Why Negative Gearing Still Works For Investors

If you're an Australian property investor, or thinking about becoming one, you've probably heard of "negative gearing". This simply means that your taxable rental income is less than your deductible expenses. The advantage of negative gearing is that you can claim the rental loss against your other taxable income, generating tax savings. These tax savings effectively help fund the costs of investing, improving the scope of your investment options. If you've been paying attention to the negative talk around negative gearing, then you may think it is a strategy that no longer works. However, this is far from the truth.

Historically the tax deductibility of rental losses has been touted as an amazing advantage for property investors. Perhaps the exuberance has done a disservice by mystifying the appeal. Negative gearing has never been a magical benefit that enables high income entities to simply avoid taxes. It just helped reduce the net outflow required to fund the high cost of property investment, and it still does.

Property is typically a long-term, lower-risk, investment. When negatively geared, it tends to be a pricey venture to enter (hence mortgage costs), with decent rates of return at the end of the journey. That said, property investment is not for everyone. Some people prefer the quicker returns of say, the futures market. If your cash flow is low, then negative gearing may not be sustainable. As with all risks, it may take longer than expected to see a positive return, or you may lose out all together. Do your research, understand your risks, and decide what works for your situation. It will readily be clear that negative gearing still has a valuable place.

With roughly a third of Australia's population living in a rented property[1], there is a big market for investment properties. A massive advantage of negative gearing is that it makes property ownership a more attainable option for a wider range of investors. Accordingly, Australian property investors primarily comprise of a broad range of small scale individual investors with medium to high incomes[2].

Since there are so many small scale investors, if negative gearing no longer worked, many would lose their investment. Fortunately historical attempts to dissolve negative gearing have met the dead end that they deserve[3]. This helps alleviate any fears that negative gearing will suddenly be disbanded. Last year's Federal Budget did, however, modify the tax saving

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[1] Australian Bureau of Statistics (2017) Census of Population and Housing: Reflecting Australia - Stories from the Census, 2016.

[2] Berry, M (2010) Investment in Rental Housing in Australia: Small Landlords and Institutional Investors, Housing Studies, 15:5, 661-681, DOI: 10.1080/02673030050134547

Wargent, P (2016) Property Investment Ownership: Tax Data Reveals Interesting New Rental Market Trends,
propertyupdate.com.au/property-investment-ownership-tax-data-reveals-interesting-new-rental-market-trends/

[3] "Stop negative talk about negative gearing". *Kevin's Updates.*
https://realestatetalk.com.au/stop-negative-talk-about-negative-gearing-brian-white/

potential for individual investors, by removing two previously allowable deductions. These changes are law from the 2018 financial year and onwards. Arguably however, these restrictions are not unreasonable.

Firstly, travel costs are no longer deductible. If you rely on a real estate agent, this doesn't change anything. Investors living near self-managed properties may lose a small claim they were previous allowed. Individuals who were flying or driving thousands of kilometres to do repairs or inspections on their property, will now have to wear the full travel cost, or assess whether it is more beneficial to pay the deductible cost of hiring a local agent.

The other limit is that second hand assets, such as a stove that came with a property, and assets previously used for personal purposes, such as a stove you installed in a house while living in it before renting it out, can no longer be depreciated. To be clear, second hand assets acquired prior to the law change continue to be depreciable, as do brand new assets purchased, and capital works deductions. (If you're unsure what capital works deductions are, check with your tax agent, since this is essentially depreciation of construction costs, which can form a significant component of your annual expense claims). While this limitation may reduce the value of negative gearing for many new investors, it doesn't completely negate it.

With these new limitations impacting the value of negative gearing it is easier for shallow, sweeping statements to dismiss the value altogether. For example, many promoters pit negative gearing against the appeal of passive income being generated from a positively geared property. However both positive and negative gearing have value, and it is shortsighted to conclude that negative gearing has no place. Positively geared properties are fewer in supply, often in more remote locations, or may require a more substantial outlay from personal funds. Conversely, negatively geared properties are more likely to be located in desirable areas, where there are typically better rental occupancy and income rates, higher capital growth, and greater potential for renovations to generate substantial improvement in value. Of course, utilising a mortgage also gives investors the power of leverage.

Negative gearing can give you an edge that broadens your options through leverage. By using borrowed money to fund an investment that brings you tax savings, and grows in value, you are not only able to invest far earlier than if you had to save up for the investment, you are increasing your potential to grow your net worth and expand your investment portfolio. For cashed up individuals it can still be beneficial to use a mortgage, since this frees up your available cash for alternative pursuits, including personal endeavours that wouldn't generate the same tax advantage if they were funded via borrowings.

Finally, perhaps particularly for the lower-medium income earners, negative gearing can help you with your savings. Many people find it too easy to simply spend money when it's right in front of them. If your budget covers your personal and investment costs, then the tax refund at the end of the year works like a forced saving. The bulk cash payout can be used to save, reinvest, repay debt, or spend on a personal treat.

Negative gearing still works for property investors because it offers substantially the same advantages that it always has. Just keep in mind that it is typically part of a long term investment strategy. The intention is not to fork out $20,000 just to save $9,000 in tax. Tax deductibility simply helps offset the initial losses made while you're waiting for the big return, and gives you the power of leverage to grow your net worth. Do your research, be aware of your risks, and make smart decisions. When you do, negative gearing provides an advantageous, viable option.

TITLE TAG:
Negative gearing still works despite new tax limitations and criticism

META DESCRIPTION:
Understand why negative gearing still works as a valuable opportunity for investors, despite new tax law limitations and criticism. Negative gearing makes property investment more attainable using the power of leverage and utilising tax benefits to offset the cost.