TAX – NEGATIVE GEARING/CAPITAL GAINS TAX

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BACKGROUND:

s 47G *distributional modelling of Labor's proposed negative gearing and CGT reform:*

- s 47G found that negative gearing benefits high income families, with 52.6 per cent of the tax benefit going to the top 20 per cent of incomes and only 5.2 per cent of tax benefits going to the bottom 20 per cent of incomes.
- s 47G also found that the CGT discount overwhelmingly benefits high income families, with the top 10 per cent accounting for nearly three quarters of the tax savings.
  - By removing the effect of the large one-off benefit coming from capital gains, s 47G estimates that figure drops to 54.3 per cent of the tax savings flowing to the top 10 per cent of families, as ranked by income.
- On Labor's negative gearing policy, s 47G found that removing negative gearing will increase revenue in the long run between $3.4 and $3.9 billion a year, depending on the increase in new housing construction flowing from the new housing exemption.
- On Labor's CGT policy, s 47G found that reducing the CGT discount from 50 per cent to 25 per cent would increase revenue by an estimated $2 billion in the long run in 2017-18 dollars.

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- Under Labor's policy, roughly two thirds of the tax revenue would come from the removal of negative gearing and the remainder from halving the CGT discount to 25 per cent.

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Yes – that is correct.

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s 22 - a point to clarify, as discussed, reflecting that there's no net income because it's a net rental loss.

"A police officer earning $90,000 and hoping to claim a $10,000 loss on a newly purchased established house would not be able to use that loss to their reduce taxable income.~~claim that loss and instead would have to pay tax on the net income earned on the property~~."

Cheers,

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s 22 – we'd instead suggest:

> The ALP policy to half the CGT discount would, in effect, increase the capital gains tax liability for most individuals by 50%.

The reason for the change is that the reduction in the discount might move some taxpayers into a higher tax threshold (as the discounted capital gain is included in taxable income). Also, taxpayers with small capital gains and income below the tax-free threshold may be unaffected by the reduction in the discount (i.e. still pay no tax).

Apologies for the delay – happy to discuss,

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s 22 passed on your request for information on the treatment of different assets under Labor's negative gearing policy. We have provided some basic examples, however we have limited these examples to property and shares. Happy to discuss if this isn't what you were after.

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	Current		ALP policy		
	Individual with other investment income	Individual with no other investment income	Individual with other investment income	Individual with no other investment income	Notes
Salary and wage income	$200,000	$250,000	$200,000	$250,000	
Other net investment income (E.g. Shares)	$50,000	$0	$50,000	$0	
Rental income	$30,000	$30,000	$30,000	$30,000	
Assessable Income	$280,000	$280,000	$280,000	$280,000	
Interest expenses (Investment property)	$40,000	$40,000	$40,000	$40,000	
Other deductible expenses	$20,000	$20,000	$20,000	$20,000	
Total deductions	$60,000	$60,000	$60,000	$60,000	
Net rental loss	-$30,000	-$30,000	-$30,000	-$30,000	
Allowable deductions	$60,000	$60,000	$60,000	$30,000	
Taxable Income	$220,000	$220,000	$220,000	$250,000	
difference		$0		**$30,000**	
Difference in tax payable (inc ML)				**$14,100**	

Assumptions

Net rental loss of $30,000 = $30,000 rental income - $60,000 deductions
Marginal rate of 47 per cent includes medicare levy
Rental income is derived from an existing property purchased after 1 July 2017.

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As requested, the attached document outlines the impact of the ALP's negative gearing and CGT policy on Australian Residents and Non-residents, as well as the broader impacts of this policy. This information is based on our understanding of Labor's policy from the ALP policy doc and subsequent media releases.

Regards

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Impact on investment in asset classes – Labor's negative gearing and CGT changes

Investment asset (acquired after 1 July 2017)	Impact of Labor's policies on Australian Residents	Impact of Labor's policies on Non-residents	Impact of Labor policies on prices
Share investments	*Affected.* The after-tax returns on share investments will be reduced for Australian residents: • Investors will not be able to use net investment losses on shares to offset salary and wage income, deferring those losses to a later point in time. However, less impact than for property due to lower loan to value ratios for margin loans. • CGT discount will also be reduced to 25 per cent.	*Minor impacts only.* Non-residents do not benefit from the CGT discount. While non-residents may be affected by changes to negative gearing, they are unlikely to have non-investment income to offset losses against.	**Unlikely to change.** After-tax returns for Australian resident investors will fall under the policy. However, prices are unlikely to be impacted as returns are unchanged for foreign residents, who are likely to be the marginal investors. Although asset prices are unlikely to change, the composition of ownership may change.
Commercial property (all)	*Affected.* The after-tax returns on commercial property investments will be reduced for Australian residents: • Investors will not be able to use net investment losses on commercial property to offset salary and wage income, deferring those losses to a later point in time.	*Minor impacts only.* Non-residents do not benefit from the CGT discount. While non-residents may be affected by changes to negative gearing, they are unlikely to have non-investment income to offset losses against.	**Unlikely to change.** After-tax returns for Australian resident investors will fall under the policy. However, prices are unlikely to be impacted as returns are unchanged for foreign residents, who are likely to be the marginal investors. Although asset prices are unlikely to change, the composition of ownership may change.

	• CGT discount will also be reduced to 25 per cent. Unclear from Labor's policy docs whether or not their proposal would apply to all investments in commercial property, or just investments in existing commercial properties.		
Residential investment property (existing)	*Affected.* The after-tax returns on existing residential property investments will be reduced for Australian residents: • Investors will not be able to use net investment losses on existing properties to offset salary and wage income, deferring those losses to a later point in time. • CGT discount will also be reduced to 25 per cent.	*Minor impacts only.* Non-residents do not benefit from the CGT discount. While non-residents may be affected by changes to negative gearing, they are unlikely to have non-investment income to offset losses against.	**The ALP policies could introduce some downward pressure on property prices in the short term, particularly if the commencement of the policy coincides with a weaker housing market.** **In the long term, increases in taxation on rental property could have a relatively modest downward impact on property prices.** Returns for Australian resident investors will fall under the policy. However, owner-occupiers who are unaffected by the changes are likely to limit the extent to which there is an impact on prices. In fact, the impact of the policy on investments in other asset classes, such as shares, may see investment in owner-occupied housing increase. Grandfathering and the high transaction costs (stamp duty) for transacting in this market may also impact upon the extent to which adjustment takes place. As with other markets, foreign investors may have a moderating influence on price, though perhaps a little less so, given the restrictions on foreign investment in existing residential real estate. More broadly, previous changes to negative gearing (1985-1987) and

			the introduction of the CGT discount (1999) had little discernible impact on the market, though the housing market itself has historically been highly cyclical and it is possible that uncertainty arising from the policy change itself could compound upon a cyclical downturn that may be underway at the time. Overall, price changes are likely to be small, though the composition of ownership may shift away from domestic investors.
Owner occupied housing	***Not affected.***	***Does not apply.***	**The ALP policies could introduce some downward pressure on property prices in the <u>short term</u>, particularly if the commencement of the policy coincides with a weaker housing market.** **In the <u>long term</u>, increases in taxation on rental property could have a relatively modest downward impact on property prices** As the after-tax returns for Australian investors in other assets such as shares and property will fall due to the reduction in the CGT discount, households may increase their investment in owner-occupied housing which remains exempt from CGT. This would tend to counter any downward pressure on prices arising out of the rental market.
Bonds	***Minor impacts only.*** While these investments provide an income stream, it would be very unusual for investors in these products to borrow to fund their investment.	***Not affected.***	After-tax returns for Australian resident investors will fall under the policy. However, prices are unlikely to be impacted as returns are unchanged for foreign residents, who are likely to be the marginal investors. Although asset prices are unlikely to change, the

			composition of ownership may change.
Trusts, including managed investment trusts	***Affected.*** The after-tax returns on units in unit trusts will be reduced for Australian residents: • Investors will not be able to use net investment loss on units to offset salary and wage income, deferring those losses to a later point in time. • CGT discount will also be reduced to 25 per cent.	***Not affected.***	After-tax returns for Australian resident investors will fall under the policy. However, prices are unlikely to be impacted as returns are unchanged for foreign residents, who are likely to be the marginal investors. Although asset prices are unlikely to change, the composition of ownership may change.
Partnerships and sole traders	***Not affected, subject to the non-commercial loss rules*** Under current rules, partnership and sole trader losses are subject to the non-commercial loss rules, which mean that you can only make use of the losses against wage and salary income in certain circumstances – for example, if you earn less than $250k in salary and have business income of more than $20k. Assuming the non-commercial loss tests are satisfied, under Labor's proposal, any partnership losses could be used to offset salary and wage income. General law partnerships are not affected. However, it is possible for	***Not affected.***	***Not affected.***

	limited partnerships to be affected as they may provide passive income (e.g. corporate limited partnerships).		
Super funds (including SMSFs)	***Not affected.*** As the policy indicates no change to superannuation funds, members would not be affected.	***Not affected.***	***Not affected.***
Business investments (using the structures outlined above)	***Not affected.*** Labor's negative gearing policy as originally announced does not explicitly exclude business income. As a result it depends whether or not investment income is interpreted to include business income. However, Labor has recently clarified that their negative gearing policy does not affect current rules on business investment deductions.	***Not affected.***	***Not affected.***

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We suggest changing 'negative gearing' in the sentence below to 'negatively geared property'. People would still be able to negatively gear equity investments.

> And for the mums and dads, nurses, teachers, police, small business owners and other on ordinary incomes who wish to use negative gearing in the future to give themselves a go at building wealth for their retirement, they will have to compete with more wealthy investors for a much smaller pool of housing stock, crowding them out of the opportunity they have right now.

We presume "Labor 's proposal therefore runs the risk that more wealthy investors will continue to enjoy the same tax incentive benefits they get now, while more modest mums and dads will have to look elsewhere." refers to structuring opportunities, as the limit on negative gearing for established property would not differentiate between more or less wealthy investors?

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