choice** for Australian investors.

For the overseas investor, with *no other Australian sourced income*, the shortfall of all tax losses can be accumulated without any immediate deduction and then used in the future to offset your future income in Australia, such as capital gains, or rental income.

This can be an enormous advantage.

Typically, most foreign investors will utilise this to reduce any capital gains tax that may occur on real resale.

Taxable losses should not be underestimated in its future value to investors.

Especially for those planning at some stage to work in Australia, you would be able to typically accrue these benefits and use them upon your arrival in Australia. It is not unusual for such people to live on very low tax or even tax-free in Australia for many years, especially if multiple properties are owned.

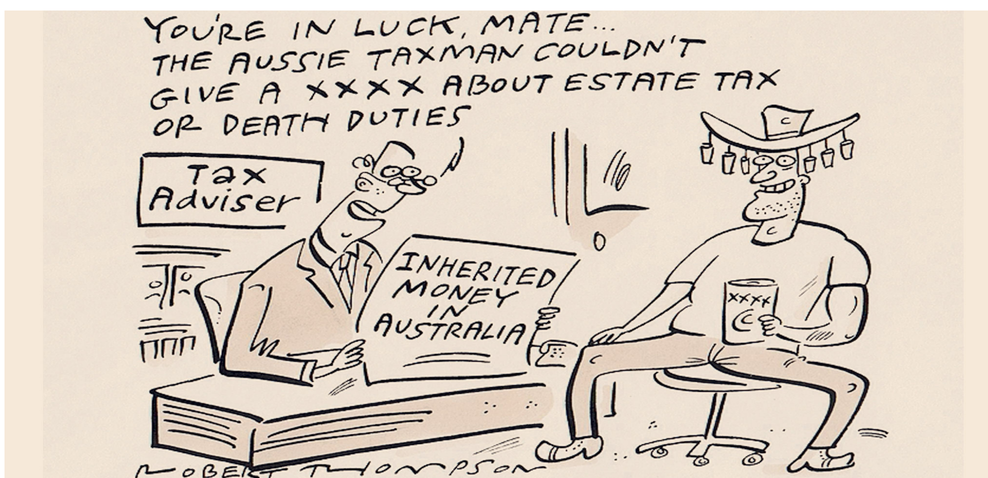
Intending migrants often leave the tax planning part of their immigration to the end. This is often a mistake. A little careful planning now, a couple of years in advance, can legally and legitimately dramatically reduce your exposure to tax upon your arrival, as well as provide you with a sound property portfolio.

Interestingly, figures show that many migrants purchase an investment property within 12 months of arrival in Australia. By doing this, they have lost most of the additional benefits of them that have been available to them if they bought the same property just two years before leaving.

Tax effective strategies for new migrants and returning expats

New migrants and expats going back to Australia after living overseas can literally save tens of thousands, if not hundreds of thousands of dollars, by following the strategies shown clearly in the free report available at

www.australianmigrationtips.com



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