Will Anthony Albanese succeed where Bill Shorten failed in making changes to the taxation treatment of property investment?

(Article published by [Pearls and Irritations] on 26th September 2024)

Press reports this week suggest that the Albanese Government has sought advice from Treasury about possible changes to negative gearing and the capital gains tax discount, to be taken to the election due to be held before the end of May next year.

If these reports are accurate – good.

Scaling back negative gearing and the capital gains tax discount would make a worthwhile contribution to solving Australia's 'housing crisis' – although it is by no means a 'silver bullet' in that respect, and it wouldn't obviate the need for additional measures on both the supply and demand sides of the housing market. And it would also make a worthwhile contribution to reducing the structural budget deficit which projections in the most recent Federal Budget indicate will persist at least into the middle of the next decade.

Ideally, the Government would seek a mandate for the same reforms it put to the 2016 and 2019 elections – of abolishing negative gearing for all investments other than new dwellings (whilst 'grandfathering' existing investors) and reducing the capital gains tax discount from 50% to 25%. But even if, as the press reports this week suggest, the Government's proposals fall short of that – for example, limiting the number of properties for which an individual investor could use negative gearing – it would be a step in the right direction. And those who, like me, would like the Government to go further, shouldn't let the 'perfect' be the enemy of the 'good', as the Greens have been especially wont to do.

I have never accepted the conventional wisdom that the policy which Labor took to the 2019 election cost it victory. After all, it took the same policy to the 2016 election, which it lost by only one seat: had it won that election, it would have represented the first time a first-term federal government had failed to win a second term since 1931. And Labor only lost the 2019 election by two more seats than it lost the one three years earlier, despite having a lot more lead in its policy saddle-bag than it did in 2016, including in particular the policy of denying excess franking credits to self-funded retirees, to whom then Shadow Treasurer Chris Bowen said, "if you don't like the policy, don't vote for us", an invitation which many of them took up.

Nonetheless. It's understandable that Labor then abandoned this policy ahead of the 2022 election. Australian political history shows that it's impossible for an Opposition to win government on a platform of ambitious economic reforms. The incumbent government will use all the vastly superior powers it has at its disposal to scare the living daylights out of voters if such ambitious reforms were to be implemented – as Paul Keating did in 1993, and Scott Morrison did in 2019. Oppositions win elections by promising not to do very much at all, but rather to do it more competently than the incumbents.

Ambitious reforms only happen when a first-term government goes to the electorate seeking a mandate for those reforms, knowing (although of course not saying) that history strongly suggests that it will get one, as John Howard did for the introduction of a GST at the 1998 election, having initially won office in 1996 on a platform which included a pledge that there would "never, ever" be a GST.

And second-term governments which successfully implement ambitious reforms can then seek a third term, pointing to the benefits which those reforms have already started to deliver.

The Coalition, and property interests, will no doubt say, should the Government include proposals to scale back negative gearing and/or the capital gains tax discount in their 2025 election platform, that the result would be a reduction in investment in rental housing.

And to the extent that they were talking about investment in *established* housing (although they would probably not seek to make the distinction clear), they'd be right.

But the Government should then respond, "Good – that's the whole point".

Because when an investor – 'incentivized' by the prospect of deferring and reducing the amount of tax otherwise payable on his or her wage and salary or other income by the use of negative gearing and the 50% capital gains tax discount – purchases an established property, and congratulates him- or herself on 'creating additional supply of rental housing', what he or she is also doing is creating additional demand for rental housing, by out-bidding a prospective owner-occupier.

So while scaling back negative gearing almost certainly will reduce the supply of rental housing, it will reduce the demand for rental housing by exactly the same amount. Thus, contrary to what the Coalition and property interests will no doubt say, there is absolutely no reason why rents should rise.

Some representatives of the Coalition and property interests will no doubt recount that "rents went through the roof" when Paul Keating abolished negative gearing in 1985, forcing him to re-introduce it in 1987. That is a complete myth.

Indeed, it's a modern-day illustration of the saying attributed to Josef Goebbels, Hitler's Propaganda Minister, that "if a lie is big enough, and you tell it often enough, it becomes accepted as the truth".

The truth of this episode is that rents *did* rise at double-digit rates in Sydney and Perth during this period – but that was because vacancy rates had fallen to barely above 1% in Sydney, and to about 2% in Perth, by the first quarter of 1985 (notwithstanding the incentives that the availability of 'negative gearing' since at least the 1930s had ostensibly provided for investment in rental housing). In other cities, where vacancy rates were higher, rent inflation actually *fell* during the ensuing two years in which 'negative gearing' was unavailable – something that shouldn't have occurred if the abolition of negative gearing were to have had the effects claimed for it.

In fact, if negative gearing is abolished or scaled back for investors in established housing but retained for new housing, it is plausible that there would actually be an *increase* in investment in new rental housing – which, unlike investment in established housing, actually does increase the supply of rental housing relative to the demand for it.

But ABS housing finance statistics show that over three-quarters of lending to property investors is for the purchase of established, rather than new housing. That is, the overwhelming majority of investment in residential housing *doesn't* add to the supply of housing – it rather, simply, drives up the price of the housing we already have.

The United States abolished its version of negative gearing – under Ronald Reagan, no less – in 1986. Since then, the rental vacancy rate in the US has averaged 8.0%, and has never been below 5.6%.

Australia has had negative gearing since at least the 1930s – despite which, Australia's rental vacancy rate has since the beginning of 1987 averaged 2.6%, and never been higher than 4.4%. So much for the proposition that negative gearing is "essential" to ensure an adequate supply of rental housing.

Representatives of the Coalition and property interests will also no doubt say in response to any proposals from the Government to scale back negative gearing – as they did in 2016 and 2019 – that negatively geared landlords are "just Mums and Dads trying to get ahead", or that they are mostly "teachers, nurses and police officers" – as it that were alone sufficient justification for a policy which, according to the Parliamentary Budget Office, has cost the federal budget $35.6 billion in revenue foregone over the past decade, and will cost it $100 billion over the next decade.

In fact, Australian Taxation Office statistics show that 36.7% of taxpayers in the top tax bracket (that is, with taxable incomes of over $180,000) in 2021-22 had rental property investments, compared with just 13.6% of people with taxable incomes of less than $180,000 (and of course some of them use negative gearing precisely to reduce their taxable incomes to less than the threshold for the top tax rate). 17.7% of all taxpayers in the top tax bracket in 2021-22 reported net rental losses, compared with 5.6% of taxpayers in other tax brackets. Put differently, someone who is in the top tax bracket is more than three times as likely to be a negatively-geared landlords as someone who isn't.

That in turn is why, according to the PBO's estimates, 43% of the revenue foregone by negative gearing goes to the top 10% of taxpayers, while less than 15% accrues to the bottom 50% of taxpayers.

The same Tax Office statistics show that 28.5% of taxpayers reporting rental property income have two or more rental properties (up from 20.3% in 1999-2000). They are more likely to be in the top tax bracket than those who have only one rental property. So restricting the number of properties which can be negatively geared would be equitable, as well as sensible. It wouldn't be as far reaching as abolishing negative gearing (for investors in established properties) altogether – but it would be a step in the right direction.

Just as the Government won plaudits for re-jigging the Morrison Governments' "Stage 3" tax cuts earlier this year, despite pledging during and after the 2022 election campaign that it wouldn't, it would gain widespread approbation for taking a pledge to scale back negative gearing to the next election, without attracting opprobrium for breaking a promise not to at the last election. Let's hope that they don't roll over to the inevitable 'scare campaign' that will inevitably be mounted by defenders of the status quo.