Chapter 9

Commonwealth taxation settings

9.1 A major focus of this inquiry was the relationship between Commonwealth taxation settings and housing affordability.

9.2 Investors in real estate, like investors in other asset classes, are able to deduct losses from their investment, including interest paid on borrowings, against other assessable personal income. This arrangement is commonly known as 'negative gearing'. Again, like investors in other asset classes, property investors are also generally able to claim a 50 per cent discount on any realised capital gain on an investment property, so long as that property has been held for more than 12 months.

9.3 This chapter examines the various arguments made by witnesses regarding the effect on housing affordability of negative gearing arrangements and the capital gains tax (CGT) discount, or indeed the two taken together. Broadly speaking, critics of negative gearing and the CGT discount told the committee that current settings distorted demand and had an inflationary impact on purchase affordability. In contrast, other witnesses contended that the existing tax treatment of investor housing was consistent with the tax treatment of other asset classes, and moreover served to stimulate housing supply and contain rental prices. After canvassing these different arguments, this chapter outlines options for reform that might be investigated be the government.

9.4 Although not attracting as much attention as the tax treatment of the investor housing, some submitters focused on the exemption of owner-occupied housing from CGT. The CGT exemption, these witnesses argued, encouraged Australians to 'overinvest' in their housing, placing further upward pressure on prices, thus favouring existing home owners at the expense of would-be first home buyers. This chapter considers these arguments.

The tax treatment of investor housing

Understanding negative gearing and the CGT discount

9.5 In Australian tax law, investors have a right to offset non-capital losses from an income producing asset against their personal income, and can thereby reduce the overall amount of personal income tax payable. 'Negative gearing' is commonly taken to refer to the ability of landlords to deduct losses from mortgage-financed rental property, including interest paid on borrowings to acquire the property, from their

overall assessable income (including labour income).[1] It is important to note, however, that other assets, such as shares, are subject to the same tax treatment. The ability to negatively gear a residential investment property is not, in other words, a housing-specific exception to or departure from the broader Australian tax law, even if it is often perceived as such.

9.6 Of course, even for income earners in the higher marginal tax brackets, discounted losses are still losses. However, property investors generally pursue a negative gearing strategy in the expectation that a property's capital appreciation will more than make up for the losses they incur from holding the property. While capital gains are subject to taxation (except for gains on assets acquired prior to the introduction of CGT in September 1985), this tax is only payable when a capital gain is realised—for instance, when an asset, such as an investment property, is sold. And whereas capital gains are taxed at the same rate as a taxpayer's other income, a CGT discount, which reduces the taxable gain by 50 per cent, applies for an asset held for more than 12 months. In this sense, an investor may pursue a negative gearing strategy with a view to not only deferring their tax liability, but indeed permanently reducing it by, in effect, converting income gains into discounted capital gains.

9.7 Prior to 1999, capital gains were adjusted for inflation then taxed at the taxpayer's full marginal rate. Since 1999, CGT has been levied on nominal capital gains, with individuals and trusts (but not companies) eligible for the aforementioned 50 per cent discount.[2] The changes to the CGT reforms, according to the 1999 Review of Business Taxation ('the Ralph Report') in which they were proposed, were intended to 'increase the international competitiveness of Australian business and to encourage greater investment by Australians'.[3]

9.8 According to Mr Eslake, whatever the original intent the combined effect of the 1999 CGT changes and already extant negative gearing arrangements has been to create a vehicle for permanently reducing, rather than simply deferring, personal income tax liability.[4]

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1 As the ATO puts it, a 'rental property is negatively geared if it is purchased with the assistance of borrowed funds and the net rental income, after deducting other expenses, is less than the interest on borrowings'. ATO, 'Expenses you can deduct in the income year incurred', https://www.ato.gov.au/General/Property/Residential-rental-properties/Expenses-you-can-claim/Expenses-you-can-deduct-in-the-income-year-incurred/. 'Negative gearing' is taken in this chapter to refer to when taxpayers use losses from a negatively geared asset to reduce their overall assessable income.

2 For assets acquired before the new arrangements were introduced in September 1999, investors can calculate their capital gains liability using either the old indexation method or the current CGT discount method.

3 Review of Business Taxation, John Ralph AO (Chair), *A Tax System Redesigned: More Certain, Equitable and Durable* (Canberra 1999), p. 14.

4 Mr Saul Eslake, *Submission 2*, p. 10.

9.9 Other witnesses also drew the committee's attention to the asymmetric treatment of expenses and capital gains for housing investors, and the incentive this creates to invest in housing as a means of minimising tax liability. As ACOSS explained:

> While deductions for investment expenses are a well-established and legitimate feature of the income tax system, deductions for 'negatively geared' investments in assets that yield capital gains (including property, shares and collectables) are not properly matched (in timing or in value) with the related income stream. Taxpayers receive immediate deductions at their current marginal tax rate against future income that mainly takes the form of capital gains.[5]

9.10 Mr Eslake suggested that the increase in landlords claiming losses since 1999 underlined the growth in popularity of negative gearing as a tax strategy since the abovementioned changes to the CGT regime:

> In 1998–99, when capital gains were last taxed at the same rate as other types of income (less an allowance for inflation), Australia had 1.3 million tax-paying landlords who in total made a taxable profit of almost $700 [million]. By 2010–11, the latest year for which statistics are presently available, the number of tax-paying landlords had risen to over 1.8 [million] (or 14% of the total number of individual taxpayers), but they collectively lost more than $7.8 [billion], largely because the amount they paid out in interest rose more than fourfold (from just over $5 [billion] to almost $23 [billion] over this period), while the amount they collected in rent 'only' slightly less than trebled (from $11 [billion] to $30 [billion]), as did other (non-interest) expenses.[6]

9.11 The Henry Review observed that around 70 per cent of property investors in 2006–07 were negatively geared, up from 58 per cent in 2001–02.[7] AHURI also highlighted the popularity of negative gearing. In its submission, it pointed to figures from the ATO showing two-thirds of individuals deriving rent had a net rental loss from their property.[8]

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5 Australian Council of Social Service, *Submission 108*, pp. 3–4. Also see City Futures Research Centre, UNSW, *Submission 152*, p. 11.

6 Mr Saul Eslake, *Submission 2*, p. 10. According to AHURI sponsored research, the 50 per cent CGT discount will not always result in a lower capital gains tax liability for property investors than the pre-1999 application of CGT on real capital gains. This research suggests if 'house prices appreciate at less than twice the rate of inflation investors have lower after-tax returns under current than pre-1999 capital gains tax arrangements. While many if not most landlords will end up paying more capital gains tax under current arrangements, the real issue for many is the failure to tax real rather than nominal gains.' Gavin Wood, Rachel Ong and Clinton McMurray, 'The impacts of the Henry Review recommendations on the private rental market: Savings income discount and rent assistance,' *AHURI Final Report No. 175* (September 2011), pp. 3–4.

7 Treasury, *Australia's Future Tax System Review final report* (Canberra 2010), pp. 69–70.

8 Australian Housing and Urban Research Institute, *Submission 93*, p. 5.

9.12 Other AHURI sponsored research, however, has suggested that this figure may be significantly overstated for a range of reasons, and estimated that the proportion of residential landlords claiming rental losses might only be one-third.[9] The Australia Institute, while concerned at the prevalence of negative gearing, conceded that in a low interest environment the proportion of landlords claiming overall losses had declined.[10]

The Henry Review and the tax treatment of investment housing

9.13 It is worth noting at this juncture that the Henry Review included recommendations directed toward providing for a more consistent tax treatment of gains and losses from savings. The review found that the inconsistent treatment of household savings led to significant arbitrage opportunities:

> The different treatment of capital gains as against other savings income and related expenses is an important driver of these opportunities. This creates significant distortions in how rental properties, in particular, are financed and for the rental property market.[11]

9.14 To this end, the review recommended applying a 40 per cent discount to most interest income, net residential rental property income, capital gains and certain interest expenses (recommendation 14). In addition to allowing for a 40 per cent discount on (among other things) rental income, this would also mean that only 40 per cent of interest (and other expenses) could be claimed as deductions, and the current 50 per cent capital gains discount would be reduced to a 40 per cent discount. The Henry Review explained how these changes were expected to impact investment in housing:

> The current personal income tax system favourably treats capital gains and amplifies this benefit when investments are geared. By discounting net rental income at the same rate as capital gains, the tax treatment of investor housing will be less responsive to gearing levels and capital gains, creating a more neutral treatment of different forms of saving…
>
> The proposed reforms would reduce the bias in favour of the capital gains generated in rental properties by treating it more neutrally compared to rental yield. Over the long term, this is likely to change investor demand toward housing with higher rental yields and longer investment horizons. This may also result in a more stable housing market, as the current incentive for investors to chase large capital gains in housing would be reduced.[12]

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9 Gavin Wood, Rachel Ong and Clinton McMurray, 'The impacts of the Henry Review recommendations on the private rental market: Savings income discount and rent assistance,' *AHURI Final Report No. 175* (September 2011), pp. 15–16.

10 Ms Molly Johnson, Researcher, The Australia Institute, *Proof Committee Hansard*, 30 July 2014, p. 63.

11 Treasury, *Australia's Future Tax System Review final report* (Canberra 2010), p. 70.

12 Treasury, *Australia's Future Tax System Review final report* (Canberra 2010), pp. 417–18.

9.15 As Professor Yates pointed out, the tax treatment of investor housing was recognised in the Henry Review as 'amongst the greatest tax-induced biases to the savings choices of households'.[13] However, the Henry Review acknowledged that its recommended reforms could have an adverse short-term impact on the level of investment in housing in Australia. As such, it recommended that the reforms as they related to investor housing should only be implemented after the delivery of separate reforms relating to the supply of housing and the provision of housing assistance.[14]

9.16 Regardless, on release of the report the then government announced that it would not implement certain recommendations in the report 'at any stage', including recommendation 14. The government further announced that it would not consider reducing the CGT discount or applying a discount to negative gearing deductions.[15]

Negative gearing and purchase affordability

9.17 Using the 2010–11 losses declared, Mr Eslake estimated a cost to revenue from negative gearing of $5 billion; this was, he contended, a 'pretty large subsidy from people who are working and saving to people who are borrowing and speculating'. More than that, he continued:

> …it's hard to think of any worthwhile public policy purpose which is served by it. It certainly does nothing to increase the supply of housing, since the vast majority of landlords buy established properties: 92% of all borrowing by residential property investors over the past decade has been for the purchase of established dwellings, as against about 72% of all borrowing by owner-occupiers.
>
> Precisely for that reason, the availability of 'negative gearing' contributes to upward pressure on the prices of established dwellings, and thus diminishes housing affordability for would-be home buyers.[16]

9.18 Making a similar point, ACOSS submitted that not only did the benefits of negative gearing skew heavily toward higher income earners, but that it served to inflate housing costs and fuel 'speculative booms in the housing market'. This, ACOSS suggested, was a function of the fact that 90 per cent of investment in negatively geared housing stock applies to existing properties.[17]

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13 Honorary Associate Professor Judith Yates, University of Sydney, *Submission 53*, p. 6.

14 Treasury, *Australia's Future Tax System Review final report* (Canberra 2010), pp. 71, 418.

15 The Hon Wayne Swan MP, Deputy Prime Minister and Treasurer, and the Hon Kevin Rudd MP, Prime Minister, joint media release, 'Stronger, Fairer, Simpler: A Tax Plan for Our Future', 2 May 2010, http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2010/028.htm&pageID=003&min=wms&Year.

16 Mr Saul Eslake, *Submission 2*, p. 10.

17 Australian Council of Social Service, *Submission 108*, pp. 3–4.

9.19 Referring to the tax treatment of investor housing (and owner-occupied housing, as discussed later in this chapter), the CFRC also argued that tax settings such as negative gearing lowered the cost of housing for investors. This in turn reinforced:

> …factors that add to housing demand and compound dwelling price pressures in the presence of supply inelasticities. Given their typically pro-cyclical effect they enhance rather than counteract market volatility and can lead to lower rates of growth.[18]

9.20 Referring to the interaction between negative gearing and CGT arrangements, the Executive Officer of National Shelter, Mr Adrian Pisarski, told the committee that these tax arrangements served to inflate demand in a system with inadequate supply. In this sense, the current taxation treatment of investor housing reinforced the barriers to market entry for would-be homebuyers:

> We have a well-documented undersupply of housing overall and an even larger documented undersupply of affordable housing. Lots of people want to get into home ownership in Australia but cannot afford to, and they are being out-competed by people who have a pocketful of tax incentives. You cannot create a properly effective, equal, free market if you distort it in such ways. We have these massive distortions that really advantage investors over people who want to purchase to occupy a property.[19]

9.21 Likewise, the Australia Institute argued that the taxation treatment of investor housing favoured property investors at the direct expense of people looking to purchase their first home:

> High income households are particularly favoured as they have the financial capacity to purchase property and a larger taxable income to deduct losses from. Through providing such generous tax benefits government policy has increased the demand for investment housing. First home owners, who often have less financial capacity, must now compete against investors for properties. These tax concessions are inequitable and further reinforce the intergenerational and income gap between home owners and first home buyers or renters.[20]

9.22 Other witnesses, including NT Shelter, Uniting Communities, Tenants Union of Victoria and Youth Action NSW also argued that the current taxation treatment of

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18 City Futures Research Centre, UNSW, *Submission 152*, p. 5.

19 Mr Adrian Pisarski, Executive Officer, National Shelter, *Proof Committee Hansard*, 10 September 2014, p. 34.

20 The Australia Institute, *Submission 92*, p. 8. Also see Mr David Baker, Director of Research, The Australia Institute, *Proof Committee Hansard*, 30 July 2014, p. 62.

investor housing created speculative demand, forcing prices higher and making it more difficult for first home buyers to buy a home at a price they could afford.[21]

9.23 In contrast, the REIA told the committee that it was a strong proponent of negative gearing because it adds to housing supply. Given negative gearing stimulated housing supply, the REIA argued, it was questionable whether it did, in fact, add to the cost of housing.[22] The HIA made a similar argument, writing that negative gearing was being blamed for distortions in the housing market that were in fact caused by supply constraints:

> Under current policy settings as they apply to Australia's housing industry, there are a number of distortions to the housing market which are causing an undersupply of housing and placing an undue upward pressure on rents. Negative gearing does not fall into this category.
>
> Independent economic modelling commissioned by HIA finds that reducing negative gearing concessions in the current housing policy environment would exacerbate existing distortions and reduce housing affordability.[23]

9.24 Treasury was asked by the committee to comment on a just-released Moody's report suggesting the existence of negative gearing adds about 9 per cent, or $44,000, to the cost of an average home in markets with high incomes. Mr Rob Heferen, Executive Director of Treasury's Revenue Group, indicated that he was not yet familiar with the report. Nonetheless, Mr Heferen explained why such findings needed to be treated with a degree of caution:

> [O]ften when these exercises are done they are done in an 'all other things being equal' kind of scenario. You limit interest deductions on investor properties to rental income. The negative gearing that comes from those interest deductions can be used to offset against other income. So, if you limit it to rental income, what is the change in the return that the investor gets and then taking that away? Often what those sorts of exercises do not do—and it is no surprise they do not do it, because it is extraordinarily complex—is to work out, if that money goes away, where it will then be invested and what is then the effect on the macro-economy. So that feedback loop that goes into more of a general equilibrium kind of thinking is something that is extraordinarily difficult. Often when it is small amounts of money it is largely irrelevant, but I suspect that, once it gets up into several billions of dollars, that is the kind of time when those secondary effects or the feedback effects become more important. That kind of modelling capacity is very unusual. It is quite rare. Certainly we in the

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21 NT Shelter, *Submission 118*, p. 5; Mr Simon Scrapel, Chief Executive, Uniting Communities, *Proof Committee Hansard*, 28 July 2014, p. 32; Mr Mark O'Brien, Chief Executive Officer, Tenants Union of Victoria, *Proof Committee Hansard*, 9 September 2014, p. 48; Youth Action NSW, *Submission 51*, pp. 58–68.

22 Mr Jock Kreital, Manager, Policy, Real Estate Institute of Australia, *Proof Committee Hansard*, 30 July 2014, p. 75.

23 Housing Industry Association, *Submission 178*, p. 8.

> Treasury attempt to get and maintain some expertise in that, but it also becomes very assumption driven. If the return is not there for an investor, where would they put that dollar?[24]

Negative gearing and rental affordability

9.25 In 1985, the Australian Government enacted legislation that 'quarantined' losses made from owning rental properties, so that losses from rental properties could only be deducted from rental income. In contrast to the arrangements which prevail today, during the quarantine period these losses could not be used to reduce tax on other sources of assessable income. Losses could, however, be carried forward to offset future rental profits and capital gains from the sale of such investments. The changes only applied to real estate purchased after 17 July 1985.

9.26 In 1987, the decision to quarantine negative gearing was reversed (with effect from 1 July 1987). The decision was ostensibly made for two reasons. First, ending the quarantine would result in uniformity of tax treatment of interest costs for all types of investment. Second, the government concluded the tax benefit to high income earners offered by negative gearing was adequately countered by other tax reform measures introduced subsequent to the enactment of the quarantine, notably the introduction of the CGT regime in September 1985.[25] However, some students of the decision have suggested it was, in the main, a response to political pressure. This pressure, they argue, came from a housing industry that argued (rightly or wrongly) that the quarantine had driven up rents as landlords were forced to pass the cost of the higher tax burden on to their tenants.[26]

9.27 The committee heard a variety of views regarding the impact of negative gearing on rents, and various interpretations of the effects of the quarantine. As noted above, the REIA argued that negative gearing added to housing supply, including the supply of rental accommodation. It contended that changing negative gearing rules, including along the lines suggested by the Henry Review, would place added pressure on supply in an already tight market. Implementing the Henry Review recommendations, the REIA calculated, would add 2 per cent to the rental cost of a median three bedroom house. The REIA also highlighted the 1980s quarantine as proof of the risks associated with any move to limit the application of negative gearing for investment property. According to the REIA, in the two years the quarantine was

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24 Mr Rob Heferen, Executive Director, Revenue Group, The Treasury, *Proof Committee Hansard*, 30 July 2014, p. 21.

25 Jim O'Donnell, 'Quarantining Interest Deductions for Negatively Geared Rental Property Investments', *eJournal of Tax Research* 3, no. 1 (2005), p. 70.

26 Pasqualina Callea, 'Negative Gearing: should we move towards the United Kingdom system?' *ConTax Newsletter* (September 2012), p. 8, http://www.taxinstitute.com.au/files/dmfile/Feature_Article_Negative_Gearing_Contax_Sept20121.pdf.

in place, rents increased by 57.5 per cent in Sydney, 38.2 per cent in Perth and 32 per cent in Brisbane.[27]

9.28 In contrast, AHURI suggested that on the whole the recommendations of the Henry Review would improve rental affordability. This, it suggested, was because while the after-tax economic costs for negatively geared investors would increase, the costs for equity investors would decline. These lower costs would flow through:

> …into long term average annual rents, which would fall by just over $300 per year (Wood 2011). This would have a mixed effect on investors' willingness to retain investments: unleveraged and equity oriented investors would likely be more inclined to retain investments under the reforms while negatively geared investors would be more likely to realise their investments. Because these supply responses would offset each other, a 'flight of investors' from private rental housing seems unlikely.[28]

9.29 Mr Eslake also disputed the idea that the abolition of negative gearing would force up rents. The alleged 'landlords strike' of the mid-1980s, he argued, was based on an erroneous reading of history: rents had only risen rapidly in two markets, Sydney and Perth, because both cities had unusually low rental vacancy rates at the time. Yet in other capital cities, where vacancy rates were higher, growth in rents were either unchanged or, in the case of Melbourne, actually slowed. Mr Eslake continued that notwithstanding this history, if a large number of landlords were to sell their properties in response to the abolition of 'negative gearing', this would not necessarily be a bad thing for renters:

> That would push down the prices of investment properties, making them more affordable to would-be home buyers, allowing more of them to become home-owners, and thereby reducing the demand for rental properties in almost exactly the same proportion as the reduction in the supply of them. It's actually quite difficult to think of anything that would do more to improve affordability conditions for would-be homebuyers than the abolition of 'negative gearing'.
>
> There's no evidence to support the assertion made by proponents of the continued existence of 'negative gearing' that it results in more rental housing being available than would be the case were it to be abolished…[29]

9.30 In broad terms, Mr John Hawkins put forth a similar argument, challenging the notion that the abolition of existing negative gearing arrangements would result in a 'calamitous reduction in the supply of rental housing':

> It has been claimed that after the restoration of negative gearing [in 1987] there was an increase in residential housing investment. But correlation does not prove causation. The stock market collapsed in late 1987 and it

27 Real Estate Institute of Australia, *Submission 88*, p. 12–13.

28 Australian Housing and Urban Research Institute*, Submission 93*, p. 6.

29 Mr Saul Eslake, *Submission 2*, p. 11.

> was this more than the restoration of negative gearing that made property investment appear more attractive.
>
> The common claim that, were concessional capital gains tax and negative gearing to be removed, investors would push up rents to ensure they receive an adequate return does not stack up. What is more likely is that the price of houses would fall until the rate of return on them is back to an adequate return (ie comparable in risk-adjusted terms to that on other investments).[30]

9.31 Mr Pisarski of National Shelter, also felt that it was necessary to directly address what he regarded as misconceptions about the effects of the quarantine:

> [The quarantine] happened to coincide with an increase in the share market at the time, and therefore capital moved from the sector of housing into the sector of shares, and negative-gearing changes that [Treasurer Paul] Keating introduced were blamed for that shift. It would have happened anyway. It was not to do with any negative-gearing changes, but a whole mythology has grown up that therefore negative gearing is a sacred cow and if you touch that we will suddenly have a collapse of the rental market. That is just not so. And if we did have people selling off lots of properties in the rental market because they no longer saw it as a good investment, then who would they sell them to? Presumably it would be to people who wanted to occupy them and live in them. Would that be a bad thing?[31]

9.32 Some witnesses not only took issue with the contention that negative gearing helped contain rents, but also contended that negative gearing actually served to distort the rental market in such a way as to undermine rental affordability. For example, the Tenants' Union of NSW suggested that negative gearing fuelled the speculative pursuit of capital gains by property investors, and made investors relatively indifferent to rental yield. The Tenants' Union of NSW further argued that this had on negative effect on the availability of *affordable* rental properties:

> In particular, the amount of low-cost rental stock has declined, both relatively and, at the lowest end of the market, absolutely.
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> This is because landlords in pursuit of speculative gains tend to purchase existing stock with high prospects of capital gain, and high values – and hence high rents. When low-prospect, low-value, low-rent stock comes up for sale, speculator landlords tend to pass over it, and it drops out of the rental market—and such stock as remains becomes scarcer, and less cheap to rent.[32]

9.33 Professor Beer made much the same point, telling the committee that one of the most damaging perverse outcomes of the current negative gearing regime was that it encouraged investors to seek capital gains over yield. In pursuit of capital gains,

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30 Mr John Hawkins, *Submission 105*, p. 2.

31 Mr Adrian Pisarski, Executive Officer, National Shelter, *Proof Committee Hansard*, 10 September 2014, p. 36.

32 Equality Rights Alliance, *Submission 95*, p. 8.

investors overinvested in high-end property, and underinvested in low-end rental property 'where there is the greatest need'. The flip-side of the same dynamic was that investors tended to underinvest in smaller or depressed markets where the capital gains appeared less reliable.[33]

9.34 Other witnesses argued that because negative gearing privileges capital gains over yield, it had the unintended consequence of discouraging institutional investment in the housing system. This is because unlike individual (or 'mum and dad') investors, institutional investors require steady, reliable yields to justify debt financing. For instance, ACOSS submitted that the current tax treatment of investor housing:

> …skews investment in housing towards individual investors (rather than institutions) and towards investments yielding capital gains (rather than a stable rental income stream).[34]

9.35 Similarly, Mr Cameron Murray also suggested that negative gearing:

> …incentivises private rental housing provision by wage earners with high marginal tax rates, to the exclusion of institutional investors who successfully provide large shares of rental housing stock in much of Central Europe.[35]

9.36 Other submitters, including the Equality Rights Alliance and Youth Action NSW, also disputed the claim that negative gearing arrangements helped to contain rental prices.[36] Some witnesses, such as United Communities and Tenants Union of Victoria, suggested that negative gearing and the CGT discount actually worked to push rental prices higher, with the increased cost of home ownership flowing through to increased competition (and thus prices) for rental accommodation.[37]

9.37 Rather than underpinning the steady and affordable provision of rental accommodation supply, AHURI pointed to research suggesting negative gearing added to volatility in the rental market:

> Modelling by AHURI suggests that one-in-four property investments are withdrawn from the rental market within 12 months (Wood 2010). Thus tenants of approximately one quarter of all rental properties occupy insecure accommodation. Low-income, and negatively geared property investors, are more likely to make early exits from the rental housing market: in one year, 50 per cent of negatively geared investors in the study

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33 Professor Andrew Beer, Director, Centre for Housing, Urban and Regional Planning, University of Adelaide, *Proof Committee Hansard*, 28 July 2014, p. 19.

34 Australian Council of Social Service, *Submission 108*, pp. 3–4.

35 Mr Cameron Murray, *Submission 17*, p. 3.

36 Equality Rights Alliance, *Submission 95*, p. 8; Youth Action NSW, *Submission 51*, pp. 69–70.

37 Mr Simon Scrapel, Chief Executive, Uniting Communities, *Proof Committee Hansard*, 28 July 2014, p. 30; Mr Mark O'Brien, Chief Executive Officer, Tenants Union of Victoria, *Proof Committee Hansard*, 9 September 2014, p. 48.

> sample sold the property, by comparison with 20 per cent of all investors (Wood 2010). Negatively geared investors also appear to move in and out of property investments, in a 5 year period 13 per cent had repeat spells in home ownership (Wood 2010).[38]

9.38 When asked by the committee about the relationship between negative gearing and rental affordability, Treasury was somewhat equivocal in its response: Mr Heferen told the committee that while he assumed the removal of negative gearing would lead to rental increases, it remained a matter of conjecture as to whether this is what had happened in the mid-1980s.[39]

Should negative gearing serve housing policy?

9.39 According to the Association of Superannuation Funds of Australia (ASFA), the policy rationale of negative gearing is to encourage investment in those assets it applies to:

> With respect to residential property, a deduction is only available to the extent that the property is made available for rent, reflecting the policy rationale to increase the stock of available rental property.[40]

9.40 The question of how well negative gearing serves this purpose, and whether the taxation treatment of investor housing should be designed to support housing supply and affordability more broadly, was a key focus of many critics of negative gearing during this inquiry. For instance, Anglicare Australia argued that while the tax settings for investor housing may have once played a role in encouraging investment in the housing market, these settings:

> …no longer serve a purpose for the common good but rather serve to benefit a select group. The negative gearing and capital gains tax mechanisms need to be put back on the table, have their utility assessed and then reformed as necessary to support the supply of new housing or affordable housing to those most in need.[41]

9.41 Mr Pisarski of National Shelter also told the committee that while he did not necessarily think negative gearing or CGT discounts should be abolished altogether, 'if we are going to provide these tax incentives we ought to get a public good out the other side'.[42] ACOSS also approached the issue of negative gearing by suggesting the Commonwealth was 'spending' $8 billion every year on investor housing tax

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38 Australian Housing and Urban Research Institute, *Submission 93*, p. 6.

39 Mr Rob Heferen, Executive Director, Revenue Group, The Treasury, *Proof Committee Hansard*, 30 July 2014, p. 22.

40 The Association of Superannuation Funds of Australia, *Submission 130*, p. 2.

41 Anglicare Australia, *Submission 159*, p. 4.

42 Mr Adrian Pisarski, Executive Officer, National Shelter, *Proof Committee Hansard*, 10 September 2014, pp. 36–37.

concessions, with half of that amount 'going to expenditure on negative gearing'. Ms Jacqueline Phillips, ACOSS Director of Policy, told the committee:

> I think it is really important that we as a community ask ourselves what we are getting for that money. We are not getting any new affordable housing stock. We know that 92 per cent of investment in negatively geared properties is in existing stock. We are not getting affordable rental properties.[43]

9.42 Drawing out the link of its characterisation of negative gearing as a tax expenditure on housing, ACOSS suggested that savings from the grandfathering of negative gearing (a recommendation discussed below) should be directed in part toward investment in affordable housing programs.[44]

9.43 AHURI, meanwhile, noted research indicating that the beneficiaries of tax expenditures on investor housing (and, as discussed later in this chapter, owner-occupied housing) were disproportionally high income earners and people over 45 years old.[45]

9.44 The RDC, however, noted that ATO statistics suggested that 72.3 per cent of all loss-making properties in 2010–11 were owned by individuals on an annual income below $80,000. Indeed, the RDC argued that negative gearing had 'created a positive relationship of mutual dependence between low and middle income Australians'. According to the RDC, the majority of negative gearing benefits flowed to middle-income Australia, which in turn provided a 'steady supply of essential, affordable housing for low income families'.[46]

9.45 Characterising negative gearing as it applies to residential investment property as a 'tax expenditure' is problematic. The government's *Tax Expenditures Statement 2014* explains that tax expenditures arise:

> …where the actual tax treatment of an activity or class of taxpayer differs from the benchmark tax treatment.
>
> Tax expenditures typically involve tax exemptions, deductions or offsets, concessional tax rates and deferrals of tax liability.[47]

9.46 What is and is not considered a 'tax expenditure' by the government depends on how the benchmark is specified. According to the Treasury, a 'benchmark should

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43 Ms Jacqueline Phillips, Director of Policy, Australian Council of Social Service, *Proof Committee Hansard*, 10 November 2014, p. 29.

44 Ms Jacqueline Phillips, Director of Policy, Australian Council of Social Service, *Proof Committee Hansard*, 10 November 2014, p. 29.

45 Australian Housing and Urban Research Institute, *Submission 93*, pp. 4–5.

46 Residential Development Council, Property Council of Australia, *Submission 212*, p. 13.

47 The Treasury, *Tax Expenditures Statement 2014* (January 2015), p. 3, http://www.treasury.gov.au/PublicationsAndMedia/Publications/2015/TES-2014.

represent the standard tax treatment that applies to similar taxpayers or types of activity'. However, it may also 'incorporate certain elements of the tax system which depart from a uniform treatment of taxpayers where these are fundamental structural elements of the tax system'. As could be inferred from this explanation, determining the benchmark is not always clear cut and does involve, in Treasury's words, 'an element of judgement'.[48]

9.47 The ability to deduct expenses incurred in earning income is considered a structural feature of the tax system. In this sense, negative gearing on investment property—and indeed other assets—is not regarded as a departure from the benchmark taxation treatment. As such, negative gearing is not included in the annual *Tax Expenditures Statement* released by the government. (However, the 50 per cent discount on CGT for assets held longer than 12 months, including investment properties, *is* regarded as a tax expenditure.)

9.48 Because Treasury treats losses on negatively geared property as regular deductions, rather than tax expenditures, it was unable to quantify the cost to revenue.[49] It might also be noted that even if Treasury's non-recognition of negative gearing as a tax expenditure were set aside, the use of 'revenue forgone' methods of estimating the value of investor housing-related negative gearing may not properly represent the cost to the Budget. This is because taxpayers would almost certainly adjust their behaviour if negative gearing on investor housing were not allowed. As the *Tax Expenditures Statement* explains, 'Introducing a tax expenditure may create incentives for taxpayers to change their behaviour to utilise (or avoid) the new tax provision. Removing the tax expenditure (so that the benchmark tax treatment prevailed) would remove this incentive and may cause a corresponding change in taxpayer behaviour.' Such behavioural changes could mean taxpayers seek to make use of other tax expenditures, meaning actual revenue gain might be considerably lower than simple 'revenue forgone' estimates would suggest.[50]

9.49 Putting aside the definitional issues, and the exact cost to revenue of investor housing-related negative gearing, several witnesses took issue with the idea that negative gearing constituted a 'loophole' or departure from the broader taxation system. These submitters argued that any change to the ability of property investors to claim losses on an investment property against income (whether earned against that property or otherwise) would amount to a distortionary departure from Australia's established taxation framework. For instance, the REIA argued that amendments to negative gearing provisions for housing would amount to:

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48 The Treasury, *Tax Expenditures Statement 2014* (January 2015), p. 129, http://www.treasury.gov.au/PublicationsAndMedia/Publications/2015/TES-2014.

49 Mr Rob Heferen, Executive Director, Revenue Group, The Treasury, *Proof Committee Hansard*, 30 July 2014, p. 21.

50 On the difference between the 'revenue forgone' and 'revenue gain' approaches to calculating tax expenditures, see Treasury, *Tax Expenditures Statement 2014* (January 2015), pp. 4–5, http://www.treasury.gov.au/PublicationsAndMedia/Publications/2015/TES-2014.

> …treating real estate differently to other asset classes and create a distortion on the investment landscape and result in a resource misallocation.[51]

9.50 Dr Harley Dale, the Chief Economist of the HIA, made a similar point, arguing that the HIA's modelling of the impact of removing or restricting negative gearing provisions as they applied to investor housing was based on the fact that negative gearing applies to many asset classes, not just residential property. As such, the HIA believed that removing or restricting negative gearing provisions as they applied to housing would have two damaging effects:

> The first is that you would get a decline in Australian living standards, because you would be placing an additional tax distortion on what is already the second most highly taxed sector of the Australian economy. Second, you would be providing a disincentive to invest, so you would see a decline in rental property and an increase in rental prices.[52]

9.51 The HIA was keen to draw attention to what it regarded as the popular misconception that negative gearing is a housing-specific tax arrangement:

> The ability to offset investment expenses against income in establishing gross taxable earnings is a key tenet of the Australian tax system. Beyond the sphere of residential property the appropriateness of this fundamental feature of Australia's tax system is rarely questioned. However, it is a highly contentious issue with respect to residential property, particularly with regard to a focus on possible influences it has on the purchasing behaviour of investors and owner occupiers.[53]

9.52 Similarly, Mr Rob Johnson contended that it was incorrect to argue that negative gearing had undermined the equity and integrity of the income tax system, or that the tax laws gave specific preference to property investment. There were, he argued, 'no loopholes, no rorts, no special provisions—there are simply no advantages given to investment in property under the tax laws'.[54]

9.53 Although some submitters suggested that the policy rationale of existing negative gearing arrangements as they applied to housing *was* to stimulate housing supply (as distinct from suggesting that these arrangements *should* be designed to do so), Treasury explained that this was not strictly correct. Rather, negative gearing as it applied to housing investment was no different to how it applied to other asset classes; in this sense, Treasury explained, it would be misleading to suggest that the 'policy justification' of negative gearing was to increase housing supply:

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51 Real Estate Institute of Australia, *Submission 88*, p. 13.

52 Dr Harley Dale, Chief Economist, Housing Industry Association, *Proof Committee Hansard*, 30 July 2014, p. 51.

53 Housing Industry Association, *Submission 178*, p. 8.

54 Mr Rob Johnson, *Submission 155*, p. 3.

> In one sense there is no policy justification for negative gearing. From a tax point of view we have two sorts of income, if you like: we have 'income' income and then we have capital gains. So capital losses can be only quarantined to use against capital gains.
>
> […]
>
> But on income that is not capital gains income, basically all costs are deductable against all income. So it is not as if there is an explicit decision to say, 'Yes, there will be a decision to allow people to deduct interest costs from, say, salary and wage income or other business income.' That does not really occur. It is a question of what is allowed. Then the policy intervention is: 'Okay; that is what the law allows; should the law be changed to deny people the capacity to claim that deduction?'[55]

Negative gearing: recommendations for change

9.54 Some witnesses advocated limiting the application of negative gearing provisions with a view to stimulating the supply of new housing stock. For instance, the Australia Institute told the committee that despite its aforementioned concerns about the impact of negative gearing on housing affordability, it was:

> …not proposing that we take out negative gearing. Negative gearing is a policy that works for families, in the way that companies are able to write off tax against profit losses as well. There is an advantage for people as well. But the opportunity exists for the negative-gearing policy to be a tool in addressing the issue of housing affordability. Targeting the application of negative gearing rather than saying, across the board, 'Any property is open to negative gearing,' would be one way of maximising the benefit of the resources that the government provides through the concessions of negative gearing.[56]

9.55 Baptist Care Australia made a similar recommendation, suggesting that negative gearing might be limited so that it only applied to the construction of new homes or for investment in social housing (including Defence Housing).[57] Meanwhile, Mr Borrowman, Associate Professor Frost and Dr Kazakevitch, in a joint submission, recommended that negative gearing be restricted to new housing stock for a limited period of time, 'to provide incentives for investment in new housing, which may be riskier than other forms of housing investment'.[58] The Victorian Public Tenants Association and the Equality Rights Alliance also provided submissions

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55 Mr Rob Heferen, Executive Director, Revenue Group, The Treasury, *Proof Committee Hansard*, 30 July 2014, p. 22.

56 Mr David Baker, Director of Research, The Australia Institute, *Proof Committee Hansard*, 30 July 2014, p. 62.

57 Baptist Care Australia, *Submission 134*, p. 15.

58 Dr Gennadi Kazakevitch, Associate Professor Lionel Frost and Mr Luc Borrowman, *Submission 23*, p. 8.

recommending that negative gearing only be allowed for new housing (with both suggesting that current arrangements might be grandfathered).[59]

9.56 AHL Investments Pty Ltd (the 'Aussie' financial group) recommended the introduction of limits on the number of properties that could be negative geared or a ceiling on the amount of losses deductible in any given year. This approach, it argued, would 'limit exploitative use of these concessions (such as individuals claiming deductions on high-value or multiple properties), rather than target those diversifying savings for retirement'.[60]

9.57 For its part, ACOSS recommended that deductions of expenses for all 'passive investments'—by which it meant 'housing, shares, collectibles and similar assets'—should be 'quarantined to offset income received from those assets, including capital gains realised on their subsequent sale'. ACOSS recommended that the current taxation arrangements be grandfathered for existing investments, so that the effect on housing investment would be gradual.[61] This change, ACOSS suggested, would constitute a 'first step to improving housing market outcomes and reducing the fiscal and social cost of this tax break'. Further, ACOSS recommended that half the revenue saved from this change should be 'earmarked for the introduction of an Affordable Housing Growth Fund and [the] proposed expansion of NRAS to promote fresh investment in affordable housing'.[62]

9.58 Mr Eslake stressed that his preference was not that negative gearing only be abolished for property investors, but that it be abolished for *all* investors. Thus, interest expenses:

> …would only be deductible in any given year up to the amount of investment income earned in that year, with any excess 'carried forward' against the ultimate capital gains tax liability, rather than used to reduce the tax payable on wage and salary or other income (as is the case in the United States and most other 'advanced' economies).[63]

9.59 Mr Eslake continued that, as a second-best option, the government should implement the recommendations of the Henry Review bearing on the taxation of investments (as outlined earlier in this chapter). Mr Eslake noted that implementing these recommendations:

> …would not amount to the abolition of 'negative gearing'; it would just make it less generous than it is at the moment. It would be likely, as the

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59 The Victorian Public Tenants Association, *Submission 40*, p. 2; Equality Rights Alliance, *Submission 95*, p. 8.

60 AHL Investments Pty Ltd (Aussie), *Submission 186*, pp. 2–3.

61 To be precise, ACOSS's submission, made in March 2014 with a view to the 2014–15 Budget, suggested the change only apply to investments made after 1 January 2015.

62 Australian Council of Social Service, *Submission 108*, pp. 3–4.

63 Mr Saul Eslake, *Submission 2*, p. 13.

> Henry Review suggested, 'to change investor demand toward housing with higher rental yields and longer investment horizons [and] may result in a more stable housing market, as the current incentive for investors to chase large capital gains in housing would be reduced'.[64]

9.60 Existing arrangements, Mr Eslake 'grudgingly' accepted, might need to be grandfathered so as not to directly disadvantage current housing investors.[65]

9.61 The Tenant's Union of NSW floated a range of possible approaches to reforming negative gearing and CGT arrangements for investor housing. These included requiring that losses incurred from owning an asset could only be set against income from that asset class. Drawing on the recommendations of the Henry Review, the Tenants' Union of NSW suggested an alternative approach might be to make income from a (non-business) asset subject to a tax discount, 'reducing (but not eliminating) the deductibility of losses against other sources of income and the preferential treatment of speculative gains'. Yet another approach, it suggested, might be to only allow negative gearing arrangements for new housing stock. The common thread uniting these recommendations was the need, according to the Tenants' Union of NSW, to restrain speculation in the housing market:

> This means resetting the tax settings that give preferential treatment to owner-occupied housing, and that encourage people to lever up and speculate as landlords.[66]

Taxation of investment housing capital gains: recommendations for change

9.62 Focusing specifically on the 50 per cent discount on CGT, Professor Wilkins suggested the pre-1999 system of adjusting CGT payable for inflation was preferable to the current discount on CGT liabilities. The previous regime, he argued was 'very sensible' and not too administratively complex, and allowed for a more neutral treatment of capital gains.[67]

9.63 Mr Cameron Murray also turned his attention to the CGT discount, recommending that it be abolished altogether for residential property, or at least limited so that it only applied to property held for more than ten years. He wrote:

> The CGT discount encourages speculative investment in residential property and merely amplifies the housing cycle. A much longer qualifying period, or the removing of the CGT discount from residential property

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64 Mr Saul Eslake, *Submission 2*, p. 13.

65 Mr Saul Eslake, *Submission 2*, p. 13.

66 Tenants' Union of NSW, *Submission 120*, pp. 12–13.

67 Associate Professor Roger Wilkins, Principal Research Fellow, Melbourne Institute of Applied Economic and Social Research, University of Melbourne, *Proof Committee Hansard*, 9 September 2014, pp. 27–28.

> would reduce investors' willingness to pay for housing, and therefore make owner occupation a more attractive choice.[68]

9.64 Housing researchers from Swinburne University of Technology also recommended removing the 50 per cent CGT concession for investment properties.[69]

Committee view

9.65 Few of the issues raised during this inquiry were as contentious as negative gearing. The committee accepts that negative gearing likely encourages higher levels of investment in residential housing than would be the case if it did not exist in its current form (for instance, if losses on investment housing could only be deducted against rental income). This, in turn, likely has a detrimental effect on home purchase affordability. On the basis of evidence received during the inquiry, the committee was unable to clearly determine what effect negative gearing had on rental affordability; it notes, however, that most witnesses who spoke to the issue challenged the idea that negative gearing helps contain rents, and some also argued that it actually serves to undermine the availability of affordable rental stock.

9.66 The committee believes it is problematic to characterise negative gearing as a tax 'loophole'—indeed, the deductibility of losses against assessable income is a long-standing feature of the tax system in Australia. Popular belief aside, negative gearing is not a feature specific to housing assets, although it is overwhelmingly used in relation to investment housing.

9.67 Regardless, the committee is disappointed that Treasury was unable to quantify the effect of the negative gearing arrangements on housing prices, or provide clear guidance on the relationship between negative gearing and rental affordability.

9.68 With this in mind, the committee suggests that, as a minimum starting point, an informed public debate about the taxation treatment of investment housing requires a full and frank assessment of how negative gearing and the 50 per cent CGT discount affects house prices and the rental market. This assessment would include the cost to revenue of negative gearing and the CGT discount, and what impact, if any, these arrangements have on economic productivity. The committee has also concluded that it would be useful for the Treasury to provide a comprehensive assessment of the effect on purchase and rental affordability of various possible changes to the taxation treatment of investment housing. This assessment should also examine the administrative practicality of various changes, and the effect such changes would have on revenue and economic activity more broadly.

9.69 The committee anticipates that the taxation treatment of investment housing will likely be addressed as part of the White Paper on the Reform of Australia's Tax

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68 Mr Cameron Murray, *Submission 17*, p. 7.

69 Institute for Social Research, Swinburne University of Technology, *Submission 86*, p. 9.

System. Any study by Treasury would necessarily have reference to and, as appropriate, build on the policy directions set out in White Paper.

Recommendation 13

9.70 The committee recommends that, to the extent such matters are not addressed by the White Paper on the Reform of Australia's Tax System, the Treasury should prepare and publish a study of the influence of negative gearing and the capital gains tax discount on home purchase affordability and on the rental market (including the effect on security of tenure for renters), the effect of these arrangements on revenue, and their effect (if any) on economic productivity. This study should examine the likely effects of alternative taxation treatments of investor housing. Alternative approaches considered in this study (including, where appropriate, in combination) should include:

- **(a) a housing-specific 'quarantine' approach, wherein losses for investment properties can only be deducted against rental income, with provision for losses in excess of rental income to be carried forward and deducted against future rental income and capital gains;**
- **(b) a broader 'quarantine' approach, wherein interest expenses on all investments, including but not limited to housing assets, are only deductible in any given year up to the amount of investment income earned in that year, with provision for losses in excess of this amount to be carried forward and deducted against future investment income and capital gains;**
- **(c) limiting the application of negative gearing arrangements to new housing stock, or designated new affordable housing stock;**
- **(d) limiting the application of negative gearing to a certain number of properties (assessing options for various limits in this regard);**
- **(e) options for phasing out negative gearing on investment housing;**
- **(f) applying the savings income discount recommended in the Henry Review to investment housing, with consideration given to the impact of this approach both with and without the implementation of the Henry Review's recommendations in relation to housing supply and housing assistance; and**
- **(g) reducing or removing the capital gains tax discount for investment properties, or reverting to the pre-1999 system of taxing real rather than nominal capital gains on investment assets.**

Tax and the family home

9.71 A number of submitters argued that the exemption of owner-occupied housing from CGT (and, indeed, state land tax, as discussed in chapter five) encouraged overinvestment in housing as a form wealth creation. As a result, house prices were

pushed higher than they otherwise would be, providing a benefit to existing home owners but serving to make it more difficult for would-be first home owners to enter the market.[70]

9.72 Owner-occupied housing in Australia is exempt from CGT and other income taxes; further, as was discussed in chapter six, it is exempt from state-based land tax. Professor Yates, in research cited in AHURI's submission, estimates that the tax benefit to owner-occupiers was worth $45 billion in 2005–06. The lion's share of this amount, $29.8 billion, is derived from the CGT exemption. The non-taxation of imputed rent—that is, the rent which owners would need to pay themselves if they rented their own houses at market rates—accounts for $6.9 billion of the total.[71] The exemption of imputed rent from GST accounts for a further $4.8 billion of Professor Yates' total, with the remaining $3.5 billion attributed to the exemption of owner-occupied housing from state-based land taxes.[72]

9.73 Referring to tax expenditures in relation to owner-occupied housing, the CFRC noted that policy settings targeted toward support for home owners are generally underpinned by 'contentions about the perceived economic and social benefits' associated with home ownership. However, according to the CFRC, the structure of indirect tax expenditures to owner-occupiers fails to assist people into home ownership:

> Instead, the greatest support goes to existing home owners, with young lower income home purchasers and renters receiving the least assistance. Indeed, given the contribution of such support to what some analysts argue is a substantially over-valued market (OECD 2013), these forms of assistance actively debar access to moderate income and lower income groups. The implicit subsidies provided through the tax system benefit home owners, not home ownership.[73]

9.74 Mr John Hawkins made a comparable point, suggesting that the CGT exemption cost the budget $30 billion per year, and in the process served to entrench economic inequality:

> As well as driving up house prices the tax treatment is regressive, discriminating against those, generally poorer, people who spend their lives as renters not owners.[74]

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70 Honorary Associate Professor Judith Yates, University of Sydney, *Submission 53*, p. 6.

71 This total is arrived at by estimating the benefit from the non-taxation of imputed rent, less operating costs and a cost for the non-deductibility of mortgage interest.

72 Australian Housing and Urban Research Institute, *Submission 93*, pp. 2–3. The source AHURI refers to is Judith Yates, *Tax Expenditures and Housing*, AHURI Research Paper (September 2009).

73 City Futures Research Centre, UNSW, *Submission 152*, p. 5.

74 Mr John Hawkins, *Submission 105*, p. 3.

9.75 Similarly, NT Shelter submitted that the preferential tax treatment of owner-occupied housing—including the CGT exemption, the exemption from state land taxes (as discussed in chapter six), and the exclusion of the family home from the pension assets test (discussed in chapter twelve)—worked to the benefit of existing home owners, rather than people seeking to enter the market:

> While it could be argued that these advantages assist moderate income households to access home ownership, it seems more likely that their effect over the long term has been to inflate house prices and encourage over investment in owner-occupied housing.[75]

9.76 Professor Yates made the broader argument that tax expenditures on housing, and in particular the exemption of owner-occupied housing from CGT, raised issues of distributional and intergenerational equity:

> Distributional analyses of these concessions highlight the extent to which older, higher income households with high housing wealth benefit disproportionately compared with younger, lower income households who are most in need of assistance. The somewhat lower benefits for older, lower income households are reinforced by the exemption of the family home from asset testing for the age pension (higher income households are less affected because they will be excluded by the income test). This provides an incentive for households potentially eligible for the pension to maintain a high proportion of their wealth in the family home in the same way as tax incentives encourage older higher income households to do the same.[76]

9.77 Taking a different view, Mr Eslake noted that while the family home was exempt from CGT, it was also the case that taxpayers were not able to deduct the costs associated with acquiring and holding the home. Mr Eslake wrote that he did not favour the removal of the CGT exemption for owner-occupied housing because:

> …consistency with other parts of the tax system would require that mortgage interest payments be deductible. That would in turn almost certainly encourage people to take on more debt, and would thus inflate the demand for housing, putting further upward pressure on prices. And it could well end up being revenue negative.[77]

9.78 Professor Yates, however, noted that while interest expenses and maintenance costs are not deductible, owner-occupiers are not subject to tax on imputed rent.[78]

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75 NT Shelter, *Submission 118*, p. 5.

76 Honorary Associate Professor Judith Yates, University of Sydney, *Submission 53*, p. 6. The exemption of the family home from the aged pension assets test is discussed in chapter twelve.

77 Mr Saul Eslake, *Submission 2*, p. 15.

78 Honorary Associate Professor Judith Yates, University of Sydney, Submission 53, p. 6. As the Productivity Commission noted in its 2004 report on first home ownership, the tax treatment of imputed rental income is not unique to housing, and individuals do not pay tax on imputed income from other assets, such as motor vehicles. Productivity Commission 2004, *First Home Ownership*, Report no. 28, Melbourne, p. 77.

While not advocating the taxation of imputed rent, which she suggested was probably 'unrealistic', Professor Yates did not agree that removing the CGT exemption would require the introduction of interest deductibility.[79]

Committee view

9.79 The committee does not believe taxing capital gains on owner-occupied housing would be constructive. While removing the CGT exemption could potentially improve affordability, this would be achieved at significant cost to home owners. Moreover, taxing the capital gains on a person's home would be inconsistent with the broad community consensus that a person's home should not be treated as simply another investment asset.

79 Honorary Associate Professor Judith Yates, University of Sydney's Senior Visiting Fellow *Proof Committee Hansard*, 10 November 2014, p. 43.