What Name Should I Buy my Property In?

This is a common question from investors and even sometimes purchasers of their own home. There is no one size fits all. Considering the cost of changing the ownership it is well worth seeking professional advice before you sign the contract. Just to repeat, before you sign the contract with the real estate agent! The following is just to help you prepare for that discussion with your Accountant. There are many issues that will turn on your particular circumstances.

For example, a professional couple at risk of being sued may not want to hold their property in their personal names but they need to hold the home in at least one of their personal names to cover it with their main residence exemption. Otherwise, they will be paying tax on inflation, not just a risk but a certainty. Over 40 years that will feel nearly as bad as being sued because they probably won't have enough left after tax to buy another home.

In these circumstances it may be worth setting up a mortgage trust. Hold the property in their personal names but as security for borrowings from the mortgage trust that keeps the property so heavily mortgaged there is nothing for creditors to come after.

Obviously, if only one member of the couple has an at-risk occupation the property could be held solely in the name of the low-risk spouse. The property only needs to be in the name of one spouse to be fully covered by the couple's main residence exemption. Yes, you read that right, a couple only get one main residence between them.

It is not always about negative gearing and making capital gains in your retirement. Too many property investment strategies assume the investor is a high-income earner with around 20 years to retirement.

Consider a younger person who is very passionate about property. They already have their own home, taken advantage of all the first home owner's incentives and covered it with their main residence exemption. They are now looking to buy an investment property using the equity in their home as a deposit. The first thing I would say to them is; be very careful about liquidity. You can't sell off the bathroom if you need some quick cash. Nevertheless, at their young age the more money they can have working for them the better, so we don't want cash languishing in the bank. Consider a share portfolio. Then they would only have to sell off what they need and have their money in 24 hours. The share market may be scary with its fluctuations, have a look at the long term using Noel Whittaker's calculator https://www.noelwhittaker.com.au/resources/calculators/stock-market-calculator/

Now back to assuming we have a young person already utilising their main residence exemption, looking to buy an investment property. Is negative gearing really what they need right now? Consider that they maybe in the lowest tax bracket now, then they will be in for the rest of their life. Or maybe very soon they hope to stop work and travel or have children. These issues should all be taken into account in the type of property they decide to purchase. For example go for capital growth from old properties in areas where there is shortage of supply rather than cookie cutter new houses where there is plenty of land for the next subdivision but because the properties are new the building depreciation assists in negative gearing.

So, what name should a temporary low-income investor that has yet to find their life partner buy an investment property in? Always ask your Accountant. Do not accept off the shelf advice designed for people twice your age. You see it might be worth considering a discretionary trust. Sure, the losses are locked into the trust but they are also saved up rather than offset against your low income. This means they will be useful when your tax bracket increases and the property becomes positively geared or you sell it. A discretionary trust is also an excellent form of asset protection when you reach that high income high risk threshold. Further, a discretionary trust does not require you to name your spouse or children. They are simply named by their relationship to you, so it keeps all the doors open for future diversion of income.

Capital gains or losses and the profit or loss each year on a rental property are distributed according to the names on the title deed, except in the unusual case of a bare trust where the name on the deed is different from the beneficial owner of the house because the beneficial owner is under some form of legal disability.

If the ownership is as joint tenants, it is owned equally between the owners so the capital gains and rent are divided equally. If one of the joint tenants dies their share automatically becomes the property of the surviving joint tenants.

If a property is held as tenants in common the percentage of ownership can be set at any ratio but changing the ratio will be a CGT event and probably stamp duty payable. When a tenant in common dies their share of the property goes to their estate to be dealt with in accordance with their will.

It's an unfortunate reality that even if you make what appears to be the most appropriate decision at the time you buy the property, you can still be disadvantaged if your circumstances change. For example, a single income couple could buy a negatively geared property in the name of the breadwinner to save tax each year, but as time passes the property could become positively geared as rents increase or it could be sold for a hefty capital gain.

One of the problems with property is that all the capital gains on sale are lumped into one year – you can't sell part of a property as you can do with shares. Having all that capital gain in one year going to one person could mean it is taxed at the maximum rate. Multiple owners can dilute this affect.

A couple have achieved the best outcome between them if they are in the same tax bracket, it is not necessary to have the same income. From 1st July 2024 the tax bracket for income over $45,000 up to $200,000 will be 30%. So, in most households with a high and a low income earner they may still be in the same tax bracket. The tax outcome is the same whether the property is making a profit or loss but when it is sold the capital gain can be split over two tax brackets and possibly offset by two lots of superannuation contributions.

Of course, if the property is owned by a discretionary trust then you get to choose each year how the profit is distributed but discretionary trusts cannot distribute losses. With a negatively geared property the losses are locked in the trust and saved up until they can be offset against profits. If you are running a business in another trust you could consider transferring some of the business profits into the property trust to soak up the losses. Having a business in a trust makes holding an investment property in a related trust a very attractive option as the losses can be utilised and profits and capital gains can be distributed differently each year to suit the circumstances. The downside is an extra tax return and financial statements as well not being able to cover the property with your main residence exemption if you ever live there. Discretionary trusts offer superior asset protection over holding a property in your personal names. If you have a profitable business in another discretionary trust then holding a negative geared investment property in a discretionary trust is probably the best strategy. Just make sure it is a separate trust. You don't want your business creditors to get access to your investment properties.

Holding a property in a company will have all the additional running costs, with losses locked in and with limited flexibility because the profit can only go to shareholders. A company would allow you to take advantage of the 30% tax rate, but you need to top this up to your personal rate or pay the company interest if you want to personally use the money held in the company. A company does not get the 50% CGT discount when you sell the property and doesn't really give you effective asset protection because you still own the shares so your creditors can seize them and take control of the company and its assets.

A unit or fixed trust has no discretionary powers to change how the profit or capital gain is distributed but in the case of a capital gain at least it qualifies for the 50% CGT discount. Asset protection is not effective because you still own the units. Running costs are similar to a company. Losses can be offset in your personal tax return if you borrow to buy the units. Nevertheless, all this does is put you into a similar situation as owning the property in your own name, with additional running costs, without the benefit of being able to cover it with your main residence exemption if you are living there.

A hybrid trust claims to give you the flexibility of distributions that a discretionary trust offers while allowing you to borrow to buy the units so being able to negative gear in your personal tax return. The bottom line is the ATO has several rulings stating this will not work in all the differing ways that it has been tried. There is also the principle in Fletchers case and TR 95/33 https://www.ato.gov.au/law/view/pdf/pbr/tr1995-033.pdf That if you are not going to receive a profit or gain from the investment then you are not entitled to negative gear the property. That is, you will only be entitled to a tax deduction for expenses up to the amount of income received.

Not only don't hybrids work but they are very costly to get out of. The ATO will consider the trust a discretionary trust so you can't offset the losses and if you borrowed to buy units you will not be entitled to a tax deduction for the interest. Ultimately you are going to have to incur the cost including stamp duty, of completely unwinding the arrangement or pay tax on the net rental income without being able to deduct any interest expense.

Self Managed Superannuation Funds (SMSFs) offer the best tax outcome in most cases and excellent asset protection. The major benefit of holding assets in the name of an SMSF is the low rates of tax paid by the fund and if it eventually becomes an allocated pension fund, it will pay no tax at all. Best of all, once you reach 60 all withdrawals from that fund are taxfree as well. The big drawback is that you can't access money in super until you are 60. However, your fund could buy and sell assets if you felt that was appropriate but the proceeds must still stay within the fund.

Super funds offer a high degree of asset protection, because creditors cannot access your superannuation unless you made unusually high contributions soon before becoming bankrupt or insolvent.

Negative gearing can be simulated by making a tax-deductible superannuation contribution to offset the property loss, assuming this does not exceed your non concessional cap.

It is against the SMSF rules to ever live in the property and that includes your associates. Borrowing is difficult and more expensive, and you can only borrow against the property when you buy it so there is no opportunity to leverage ongoing capital growth.

There are arrangements where a SMSF can purchase a property with a member or through a company where it only owns some of the shares and slowly purchases the rest. In these arrangements the property cannot be used as security for a loan. Further, each time the SMSF purchases more shares it will trigger CGT for the seller (probably you) of those shares. These strategies are complex and require considerable planning but have their place especially when you have enough cash or other assets to keep the bank happy.

Generally, the cost of running a SMSF for the sake of just one property does not stack up. Due to the lack of leverage they are not suitable for people starting out in the property market but well worth considering when you have reached the stage that, if you borrowed as much money that the banks are willing to lend based on your assets, you just couldn't sleep at night. That is when you know you are ready to lose the leverage of not being able to borrow against your equity in return for great tax benefits and asset protection.

It is important to note that borrowing to buy a property in anything other than your own name becomes more difficult and expensive.

So which is the best for you? Get professional advice on this before you sign anything and dust off your crystal ball. In the vast majority of cases properties are bought in individual names but it does not mean that is right for you.