XO ACCOUNTING

Rental Property Investment

- TAXATION & MANAGEMENT GUIDE

Introduction to this Guide

Our focus with this guide is to bring all the basic information into one place as an aid to potential and exisitng investment property owners. We want to offer it as a check to remind you of what you need to think about and make sure that you are;

- Structured correctly
- Maximising your tax deductions and handling depreciation costs to your advantage, and
- Managing your rental property for your benefit and that of your tenants

This guide is the starting point, we can then take your current position and review it and find the best structure for your rental property business, and meet your current tax obligations, so that you are property set-up for future gains on your investment.

First things first...

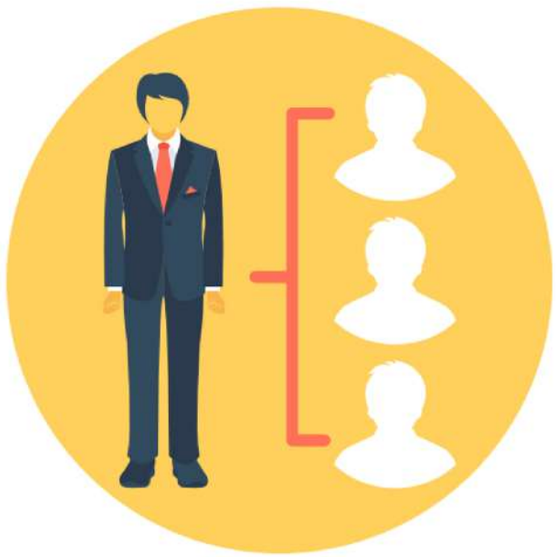
Structure

The best structure for your rental property investment.

Choosing your structure will affect your taxation position, your personal legal liability and the sustainability of your business. It can also ease the path for future property purchases to enlarge your portfolio - the ownership structure of your property affects your maximum return, so you want to get it right from the start. Also people have different lives and ambitions, so the right structure for one rental investor may not be right for another.

The main structures to manage a rental property business are:

1. Individuals
2. Company
3. Trust
4. Self Managed Super Fund (SMSF)



1. Individual

This is the easiest structure to set up, where an individual(s) owns the rental property and are:

- Personally responsible for any property debts or losses and...
- The entire taxable income of the property is the individuals taxable income.
- This structure makes for a limited ability to spread the income between family members and make tax savings,

2. Company

When a person or group decide to incorporate a company, A Standard Company is a legal entity seperate from its shareholders, where a rental property becomes an asset of the company. Any tax losses must be carried forward until they are used up by future profits and capital gains can only be distributed to shareholders tax-free once the company has been liquidated

3. Trust

Setting up a trust (often a Family Trust) can be a flexible way to distribute income and assets among various family members to provide some income tax savings. However there are some disadvanateges to this structure.

If a rental property is making a loss , from a tax perspective these losses cannot be passed on to individuals for tax purposes and can only be offset against other trust income and carried forward to be offset against future income, so a trust, to use rental losses to its best advantage.

Transferring a rental property to a trust is effectively a sale, so if the sale price exceeds the book value of the property, the ATO will want some of the claimed depreciaiton back.

If you wish to preserve an asset for future years, a trust provides the best structure for asset protection.
Annual accounts must be prepared and filed each year with the ATO.

4. SMSF

SMSF is usually the most tax effective way of owning a property in the long run. The members of the SMSF are the beneficial owners. SMSF assets are subject to Superannuation Industry Supervision Act 1993 (SIS).

SIS limits the use and access to all assets held by a SMSF. So members and related partners can not have the use of the property unless it is used solely in the running of their own business. The major tax advantage of a SMSF is its low tax rate of 15% if a property generates taxable income and no Capital Gains Tax (CGT) if you enter pension phase (usually after age 60).

The best place to start with deciding on the best structure for your rental business is to work out what you want to achieve from it and discuss this with your professional advisor, who can advise you accordingly.

Tax Deductions and Depreciation

Deductible Expenses

With rental property ownership comes the ability to claim expenses against your rental income - the list below covers the main costs of earning rental income, all costs for private use are excluded.

- Insurance and rates - including house and contents insurance, mortgage repayment insurance, income protection and landlord protection insurances and council rates.
- Interest - only deductible on money you have borrowed to buy your rental property (mortgages)
- Property Management Fees and Commission - any fes or commission paid to agents who collect your rent, maintain your rental or find tenants.
- Accountant's Fees - these can be claimed for the management of your accountants, preparation of tax returns and advice provided, but not the costs involved in setting up your rental property.

- Body Corporate - fees paid to a body corporate manager usually when the property is an apartment/townhouse.
- Repair and Maintenance Costs - you can claim the costs for any repairs to the property or general maintenance. If you do the work yourself, you can only claim for materials, not your time. There is a distinction between repairs and improvements - improvements cannot be claimed as an expense. As an example, a broken basin can be replaced in a bathroom as a repair, but a completely re-designed and re-fitted bathroom would more likely be considered a non-deductible capital improvement.
- Depreciation - can be claimed on your chattels - the normal aging of furniture and fittings that have been bought for your rental property.
- Building Depreciation - can claim up to 2.5% of contribution cost per annum up to 40 years.

Making the most of Interest Deductions

Listed above as a standard deduction, is intesrest on your mortgage or loan that relates to your rental property. As a general rule, no tax deduction is allowed for mortgage interest relating to your personal residence, but tax deductions are allowed for interest on rental properties, and you can structure your loan to maximise interest in relation to your personal residence.

There are some options with buying rental property in a company structure that can effectively transfer personal debt to tax deductible debt.

Speak to us about our Mortgage Reducer Product that maximises your interest deduction

Depreciation
- For Chattels

What does remain however, is the ability to claim depreciation on the chattels that exist in a property - this is a choice, you can claim it or elect not to claim it but you must stick with thar decision and cannot 'chop and change' in other years. To this end we would strongly recommend that you consider using an independent valuation completed by a registered valuer to establish a true value for chattels as a starting figure. (ATO will only accept a quality surveyors chattel valuation for this purpose). We strongly recommend BMT Quantity Surveyors.

To maximise the tax benefits, at the time of purchasing your rental property, you need to be able to accurately allocate the split between the land, building and chattels - so this is where your chattels valuation will be of most use rather than the 'normal' guessing by the buyer and seller. 'Chattels' can include a wide range of items, from water heaters through to satellite receiving dishes, fencing and clothesline.
A professional chattel valuation can make a significant difference to this allocation - they will consider chattels that buyers and sellers routinely overlook.

Organising Your Rental Property

Renting

Making the most of your investment depends on your circumstances, but the common approach is to find a tenant, collect their rent and achieve an income stream that will be sufficient to meet the expenses of the rental property and in time give you yield on your investment.

A rental property is not a passive investment and relies on your actions to make it work at an optimal level.

From setting the rent, advertising, interviewing, choosing a tenant through to ensuring that you do not discriminate and deciding on acceptable pets - there are many business decisions to make before your investment starts to work. In selecting a tenant, you are looking at establishing a relationship based on mutual trust and good faith - rather like an employment contract and there is an ethical and professional requirement to get this process right from the start.

Rental agreements, bond lodgements, refunds, transfers, automatic payment forms and direct debits are a few of the documents you need to get completed correctly before the tenancy begins.

Property Management

If running the business of a rental property is conflicting with your other activities there are a number of property management companies who will do this work for you. Their costs are tax deductible.

Matters to consider when choosing a property manager need to result in you feeling confident that your investment will be professionally managed.

Don’t forget that you are largely leaving the collection of you rent, the choosing of your tenants, the treatment of those tenants and the maintenance of your investment to another group of people. You need to be reassured that for the fee they charge, they are doing a job to the same high standard as you would yourself - as disputes and disagreements with property management companies are not covered by the Residential Tenancies Act.

Doing 'due dilligence' before selecting your property manager would be advisable as the cost is generally 7% - 10% of the rent, with additional fees added for work such as property inspections, advertising and marketing or credit check fees. The cost of a Property Manager is tax deductible for the rental property owner, so the figures may work in your favour if you choose your management company carefully.

Retaining Documents and Keeping the Books

As your rental property is your business, in order to maximise the tax benefits from your investment it is essential to retain and organise your records - with the advent of cloud-based technology, this has become an efficient and simple process to achieve.

If you discuss the use of accounting software with your advisor, you will benefit from the current advances in accounting efficiency.

Regardless of the system that is chosen there are essential documents and actions that need to be attended to for tax purposes:

- All invoices, statements, legal documents, rental agreements and loan statements must be retained
- Original purchase documents, loan contracts, settlement statements for five years after sale of property

These can be completed electronically, which makes the process of completing your tax obligations a seamless system between you and your advisor, so it will pay to discuss this at your set-up meeting for your rental property business.

Summary Charts

Set out below are summary charts that provide a reference for the tax treatment for common costs relating to rental property investment.

Expenditure	Analysis	Tax Treatment
Expenditure	**Analysis**	**Tax Treatment**
Purchase of rental property	Obtain a registered valuation to allocate land, rental building and chattels values to maximise depreciation.	Land - capitalise and do not depreciate. Building - capitalise and depreciate Chattels - capitalise and depreciate
Accounting fees for advice, managing your accounts and completion of tax returns.	Finance and Tax	Fully deductible expense.
Legal fees incurred in arranging a mortgage to finance the rental property; for preparing a tenancy agreement; for the sale or purchase of the property	Legal Fees	Not Deductible but added to the cost base of property
Cost of valuer to prepare valuation report.	Valuation fees	Fully deductible expense.
Expenditure on a rundown property to improve it substantially and make it fit for renting out.	May be treated as dilapidation or improvement expenses and therefore as part of the cost of the rental property.	Capitalise and do not depreciate.
Taking down a badly deteriorated wall and putting a conservatory in its place.	Improvements to rental property	Capitalise as part of building and do not depreciate
Bank administration fee for a mortgage.	Loan Fee	Fully deductible expense @ max. $300 p.a

Expenditure	Analysis	Tax Treatment
Mortgage principle payments.	Reduces mortgage balance.	NOT deductible.
Interest on rental property mortgage.	Interest	Fully deductible expense.
Rates on rental property.	Rates	Fully deductible expense.
Insurance on rental property.	Insurance	Fully deductible expense.
Mortgage repayment insurance for mortgage on rental property.	Insurance	Fully deductible expense.
Interest on money borrowed to acquire an asset apart from the rental property, with rental property being used as security for loan.	Drawings	Private expenditure, not deductible.
Agent's fee to collect the rent and maintain the property; commission paid to agent to find tenants for property.	Agent's fee and commission	Fully deductible expense.
Replace broken shower head. Plastering and painting crack in wall. Replacing a blown element in a hot water cylinder. Redecorating the property to return it to the state it was in when you purchased it for use as a rental property.	Repairs and Maintenance	Fully deductible expense.
Redecorating expenses or other maintenance, and property is therefore temporarily unavailable for letting.	Repair and Maintenance	Fully deductible expense.

Expenditure	Analysis	Tax Treatment
Using your motor vehicle to carry out a property inspection or to do some repairs on the property.	Motor vehicle expenses	If you use your own vehicle, you may be able to claim some vehicle running costs. There are two options for claiming your motor vehicle expenses; *use the IRD or AA mileage rates for up to 5,000km of rental activity trips: *claim a percentage of the running costs of your motor vehicle related to your rental activity, based on your log book: You will need to keep a logbook for three months every three years. Just record the business trips. You will need to also record the dates and reason for each trip in the logbook. You can use the difference between the odometer reading at the start and end of the three months to work out the percentage of vehicle expenses claimable.
Accounting fees for preparing rental income statements and for preparing tax returns.	Finance & Tax	Fully deductible expense.
Expenses incurred while property is empty. Rental property is available to be rented out.	Various expenses as detailed above.	You may be required to prove the property has been advertised as available for rent. In most cases these expenses will be fully deductible.

How XO Accounting Can Help You

Choosing the Right Property

At XO Financial Services, unlike almost ALL other financial advisers in Australia we offer Direct Property Investment Advice as part of your financial strategy. It is included in the Statement of Advice (SOA) so we are legally obligated to act in your best interest. Most financial advisers exclude property from your SOA thus do not have that same obligation.

Our advisors will help you to strategically build an investment property portfolio, tailored to your individual needs and circumstances, as well as helping you to tactically determine the right investment grade properties.

Finances

Unfortunately, most bank affiliated financial advisers and finance brokers will recommend their own products. This is a significant conflict of interest, thus ensuring you may not get what's in your best interest.

We have access to some of the best loans for property investors including our Mortgage Reducer product that maximises the interest deductibility through rebalancing the interest payments of their home loans and investment properties, potentially saving them $'000's of dollars in tax every year.

Tax and Accounting

XO Accounting have all the tools and expertise to ensure your tax position is maximised, no matter what structure you use to hold your property. Our team are able to identify every possible deduction you are entitled to claim whether it be your annual tax return or upon sale and calculating any possible capital gains tax.

Record Keeping and Goal Tracking

XO Accounting recently introduce My Prosperity an online program that our clients can use to

- Manage their Investment properties including recording property expenses and rent (Including and interface with your property manager ensuring your rent is paid correctly)
- Track all your (Including analysing all transactions and having up to date balances) including Bank Accounts, Loan Accounts and Credit Cards
- Know the current value of your Listed Australian Shares, Superannuation, Most managed funds, Property (Both your home and investment) and Motor Vehicles
- Set and track your personal financial goals such as Net Wealth, Savings and Debt Reduction
- Store all your important documents and receipts

Have a FREE 30 min online general meeting

GO TO OUR WEBSITE TO BOOK A MEETING

@ www.xoaccounting.com.au or call us on 1800 106 141