

A photograph of a man and a woman sitting on a light-colored couch, looking at a laptop screen. The woman is on the left, wearing a light blue denim shirt, and the man is on the right, wearing a plaid shirt. The laptop is open in front of them, and the background is a blurred brick wall.

What is Negative Gearing?



Hywood Partners

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In many meetings with clients the idea of ‘negative gearing’ is often raised. We’d like to explain what negative gearing is, how it works, and the pros and cons of such a strategy.

Negative Gearing is borrowing money to invest in an income producing asset (usually property) with the income (rent) being less than the costs of owning the asset (interest is often the biggest expense). The difference (i.e. the loss) is then used to reduce the investor’s taxable income and thus reduce the tax payable.

Property is by far the most common asset used for negative gearing strategies but there’s nothing to stop someone negative gearing into other ‘income producing’ assets, such as shares.

By borrowing funds the investor is able to invest more which can magnify the gains should the assets value appreciate. However, should the reverse be true and the assets value falls, gearing magnifies these losses as well.

People in the higher marginal tax rates, i.e. taxable income over \$80,000 and especially those with taxable incomes over \$180,000 benefit the most from negative gearing as the loss is effectively subsidised by the Federal Government by either 39% for those with taxable incomes over \$80,000 and 49% for those lucky enough to have a taxable income over \$180,000 (including Medicare Levy and Temporary - Budget Repair Levy).

PROS

1. Allows a taxpayer to reduce his/her tax liability, as such the Federal Government is subsidising your investment.
2. Should the investment increase in value, by using borrowed funds (other people's money) the return to the investor is magnified.

CONS

1. Can often involve borrowing a significant amount of money, especially if purchasing a property. For example, the median house price in Perth for the March 2016 quarter was \$527,250.
2. The costs to get in and out can also be substantial. The Stamp Duty in WA on purchasing a property at that median price would be \$19,061 and when you want to sell the property, based on 2%, the real estate agent is going to charge around \$10,000 to sell it on your behalf.
3. In the case of property, the investment is very inflexible. Should something unforeseen occur, you can't sell part of the property to raise emergency funds.

Negative gearing has been a valid strategy and many people have done very well using it as a method of reducing their taxes and in the long term creating wealth.

However, given the levels of debt often involved negative gearing can result in the investor taking on levels of risk they are not aware of and possibly not prepared for.

Quality advice should ensure clients understand the risks they are entering into and possibly introduce strategies to mitigate, minimise, or possibly even eliminate some of the risks.

Work hard. Play hard. Plan hard.

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Disclaimer:

The information contained in this E-Book is general and factual information only and does not take into account the personal needs, goals and objectives of any person that reads it. We recommend you seek professional financial advice before implementing any financial strategy or financial investment.

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