
Negative Gearing - Quarantined losses and recoupment

Below is an example based on the EM of how the quarantining rules apply.

Tyson owns four residential dwellings which he rents out to derive rental income. Residential Dwellings A and B were acquired in 2025 and are not subject to the quarantining rules. Residential Dwellings C and D are subject to the quarantining rules.

Treatment in 2027-28 income year

The net income from residential dwellings for the 2027-28 income year are as follows:

Property	Net rental income/loss in 2027-28 (\$) after offsetting deduction
Residential Dwelling A (negative gearing applies)	3,000
Residential Dwelling B (negative gearing applies)	2,000
Residential Dwelling C (quarantined)	5,000
Residential Dwelling D (quarantined)	(15,000)

Determine any net income amount, disregarding exceptions from the general rule

Dwellings A and B given they relate to using or holding residential dwellings covered by the relevant exceptions can be disregarded.

Dwellings C and D need to be considered to determine whether there is an excess amount - there is an initial excess amount of \$10,000.

Determine whether the net income amount can be reduced

Dwellings A and B have net income of \$5,000. The initial excess amount of \$10,000 can be applied against this net income leaving a quarantined amount (ie non deductible amount) of \$5,000 for the 2027-28 income year.

Apply quarantined amounts against any capital gains from residential dwellings

There are no capital gains for the current income year and therefore the remaining quarantined loss of \$5,000 as an amount relating to using or holding residential dwellings as residential accommodation in the next income year (2028-29).

In the following year Dwelling B is sold generating a capital gain of \$20,000. The net income and capital gains from each residential dwelling is as follows:

Property	Net rental income in 2028-29 (\$)	Capital gain in 2028-29 (\$)
Residential Dwelling A (negative gearing applies)	5,000	
Residential Dwelling B (negative gearing applies)	(1,000)	20,000
Residential Dwelling C (quarantined)	8,000	
Residential Dwelling D (quarantined)	(10,000)	
Quarantined loss carried forward from previous income year	(5,000)	

The process is repeated to identify net income from residential properties.

Dwellings C and D as well as the carried forward loss from the 2027-28 income year are considered in determining if there is an excess amount. This is \$7,000 (being \$8,000-\$10,000-\$5,000).

Application against residential income

Despite Dwelling B having a rental loss of \$1,000, the total amount from Dwellings A and B, is net income of \$4,000. The initial excess of \$7,000 is reduced by \$4,000, leaving a quarantined amount of \$3,000. This quarantined amount is not deductible for income purposes the 2028-29 income year.

Application against any capital gains from residential dwellings

The capital gain of \$20,000 related to residential dwellings and therefore the \$3,000 can be applied to reduce the capital gain to \$17,000.

As can be seen by the above integrated example:

- > Where a taxpayer has quarantined losses that cannot be offset in a particular year, the losses are carried forward and can be offset against future income or gains made on *residential property*. As such, if a taxpayer has a clear plan to have net residential income then the losses can be recouped and the impact is timing only.
- > Prior year quarantined losses can be against residential rental income or capital gains. It does not need to be a capital gain or rental income from that particular property for the offset to be available.

The methodology within the legislation appears to result in an automatic offsetting where residential capital gains are made and there are quarantined losses. This means taxpayers cannot retain the not deductible losses for use against income. The commercial impact of the offsetting may be watered down where the losses are applied against gains rather than income.

Where a net loss that has not been able to be recouped and a taxpayer has disposed of all residential properties, then the quarantined losses would appear to be carried forward but unable to be utilised.

As always please reach out to your Engagement Partner to discuss how these changes will affect your individual circumstances.