Property Investing Basics

This article is dedicated to the client who sold his rental property just before he retired rather than just after. A very frugal man who does not waste money on tax advice. For the sake of a bit over a year he paid more than $30,000 extra in tax. At times here I may appear to state the obvious but I think it needs to be said.

How Property Investing Works as a Tax Effective Wealth Creating Strategy

The great thing about property as a start out investment is that it is very cheap to borrow against. You can expect the interest rate on a margin loan on shares to be twice as much as the interest rate on a loan where you use a house as security. So the idea, when you are young is to borrow as much as you can then wait for the price to rise increasing your equity and buy more. Very risky of course but hopefully you start young and have time to smooth out the bumps and mistakes.

Now combine this with the tax advantages property offers through building depreciation. This is a tax deduction that you are not out of pocket for and you are betting the property is going to go up in value not down like the depreciation schedule shows. For a property to qualify for depreciation it has to be built or renovated after 16th September, 1987. The newer the property most likely the higher the amount of depreciation you can claim. This needs to be balanced with the expectation that higher capital growth will come from older properties because they have position, position, position.

The building depreciation you claim while you are renting the property will reduce the cost base, that is increase the amount of capital gains tax you pay when you eventually sell. Fortunately, due to the 50% CGT discount the increase in the capital gain will only be half of what you have been claiming over all the years. Further you are probably in the highest tax bracket of your life time when you are claiming this depreciation.

Retirement

Here is the clincher that makes this strategy complete. You do not sell the rental property until you have retired, finished work and are only receiving income from super which will be tax free. That allows the capital gain to use up your tax free threshold etc. Further, if you are young enough and have some unused superannuation contribution caps from previous years (very likely if you haven't been working for a few years) you can offset a whole lot of the capital gain by contributing it to super. By the time you are over 60 and retired super is just like money in the bank. You can access it whenever you want, take it straight back out again the next day if you really want to.

Timing is everything at this point in time and it is certainly worth a few hundred dollars spent with an Accountant to get this right. For example superannuation contributions need to be made before the 30th June in the year that you sign the contract to sell. The CGT is also payable in the tax return for the year you sign the contract, not settlement. Even if you are retired it may still be worth waiting an extra year to qualify for another unused cap but there are age, superannuation balance caps and working requirements traps so get advice.

BAN TACS Accountants have CGT specialists Accountants and a Financial Planning arm that can work together to give you the best result. If you can't BAN TACS at least minimise it legally.