My submission is split into two parts. The first relates to negative gearing and the second related to the 50% CGT discount (upon disposal) -whether they relate to real property or other asset classes such as shares. However, for the purposes for this submission, I will focus on how they apply to real property.

**PART 1**

Negative gearing has received a lot of media coverage recently, especially as we are in the middle of an investor led property price boom, particularly in Sydney and Melbourne. Most of the debate is centred around whether this tax incentive (for investors) is a contributing factor to significant price rises at the expense of home buyers (HB), including first HB who do not have these tax incentives at their disposal, yet are still required to compete with investors to purchase the same property (but for different reasons).

Currently, net rental losses in any given year can be offset against other income (such as salary and wages) recorded in that year to reduce total tax payable. For most investors, the tax break equates to approximately 34.5% (of the net loss) but could be as high as 47%. Essentially this means that loan repayments on a negative geared investment property is generally financed from three different sources:

1. the tenant (rent)
2. the owner (capital contributions); and
3. taxpayers (tax refund).

Rather than removing negative gearing altogether, I suggest two alternative solutions worth exploring as they provide:

* a better outcome for government in terms of increased tax revenue (over the short to medium term); and
* a relatively neutral outcome for investors over the life of property ownership.

**Alternative 1:**

Net rental losses (ie total allowable deductions which exceed total rental income) returned in any given tax year should not be allowed to be offset against other income. Rather, the losses should be allowed to be carried forward indefinitely to be offset against net rental gains returned in future years (similar to business tax losses).

**Alternative 2:**

Net rental losses returned in any given tax year should not be allowed to be offset against other income. Rather the losses should be allowed to increase the cost base for CGT purposes at the time of disposal (of the property).

Furthermore, investors should be allowed to choose from the two alternatives, depending on individual circumstances.

**PART 2**

Another hot topic at the moment is the 50% CGT discount applicable to the disposal of properties held for 12 months or more. To reduce the risks associated with property speculation and provide a better incentive for investors to retain their investments in the rental pool for longer periods, I recommend the removal of the discount altogether for properties held for less than 5 years. For properties held for 5 years or more but less than 10 years, a 50% CGT discount should be retained (but only for the percentage of time held over 5 years). This recognises that capital gains were derived over a number of years and had gains been equally apportioned on an annual basis the effective marginal tax rate would most likely have been lower than otherwise. For properties held for 10 years or longer, there should be no CGT (but only for the percentage of time held over 10 years).

To illustrate how I propose this to work,  assume an investor made a net capital gain (NCG)

of $100,000 on the sale of a property over 4 different periods (eg 4, 8, 12 and 15 years). The results are as follows:

|  |  |  |
| --- | --- | --- |
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| |  |  |  |  |  | | --- | --- | --- | --- | --- | |  | Years of ownership | | | | |  | 4 yrs | 8 yrs | 12 yrs | 15 yrs | | Current NCG reported (incl 50% discount) | $       50,000 | $        50,000 | $     50,000 | $     50,000 | | Proposed NCG reported | $     100,000 | $        81,250 | $     62,500 | $     50,000 | | Difference | -$       50,000 | -$       31,250 | -$     12,500 | $             - | |  |  |
|  |  |  |
| The results clearly show a reduction in NCG reported the longer the property is held. The break even point whereby the NCG reported (under the proposed rules) would be no different to that reported under the current rules, is a hold period of 15 years. |  |  |
| Naturally, these changes would also be applicable to other asset classes, such as shares. |  |  |