# Negative Gearing for Foreign Australian Property Investors

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Australia is one of a handful of countries which provides a favourable taxation treatment to investors in investment property. While in the US and Canada, there are limitations placed on negative gearing, in Australia, there are no restrictions on the ability of investors to negative geared their investment properties – be it on the income of the taxpayers, on the size of the losses nor the period over which the losses can be deducted. According to Australian Tax Office's (ATO) data, about 1.7 million property owners in Australia are utilising negative gearing.

## What is Negative Gearing?

According to ATO, negative gearing occurs when investors borrow money to make an investment, where the interest and allowable deductions exceed the investment income and can be claimed as a deduction against other types of income.

On the contrary, positive gearing occurs when the investment income exceeds the interest and allowable deductions.

## History of Negative Gearing

The Australian Government had introduced negative gearing as a form of tax benefit with the primary objective of increasing the pool of properties available for rent and to stimulate the economy through enhanced investment in building and properties. However during July 1985, former Treasurer Paul Keating quarantined the tax benefits of negative gearing in property investment. This prevented the investors from claiming the shortfall between rental income and rental expenses as eligible tax deduction and property investors had to carry forward the losses until the property was sold. This compelled investors to sell off their rental properties and resulting in lack of enthusiasm in buying rental properties. As a result, between 1985 and 1987 the rental market in Sydney and Perth has increased by 40% and 35% respectively.

Considering its adverse impact, Treasurer Keating had to restore the old rules in September 1987 and to allow negative gearing for property investors.

## How it affects Foreign Resident Property Investors

As a foreign resident for tax purpose in Australia, you will only be subjected to tax for Australian sourced income (section 6-5 of the Income Tax Assessment Act [ITAA] 1997) i.e. income generated that has a connection with Australia. All your other income derived from your home country or elsewhere will not be subjected to Australian tax.

Fortunately, having the same rights as a resident, as a foreign resident you can use negative gearing for your Australian investments. This means that you can offset your negative gearing against other Australian income including rental income from another Australian investment property.

**Example**
Mark, a foreign resident in Australia owns two investment properties in Melbourne. His first property earns a return of 6% per annum on his A$500,000 investment. His assessable income for the year ended 30 June 2013 is A$30,000 and total tax deductions are A$35,000. Therefore, he has negative geared his first property by A$5,000.

His second property earns a return of 5% per annum on his A$400,000 investment. His assessable income is A$20,000 and total tax deductions are A$15,000. In this situation, he has positive geared his second property by A$5,000.

As Mark is able to offset his negative gearing against other income, his taxable income for the year ended 30 June 2013 is A$0 and therefore he has no tax to pay.

## Conclusion

Foreign resident is entitled to negative gearing.

The famous Philanthropist Louis J. Glickman once remarked: "The best investment on earth is earth".
As seen above, using Negative Gearing, residential property investors can offset investment property losses against their other forms of income as a tax deduction, while foreign resident property investor, due to non-availability of adequate Australian Income, can carry forward their losses to subsequent years.

Thus for anyone thinking of entering the property investment market, negative gearing can be a tax efficient investment strategy. However negative gearing exposes an investor with the vulnerability to fluctuation in one's other income including salary, loss of a tenant or sudden spike in the interest rate. Hence the investor has to ensure that their foundation is not shaky through adequate planning before adopting negative gearing strategy.

With the right property, an investor can use negative gearing as an effective tax efficient strategy. As Benjamin Franklin once said: "An investment in knowledge always pays the best interest".

We would like to speak to you and assist if you have any questions or concerns. Contact us now for your **complimentary** and **no obligation** first meeting to discuss on negative gearing and how it can work for you.

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