Compiled by Stuart Wemyss

WATCH OUT FOR LAND TAX. It's coming to get you!

Not many property investors know a lot about land tax. It's not surprising, as the vast majority of property investors won't pay for land tax until a number of years after they buy an investment property. However, it's an insidious tax in that it sneaks up on you and is at its worst (most costly) when you least need it – in retirement. The decisions about property investments you make today will determine how much land tax you'll pay in the future. It's definitely something you need to know more about.

An investor who acquires, for example a $1.5 million poorly structured property portfolio (three properties) could end up with a land tax bill that reduces the property portfolios net income by 50 per cent in 20 years time. Let me explain. I have forecast that this property portfolio will produce around $99k of net pre-tax income (rental less expenses such as interest but before land tax) in today's dollars in 20 years time. The land tax bill will be around $48k thereby reducing the investors net pre-tax income to just $51k (in today's dollars)! That's a lot to give to the State government when you are retired!

Lack of planning could see you suffer in retirement and perhaps regret you didn't make more informed decisions when you purchased an investment property.

WHAT IS LAND TAX?

Land tax was introduced in Australia in the late 1800s to early 1900s with South Australia being the first State to introduce the tax in 1884. The tax was introduced as a means of taxing the wealthy (and to attempt to break up the big estates) and raising revenue as revenue received from the sale of Crown land slowed. Each State introduced its own land tax regime (for a short time there was also a Federal regime).

Land tax is generally levied on the value of unimproved land holdings held as at 31 December each year. General exemptions exist in many States such as the exemption for your primary place of residence, land used for primary production and so on.

Revenue offices in each State generally use the councils' 'site value' or 'capital unimproved value', which is normally recorded on a property's council rates notice to determine the 'taxable land value' of each property.

HOW IS IT CHARGED?

Land tax liability is normally charged as a percentage of the taxable land value. Some States have a flat rate and others have a sliding scale. Most States have a 'tax-free threshold' so that land tax isn't payable until your land value exceeds the threshold. Most States charge different rates of land tax to trusts compared to individuals. The table at the bottom of this page sets out an overview of land tax for the major States and indicates how much land tax would be payable on $1m of land (held in one individuals name).

WHY MOST INVESTORS WILL PAY THROUGH THE NOSE!

All in one name

Holding all investment properties in one person's individual name is a nightmare for land tax. Each individual has a tax-free threshold, so spreading ownership will often reduce land tax.

Take a recent analysis we undertook for some clients. The clients are a married couple. Both are employees with the husband earning about $190k and the wife earning $80k. An analysis determined the financial implications of one or both (in various percentages) owning a new investment property. They already owned other property. Intuitively, you might think that it would be better to put the property 100 per cent in the husband's name because he would get the highest income tax benefit. You would be totally correct. However, we found that this created additional land tax liabilities, which fully offset any income tax benefits gained from the property, being 100 per cent in the highest earner's name. This is an excellent real-life example of how some people structure their investments to maximize income tax benefits today, but it will create major land tax liabilities later on.

State	Individual names	Tax on $1m of land (individual)	Property held in a trust
NSW	Flat rate of 1.6% for land value above $368k	$10,212	Flat rate of 1.6% for land value above $1 (no threshold)
VIC	Sliding scale of rates for values above $250k	$2,975	Sliding scale of rates for values above $25k
QLD	Sliding scale of rates for values above $600k	$4,500	Sliding scale of rates for values above $350k
SA	Sliding scale of rates for values above $110k	$11,420	Same as individuals
WA	Sliding scale of rates for values above $300k	$2,700	Same as individuals

All in one State

As discussed above, each State has its own land tax regime. Most States offer investors a tax-free land tax threshold, which means investors might be able to own one investment property in each State before incurring a land tax liability (or at least not much of a liability). Concentrating your investment properties in one State means you are not taking advantage of the tax-free thresholds other States are offering you.

My initial example in the opening paragraphs involved an investor who owned three investment properties (with a land tax bill of $48k in 20 years). These properties were assumed to all be in NSW. However, if we spread the holding over NSW, Victoria and Queensland (one property in each State), I project the land tax bill would reduce from $48k to $22k in today's dollars – that's less than half! In addition to this, the investor will benefit from some geographical diversification which may smooth investment returns and provide additional benefits. Investing outside your home State has great benefits. This in itself is a compelling reason to develop a smart investment strategy – I'm sure you agree.

No strategy

There are a number of things that need to be considered when developing an investment property strategy. These include market aspects – what's available to buy, purchasing power and likely investment returns; and your own investment requirements, such as income tax benefits, asset protection, future changes in income, exit or retirement strategy and of course land tax. The benefit of developing a long-term investment strategy is that you can weigh all these things up and spread your risk at a portfolio level.

For example, if you determine that you want to hold two investment properties: an apartment and a two or three bedroom house, then it might make sense to hold the house in Victoria (one of the cheapest land tax States) and the apartment in say Queensland (as an apartment is likely to have a lower implied land value).

In another example, assuming your strategy is to hold one property in a personal name and one in a trust, it would be worth considering holding the personal name property in Victoria and the trust property in Western Australia (assuming both offer equally good investments). It is this type of strategic planning that can allow you to plan ahead for all considerations – land tax being one of them. Instead, most people invest in an ad-hoc manner and end up with a patchwork property portfolio that ends up being very tax inefficient.

INVESTMENT STRATEGIES CANNOT BE TAX-BASED

Of course, we cannot develop an investment strategy centred on minimizing land tax. Investment strategies that are highly sensitive to tax legislation are not very valuable because changes in legislation can render strategies worthless. I believe that investment strategies should be developed according to sound, long-term investment fundamentals. Of course, you need to have regard to tax and other issues. However, strategies shouldn't be totally dependent on certain tax outcomes. There are many different considerations when developing an investment strategy and land tax is only one.

Many NSW-based investors may read this article and think "the next investment property I buy will be in Melbourne because the level of land tax in NSW is crippling". That might be a very wise strategy. However, the decision shouldn't be made solely on land tax considerations. Investing in Melbourne is often a sound decision, as it's an established market that provides solid long-term returns. For this reason, diversifying and investing in Melbourne makes good sense and the lower land tax is a great side benefit. However, if after a few years, the Victorian government decided to increase land tax to the same level as NSW (they better not!), the decision to invest in Melbourne is still appropriate for the non-tax based reasons previously mentioned. In summary, investment strategies shouldn't be too sensitive to changes in legislation.

WHAT YOU NEED TO DO NOW

If you are an existing property investor, you need to consider how your investing decisions will impact your land tax liabilities in the future. That is, you need to project forward your land tax liability in comparison to your property's net income. You'll be able to take this analysis into account when making future investment decisions.

If you are new to property investing and haven't made a start yet, you are in a good position to make astute planning decisions. This article should have demonstrated the multitude of considerations that need to be addressed when developing a property investment strategy. Forward planning can save many thousands of dollars!

My latest book (The Property Puzzle) takes readers through a simple seven step process to developing their own investment property strategy. Of course, I highly recommend it! The Property Puzzle is a good start for investors to at least gain an appreciation for the process involved in developing a strategy and what factors need to be considered. Of course, there is no substitute for tailored professional advice. Therefore, speak to an experienced financial planner or accountant that is capable of developing an astute property investment strategy so that you'll be on the front foot and ensure that these tax (and wealth) planning issues are addressed now rather than risking nasty surprises sometime in the future.

Stuart Wemyss is a director of financial advisory firm ProSolution Private Clients. Stuart and his team have many years experience providing financial and mortgage advice to dentists. Contact on 1300 880 224 or www.prosolution.com.au