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CHARTERED ACCOUNTANTS™
AUSTRALIA + NEW ZEALAND

Negative Gearing

What is Negative Gearing?
It is the term given when interest paid on borrowed funds to finance acquisition of an income-generating investment (i.e. rental property, shares which generate dividends, or any other investment that generates assessable income) exceeds income received. That is, it produces a tax loss. Another term used is "leveraging".

Advantages

- No limit on interest deduction allowed.
- Recommended interest only loan (allows you to repay more of non-deductible loans/debts).
- Higher level of capital to be invested.
- Losses incurred can be offset against other assessable income.
- Reduces taxable income thereby reducing tax payable.
- Total control of assets.
- Investment (i.e. rental property) can be purchased as "tenants-in-common" with different % of ownership. If held as "joint tenants", upon death property passes automatically to survivor.
- If individual salary earner, you can apply to the ATO to have your PAYG withholding tax reduced instead of receiving a large refund after lodgement of tax return.
- Can borrow to purchase shares and managed funds by way of a margin loan where security is taken over the investment.
- For low income earner, tax losses can be carried forward to future years to be offset against future income/earnings.

Disadvantages

- Loan should be in same name as investment holder.
- If investor is high income earner, means possibly more capital gains tax payable on sale of asset.
- Investment may decrease in value on sale and not cover the borrowings.
- Need to keep investment loan separate from personal loans.
- Be wary of line of credit loans if funds used for non-income producing purposes.
- If refinancing loan, new loan cannot be more than balance of old loan (especially if equity has increased).
- Be careful of loan redraw facilities if funds are not used for income-producing purposes.
- For Centrelink benefits (e.g. aged or disability pensions, FTB, seniors health care card etc) a negatively geared "tax loss" is ignored.
- If Discretionary Trust borrows funds for investment in shares and makes a loss, any franking credits on dividends received will be wasted.
- If Company borrows funds for investment purposes and the value of asset increases realising a capital gain on sale, there is no CGT discount applicable. Also the company can only distribute the profit as a dividend to shareholders.

Compliance Requirements

- Tax Return – Yearly.
- Financial Records – Income/investment and expenditure statements, loan statements.

General Comments
Negative gearing is an effective way towards wealth creation with tax benefits.