Shattered opportunity: 
How scrapping negative gearing will smash the middle class

A Menzies Research Centre Policy Brief
Part A: Background

“Frugal people who strive for and obtain the margin above these materially necessary things are the whole foundation of a really active and developing national life.”
Robert Menzies, May 1942.

Housing is the single largest contributor to the net worth of Australians.

The estimated overall value of the 9.6 million dwellings in Australia is $6.5 trillion, more than double the value of superannuation funds ($2.7 trillion) and more than four times the value of Australian listed stocks ($2 trillion).

Some 27% of Australian homes are privately rented, giving us one the largest pools of private rental accommodation per head of population in the world.

The health of the private rental property sector is due in no small part to the structure of the taxation system which provides two major incentives for investors: a concession on capital gains tax, and the ability to claim a tax deduction against the cost of borrowing.

Labor plans to abolish both.

Gearing is the term used for borrowing money to invest in assets such as property or shares. Investors can be positively or negatively geared, depending on whether the income from their investment is more or less than their expenses.

In Australia, the term “negative gearing” is generally confined to residential property investment. According to the Australian Taxation Office, a rental property is “negatively geared” where the deductible expenses (including interest on the loan borrowed to finance the property) exceed the income earned from the property.

In net terms, negative gearing offers only slight relief from other taxes.

The $3.7 billion in net rental losses property investors deducted from their tax liability in 2013/14, for example, was only a fraction of the capital gains tax paid on $51.2 billion of profits made from dwelling resales in the 2015 calendar year and the $45 billion in property related taxes to state and local governments.1

Yet it is an important incentive to Australians, particularly middle-income owners that has contributed to the popularity of property investment in Australia.

At its heart, the strength of residential property investment is a reflection of Australia’s strong middle class which has benefited from policy choices, many of them bipartisan, since the late 1940s.

It reflects the Liberal philosophy of Australia’s longest-serving Prime Minister, Robert Menzies who described the middle class as “the motive power of human progress.”

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1 Profile of the Australian Residential Property Investor, CoreLogic, 2016.
Part B: Introduction

You don’t need to be rich to be a property investor in Australia. More than a million Australians on modest incomes have been able to invest in rental property thanks to the negative gearing provisions re-introduced by the Hawke Labor government 32 years ago.

Now Labor is proposing to abolish negative gearing for all investment properties other than new ones. It is also proposing to reduce the capital gains tax discount on investment property from 50 per cent to 25 per cent, increasing the amount of tax paid on the sale of a property by 50 per cent.

Labor’s property tax grab will be a double disincentive for future generations to invest in property and enjoy the benefits of an income stream and accumulated wealth that their parents and grandparents enjoyed.

It will make it harder for young Australians to accumulate wealth over their lifetimes, forcing more future retirees onto state benefits.

Labor’s claim that negative gearing is “welfare for the wealthy” grossly misrepresents the profile of the average Australian property investor. The average negatively geared property investor has a taxable income $84,590, similar to the average full-time adult average wage.²

For every negatively geared investor earning more than $500,000, there are 49 who earn between $37,000 and $80,000.

Labor’s proposal to abolish negative gearing will not hurt the wealthy, who can largely afford to buy an investment property without claiming a tax deduction. It will punish middle-income Australians who would not be able to afford the mortgage payments on an investment property if the cost of borrowing was not tax deductible.

Far from easing so-called “intergenerational inequality,” Labor’s policy will entrench it. Baby boomers and Gen-Xers who have already invested in property will continue to be able to deduct tax against interest payments.

Their children, however, will not be afforded the same opportunity to invest in property and gain the benefits of wealth accruing over their lifetime. It will increase the chances of retiring with less wealth than their parents. Fewer of them will enjoy the dignity and security of self-funded retirement.

Choice versus compulsion

Negatively-geared investors are not tax avoiders, as Labor claims. Most intend their rental property to provide a nest-egg for the future that will complement their superannuation savings.

Labor’s policy strips away the right of Australians to make their own investment choices and replaces it with compulsion.

Under a Labor government, a person on a salary of $80,000, slightly below the average wage, will be forced to put aside $370 a fortnight into a superannuation fund, $77 more a fortnight than under the current arrangements.

Those who prefer to save through their retirement by investing in property, however, will face a heavy tax penalty. The annual tax bill for person on a salary $80,000 will increase by $2828.

This is unlikely to deter the small minority of property investors on large incomes. But it will make a material difference to the disposable income of those on medium incomes.

It means that future Australians will be denied the benefit of financial security that comes from investing in property as a complimentary retirement savings strategy.

It means future generations may find themselves retiring with less in the bank than their parents did. It increases the likelihood that they will be forced onto the state pension.

² ABS 6302.0 - Average Weekly Earnings, Australia, Nov 2018
Property investment benefits the community

The benefits of strong middle-class investment in rental property flow to the whole community.

It increases the supply of rental property, allowing competition to drive down rents.

Private investment in rental housing stock lessens the need for public housing, which lessens the need for government-funded rental accommodation.

In Australia just 4 per cent of households live in public housing while 27 per cent rent privately. In the UK, by comparison, 18.2 per cent of households are in public housing and 17.1 per cent in privately rented dwellings.

Property investment provides financial security in retirement

Australians collectively own 2.6 million investment properties worth a total of $1.3 trillion, making it the second largest source of wealth after superannuation.

The average Australian owns the equivalent of more than $300,000 in non-financial assets, chiefly real estate, more than the citizens of any other country.

The rewards from investment are shared more evenly in Australia than in any other developed country. More than two-thirds of Australians (67 per cent) are worth more than $US100,000, the highest proportion of any country in the world. The equivalent percentage in the US is 25, in New Zealand, and just 17 per cent in Sweden, a nation often proclaimed as the model of social and economic equality.

Our rate of US-dollar millionaires is 7 per cent, second only to Switzerland.

This extra wealth, in addition to the $2.7 trillion in superannuation we have collectively saved, gives more Australians a chance of a healthy, wealthy and secure retirement.

These figures confirm that Australia is the most successful middle-class nation in the world, thanks mostly to our ability to invest in property and save with superannuation.

Who are the investors?

Property investors are more evenly spread across age, income and political affiliation than we imagine.

One in six taxpayers own a rental property and more than one in ten negatively gear, according to Australian Tax Office data.

One in five voters at the last election reported owning an investment property at the last election, a figure slightly higher than that released by the Australian Tax Office. It shows that the benefits of rental property ownership are felt by members of the family other than the registered owner.

It also suggests the political risks of abolishing negative gearing are higher than Labor thinks.

A survey of voters after the 2016 election highlights the diversity of negatively geared investors. They include:

- 49 per cent of graduates
- 25 per cent of immigrants
- 36 per cent of Asian born immigrants
- 24 per cent of self-employed
- 18 per cent of trade union members

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3 Australian Institute of Health and Welfare
4 Australian Housing and Urban Research Institute
5 Credit Suisse Global Wealth Data Book 2018
Of the 21 per cent of voters with property investments at the 2016 election:

- 26 per cent voted Labor
- 50 per cent voted Liberal or National
- 6 per cent voted Green
- 18 per cent voted “other”

**Summary**

The Australian Labor Party’s policy will be a disaster for both Australia’s existing middle class and the young Australians who aspire to join its ranks. Despite it being sold as a solution, in reality it will reduce the wealth of Australia’s broad, hard-working middle class, increase the intergenerational inequality it seeks to redress, and force people to become more reliant than ever on state housing and handouts.
Part C: Negatively geared investors are middle Australia

Critics of negative gearing frequently assert that net rental losses amount to tax minimisation by the wealthy. Labor’s Chris Bowen described it as “welfare for the wealthy.” Nothing could be further than the truth.

Negatively geared investors are exactly the type of people you’d expect to be eligible for a home loan: experienced workers with steady, full-time jobs.

They tend to be older than the average taxpayer. In 2015/16, the median negative gearing user was aged between 45 and 49 compared to a median age of 40 years across the general workforce.

The vast majority of negatively geared investors are more than a decade into their full-time working career. Since the accumulation of relevant experience is recognised on the payscale, it is no surprise that negatively geared investors earn higher wages.

Negatively geared investors tend to work longer hours than others, translating of again into higher earnings.

The fact that negative gearing users earn more than the average taxpayer is no more remarkable than a 49-year-old full-time worker earning more than his retired father and 19-year-old son.

Negatively geared investors earn close to an average income adjusted for age

The ATO’s dataset does not provide an exact average income for all negatively geared property investors. However, it does state the number of taxpayers claiming a net rental loss grouped according to their taxable income. This data can be used to approximate the average income among Australia’s 1,257,301 negatively geared property investors.

Using the data from 2015/16, we have calculated the average user of negative gearing had an approximate taxable income of $84,590.

Although negative gearing users are found in all adult age brackets, more than seven in ten are aged 30 to 54. The table below compares the average income of negatively geared property investors with other taxpayers across these age ranges divided into five-yearly increments.

Table 1. Average income of negatively geared property investors and workers by age

<table>
<thead>
<tr>
<th>Group</th>
<th>Average taxable income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Negative gearing users</td>
<td>$84,590</td>
</tr>
<tr>
<td>Non negatively geared, 40-44</td>
<td>$84,872</td>
</tr>
<tr>
<td>Non negatively geared, 45-49</td>
<td>$83,363</td>
</tr>
<tr>
<td>Non negatively geared, 50-54</td>
<td>$83,039</td>
</tr>
</tbody>
</table>

Source: ATO 2015-16 taxation statistics, WageSage

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6  Australian Tax Office
7  ABS, Labour Force, Australia, Detailed, Quarterly, cat. no. 6291.0.55.003, trend.
8  ATO 2015-16 taxation statistics, average author’s own calculations.
9  ATO 2015-16 taxation statistics.
Negatively geared investors earn an average taxable income directly comparable with the group that represents their median age: taxpayers aged 45 to 49.

Negatively-geared investors, in other words, are not significantly better off than other taxpayers at a similar life stage to themselves.

To be sure, it is the nature of averages that there will be many individuals significantly above and below these figures. The point, however, is that these calculations categorically rule out the possibility of negatively geared investors earning substantially more than their non-geared peers.

**Negative gearing benefits entire households - not just owners**

Bill Shorten has described negative gearing as providing “subsidies” for a “lucky few”, while sacrificing the interests of first homebuyers by making it harder to enter the housing market.

The problem with this line of reasoning is that it wrongly assumes that the benefits flow only to the registered owners of investment properties. Owners of negatively-geared property usually form part of a financially interdependent household.

Even small increases in discretionary income can widen significantly the lifestyle and choices available to working families. Beyond improving weekly budgets, negative gearing brings investing in property into reach for the vast majority of Australians who don’t earn a particularly high income. This helps to give lower and middle-income earners the chance to share in the bounty of Australia’s real estate market; arguably our safest and best performing class of investment. In doing so, negative gearing helps more Australian households to create wealth and pursue financial freedom.

**How many true beneficiaries of negative gearing are there?**

In the most typical case, the husband and two children of the owner of a loss-making rental property will share in the benefits of negative gearing, regardless of whether the property is technically held in their name. However, beneficiaries of an investment property will often extend beyond dependent children.

Parents who require assistance in old age along with financially-dependent adult children also have a stake in their family’s financial welfare.

There is no existing data on the average household size of negative gearing users. Nevertheless, the Australian Bureau of Statistics Data on average household size per age group can be used as a proxy to estimate the number of people who live in the household of someone who uses negative gearing. It’s worth noting that average household size is a conservative measure that is likely to understate the true number of Australians who receive some benefit from negative gearing. This is because it fails to account for adult children completing tertiary education who have left home, but are not yet financially independent, as well as elderly parents.

In the below table, we use the average household size per age group to estimate the number of Australians living in the same household as the owner of a negatively-geared property. Our estimates find approximately 5,457,229 Australians belong to a household in which at least one member users negative gearing.
Table: Indirect beneficiaries of negative gearing

<table>
<thead>
<tr>
<th>Age group</th>
<th>15–24</th>
<th>25–34</th>
<th>35–44</th>
<th>45–54</th>
<th>55–64</th>
<th>65+ All</th>
<th>All</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average household size</td>
<td>2.4</td>
<td>2.5</td>
<td>3.4</td>
<td>3.0</td>
<td>2.2</td>
<td>1.7</td>
<td>2.6</td>
</tr>
<tr>
<td>No. negative gearing users</td>
<td>22,398</td>
<td>297,581</td>
<td>471,547</td>
<td>548,258</td>
<td>462,336</td>
<td>231,971</td>
<td></td>
</tr>
<tr>
<td>Estimated no. of people living with user of negative gearing</td>
<td>53,755</td>
<td>743,952</td>
<td>1,603,259</td>
<td>1,644,774</td>
<td>1,017,139</td>
<td>394,350</td>
<td></td>
</tr>
<tr>
<td>Total beneficiaries of negative gearing</td>
<td>5,457,229</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: 2016 Census quick stats, ATO 2015-16 taxation statistics

Labor’s proposed changes will hurt average households most

The claim that abolishing negative gearing for established properties will make the tax system more fair and equitable is without foundation. The largest affected group are ordinary households, which will face higher ongoing costs if they choose to invest in residential real estate.

Full-time workers aged between 30 and 54, the dominant age group among negatively geared investors, face greater financial pressures characteristic of the so-called “working poor”. It is age-bracket that needs to accommodate the pressures of a growing family while beginning to prepare for retirement. Few of this cohort could seriously be considered wealthy.
Part D: Negative gearing and tax equity

The Australian Labor Party’s “Positive plan to help housing affordability” is based on spurious assumptions and poor information. It claims:

“...tax subsidies are highly inequitable, with the vast majority of benefit to high income earners... For negative gearing, the top 20% of income earners receiving around half of the negative gearing benefits, according to NATSEM. These subsidies – negative gearing and the capital gains tax discount – overwhelmingly provide benefit to the wealthiest Australians.”

The NATSEM analysis, commissioned by GetUp and The Australia Institute, is deeply flawed. It claims that over a third of negative gearing “tax benefits” went to the top 10 per cent. These “tax benefits” refer the total amount of net rental losses claimed across the country.

In essence, Labor’s argument is that because higher income earners tend to claim larger net rental losses than low and middle income earners, negative gearing is regressive and consequently unfair. Or, as Bill Shorten puts it, “negative gearing tax subsidies proportionally favour the well off. Everyone else is missing out.”

The claim is based on a fundamental misunderstanding of the purpose of concessions within the tax system.

First, tax deductions are not an efficient mechanism for wealth redistribution. Deductions and concessions are generally directed at achieving other tax policy objectives, such as neutrality and efficiency.

Second, negative gearing does not make the tax system significantly more regressive. High-income earners claiming significant rental losses still pay exponentially more tax – both in proportional and absolute terms – than low and middle-income earners.

The abolition of negative gearing, therefore, would not significantly alter the distribution of the income tax burden.

Equity is not the only element in tax design. Efficiency, transparency and simplicity are also key design principles of Australia’s tax system, as the Henry Tax Review emphasised in 2008.

Redistribution was never the purpose of negative gearing. Rather, it simply gives effect to the well-established tax principle that a business or individual should be able to deduct expenses that have been incurred in order to generate assessable income.

This same principle also extends to work-related expenses and other classes of investments. Deductions of this kind are a longstanding feature of the tax system, and are aimed at promoting efficiency and neutrality, not redistributing wealth.

A one-eyed focus on the equity of individual aspects of the tax system tends to promote a distorted view of how redistributive the tax and transfer system really is. It is why the Henry Tax Review favoured an holistic appraisal of the equity of tax system rather than scrutinising individual components or concessions in isolation.

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12 Quote cited by Helen Davidson on 18 June 2016 https://www.theguardian.com/australia-news/2016/jun/18/labor-seizes-on-treasury-advice-that-wealthy-get-most-from-negative-gearing
Negative gearing has minimal impact on the progressiveness of the tax system

Australia’s tax system is widely recognised as being among the most progressive in the world. In the context of taxation, progressivity refers to an increasing tax burden in line with means or income.

The following graph shows that the impact of abolishing negative gearing would be small:

<table>
<thead>
<tr>
<th>Taxable income of negative gearing user</th>
<th>Estimated income tax liability with negative gearing</th>
<th>Estimated income liability if negative gearing abolished</th>
</tr>
</thead>
<tbody>
<tr>
<td>18,201</td>
<td>0</td>
<td>960</td>
</tr>
<tr>
<td>25,001</td>
<td>949</td>
<td>2,577</td>
</tr>
<tr>
<td>30,001</td>
<td>2,197</td>
<td>3,664</td>
</tr>
<tr>
<td>37,001</td>
<td>3,667</td>
<td>6,007</td>
</tr>
<tr>
<td>40,001</td>
<td>4,657</td>
<td>6,994</td>
</tr>
<tr>
<td>45,001</td>
<td>6,307</td>
<td>8,817</td>
</tr>
<tr>
<td>50,001</td>
<td>8,017</td>
<td>10,708</td>
</tr>
<tr>
<td>55,001</td>
<td>9,817</td>
<td>12,557</td>
</tr>
<tr>
<td>60,001</td>
<td>11,617</td>
<td>14,386</td>
</tr>
<tr>
<td>70,001</td>
<td>15,167</td>
<td>17,911</td>
</tr>
<tr>
<td>80,001</td>
<td>18,617</td>
<td>21,445</td>
</tr>
<tr>
<td>90,001</td>
<td>22,067</td>
<td>25,537</td>
</tr>
<tr>
<td>100,001</td>
<td>26,117</td>
<td>30,064</td>
</tr>
<tr>
<td>150,001</td>
<td>45,997</td>
<td>50,508</td>
</tr>
<tr>
<td>180,001</td>
<td>57,697</td>
<td>63,980</td>
</tr>
<tr>
<td>250,001</td>
<td>90,597</td>
<td>99,070</td>
</tr>
<tr>
<td>550,000</td>
<td>231,597</td>
<td>245,082</td>
</tr>
</tbody>
</table>

Source: ATO 2015-16 taxation statistics.
The above graph models the distribution of the income tax burden both with and without negative gearing deductions.

Again, it is apparent that negative gearing has minimal impact on the distribution of Australia’s income tax distribution. Negative gearing users earning higher incomes of $180,001 or more have an income tax bill many magnitudes greater than those earning middle incomes of between $50,001 to $90,001. True, in terms of raw dollars, the tax bill of those at the top would take a larger leap if negative gearing were abolished. But in the scheme of how much each bracket already pays, the difference is minimal.

The table below sets out the number of negatively-geared investors per income band.

<table>
<thead>
<tr>
<th>Number of negative gearing users per income bracket</th>
</tr>
</thead>
<tbody>
<tr>
<td>$10,000 or less</td>
</tr>
<tr>
<td>$10,001 to $25,000</td>
</tr>
<tr>
<td>$25,001 to $37,000</td>
</tr>
<tr>
<td>$37,001 to $45,000</td>
</tr>
<tr>
<td>$45,001 to $60,000</td>
</tr>
<tr>
<td>$60,001 to $70,000</td>
</tr>
<tr>
<td>$70,001 to $90,000</td>
</tr>
<tr>
<td>$90,001 to $100,000</td>
</tr>
<tr>
<td>$100,001 to $150,000</td>
</tr>
<tr>
<td>$150,001 to $250,000</td>
</tr>
<tr>
<td>$250,001 to $500,000</td>
</tr>
<tr>
<td>$500,001 plus</td>
</tr>
</tbody>
</table>

Source: ATO 2015-16 taxation statistics.
This data shows that negatively geared investment is hardly the preserve of the rich:

- Only one in ten negatively geared investors has a taxable income of above $150,000.
- Less than 1 per cent of negatively geared investors have a taxable income of more than $500,000.
- Those earning a taxable income of $250,001 or more make up only 3.24 per cent of negative gearing users.
- For every negative gearing user earning $500,000 or more, there are 49 who earn between $37,000 and $80,000.14

**Low and middle-income earners benefit more from negative gearing**

Labor’s narrow focus on the size of net rental loss deductions also ignores the relative benefit of negative gearing for low and middle-income earners. In the context of tax policy, relative benefit means the tax saved from negative gearing as a percentage of income.

Assessing the relative benefit of changes to the tax system is common practice because it takes into account that individuals have markedly different incomes and tax liabilities. It also recognises that the practical impact of a change to the tax system will differ depending on each person’s circumstances.

For example, during the GST debate in the late 1990s, commentators noted that poor households would receive a greater relative benefit than the rich from exempting certain foods, since the grocery bill absorbed a larger proportion of their disposable income.

Relative benefit is particularly relevant to negative gearing because it recognises that the lifestyle and purchasing decisions of low and middle-income households – especially those with children - are particularly sensitive to changes in their financial position.

Whereas $70 per week might go largely unnoticed in an upper income household, this same amount could tangibly improve the lifestyle of a low or even middle-income household. For many Australian families, $2,828 a year – the approximate tax saving for a typical negatively geared taxpayer earning $80,000 a year – could make the difference between being able to afford private health insurance, an annual holiday, or extra tutoring for a child with special needs.15

By contrast, in the case of high-income households, these lifestyle decisions are unlikely to be swayed by a windfall of a few thousand dollars per year. If equity is to be a consideration, the relative benefit of negative gearing across income brackets should carry more weight than the absolute comparisons favoured by Labor.

**Benefit of negative gearing relative to after-tax earnings**

This table shows how much the average negatively geared investor in each income band saves as a proportion of their after-tax earnings. Effectively this shows on average how much negative gearing increases each income band’s take home pay on average.

Column 2 sets out the average reduction to personal income tax gained from negative gearing deductions, based on taxable income. Column 3 quantifies this saving as a proportion of after tax income.

This table demonstrates that the average relative benefit of negative gearing is greatest for taxpayers earning $25,000, followed by those earning between $40,000 and $50,000.
### Average benefit of negative gearing as a proportion of tax-paid

A second way of measuring the relative benefit of negative gearing is by calculating the average amount saved through negative gearing as a percentage of each income band’s tax liability.

Effectively, this shows the average ‘discount’ to an individual’s tax bill depending on income.

<table>
<thead>
<tr>
<th>Income</th>
<th>Income tax paid currently</th>
<th>Average saving</th>
<th>Tax saved as a proportion of tax paid [discount on tax bill]</th>
</tr>
</thead>
<tbody>
<tr>
<td>30,001</td>
<td>2,197</td>
<td>1467</td>
<td>66.70%</td>
</tr>
<tr>
<td>40,001</td>
<td>4,657</td>
<td>2337</td>
<td>50.20%</td>
</tr>
<tr>
<td>50,001</td>
<td>8,017</td>
<td>2691</td>
<td>33.60%</td>
</tr>
<tr>
<td>60,001</td>
<td>11,617</td>
<td>2769</td>
<td>23.80%</td>
</tr>
<tr>
<td>70,001</td>
<td>15,167</td>
<td>2744</td>
<td>18.10%</td>
</tr>
<tr>
<td>80,001</td>
<td>18,617</td>
<td>2828</td>
<td>15.20%</td>
</tr>
<tr>
<td>90,001</td>
<td>22,067</td>
<td>3470</td>
<td>15.70%</td>
</tr>
<tr>
<td>100,001</td>
<td>26,117</td>
<td>3947</td>
<td>15.10%</td>
</tr>
<tr>
<td>150,001</td>
<td>45,997</td>
<td>4511</td>
<td>9.80%</td>
</tr>
<tr>
<td>180,001</td>
<td>57,697</td>
<td>6283</td>
<td>10.90%</td>
</tr>
<tr>
<td>250,001</td>
<td>90,597</td>
<td>8473</td>
<td>9.40%</td>
</tr>
<tr>
<td>550,000</td>
<td>231,597</td>
<td>13485</td>
<td>5.80%</td>
</tr>
</tbody>
</table>

Source: ATO 2015-16 taxation statistics.
Claims of unfairness miss the bigger picture

Labor’s observation that tax subsidies are “highly inequitable” is valid insofar as higher income earners do claim larger rental loss deductions than lower and middle-income earners. In 2015/16, the average rental loss claimed by a property investor with a taxable income of $60,000 was $7,474. In comparison, negative gearing users earning $150,000 claimed deducted $11,567.

Yet Labor’s contention that this renders the existing arrangements unfair ignores two foundational points about the nature of tax concessions like negative gearing and their role within the tax system:

**Tax deductions are not mechanisms for wealth redistribution**

1. Foremost, it is to be expected that those with more disposable income to invest in property typically claim larger net rental deductions than middle and low-income earners. This is true of most deductions and concessions, which are generally directed at achieving other tax policy objectives, such as neutrality and efficiency, as opposed to redistributing income.

**Negative gearing does not make the tax system significantly less progressive**

2. In terms of equity, negative gearing has a negligible impact on the progressiveness of the tax system. High-income earners claiming significant rental losses still pay exponentially more tax - both in proportional and absolute terms - than low and middle-income earners. The abolition of negative gearing would not significantly alter the distribution of the income tax burden.

These points are explored in greater depth below.

**Most tax concessions and deductions are not progressive**

To the uninitiated, the fact that higher-income earners typically claim larger net rental losses would seem to support Labor’s argument that negative gearing fails the test of fairness.

What the current debate has largely overlooked is that higher-income earners claim larger deductions not only for rental losses, but most types of deductions and concessions.

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16 ATO 2015-16 taxation statistics.
17 ATO 2015-16 taxation statistics.
Prominent examples include:

- Capital gains tax exemption for main residence
- Concessional taxation of superannuation entity earnings
- Concessional taxation of employer superannuation contributions
- GST exemptions on food, health and financial supplies

This is hardly surprising for the simple reason that a higher income means more expendable funds to purchase deductible expenses in the first place. Even though an expense may be deductible, the benefit of that deduction generally only comes after the purchase, usually in the form of a tax return or reduced tax liability. As a result, a person’s capacity to purchase deductible expenses or take advantage of other concessions is ultimately constrained by their expendable income.

In the case of property investing, higher income earners have greater borrowing power, enabling them to purchase more investment properties. More investment properties will generally result in larger net rental losses that can be deducted against income tax.

As with superannuation or the capital gains tax exemption for main residences, the unequal distribution of negative gearing deductions is an unavoidable consequence of allowing the same concession to be claimed by all taxpayers, regardless of income.

**Negative gearing is consistent with well-established tax principles**

One of the problems with Labor’s critique that negative gearing is unfair is that redistribution was never the purpose of negative gearing. Rather, negative gearing simply gives effect to the well-established tax principle that a taxpayer should be able to deduct expenses that have been incurred in order to generate assessable income.

This same principle also extends to work-related expenses and other classes of investments. It’s basic rationale is that because it may be necessary to incur certain expenses to generate income, it is fairest for an individual to be taxed on what is effectively their net income – which is properly calculated by deducting such expenses from gross income.

Deductions of this kind a longstanding feature of the tax system, and are aimed at promoting efficiency and neutrality, not redistributing wealth.

**Equity can conflict with other policy objectives**

Fairness and equity commonly conflict with these other important tax policy considerations. To take superannuation as an example, it would be near-impossible to implement a retirement income system like Australia’s without granting larger tax concessions to higher income earners. This is because a concessional taxed compulsory super contribution equal to nine per cent of a high-income earners wage will of course be larger than a low or middle-income earner.

While the regressive nature of superannuation tax concessions is a point of contention, it is not seriously advanced as reason for the system’s wholesale abolition - especially by the federal Labor Party.

The case of superannuation illustrates why equity and fairness cannot be the sole criterion for tax policy. Instead, such concerns ought to be balanced against other public policy objectives, in view of the tax system as a whole.

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Part E: CONCLUSION – A sin tax on thrift

By abolishing negative gearing, Labor is imposing a sin tax on thrift. It will significantly increase the tax burden of the middle class while having relatively little effect on wealthy investors. The regressive effects what is effectively a new housing tax will be felt most acutely by the working poor, middle-income groups with larger financial commitments. It will act as intended as a disincentive to private housing investment, countermanding its positive benefits. Since the concessions will remain for existing property investors, it will increase so-called intergenerational inquiry by locking millennials out of an investment that has benefited their parents. Since property investment for the middle classes is principally a means to achieve long-term financial security, particularly in retirement, the tax treatment should reflect the principles applied to superannuation, contributions to which are taxed at a concessional rate. As things stand, Labor’s policy serves as a disincentive to save for financial security in retirement and an incentive to fall back upon the benevolence of the state.
Shattered opportunity: How scrapping negative gearing will smash the middle class

APPENDIX 1: Asset ownership and the electorate

1. The Extent of Asset Ownership

After the Second World War, successive governments actively encouraged home ownership through cheap loans. Widespread home ownership was intended to ward off the threat of communism, but also to ensure the effective integration of postwar immigrants. As a result of this policy, home ownership increased consistently through the 1950s and 1960s, peaking at around seven out of every 10 adults in the mid-1960s, a figure that has remained relatively stable ever since. Of the 67 percent who reported owning a home in the 2016 Australian Election Study, 33 percent said they owned the property outright, and 34 percent said that they had a mortgage.

Table 1: Asset Ownership, 2016 (Percent)

<table>
<thead>
<tr>
<th></th>
<th>Family home</th>
<th>Shares</th>
<th>Investment property</th>
<th>SMSF</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Yes</strong></td>
<td>67</td>
<td>32</td>
<td>21</td>
<td>21</td>
</tr>
<tr>
<td><strong>No</strong></td>
<td>33</td>
<td>68</td>
<td>79</td>
<td>79</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>100</td>
<td>100</td>
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<td>100</td>
</tr>
<tr>
<td><strong>(N)</strong></td>
<td>(2,650)</td>
<td>(2,647)</td>
<td>(2,665)</td>
<td>(2,652)</td>
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</table>

Estimates are based on the enrolled electorate, and exclude don’t know responses.

Source: 2016 Australian Election Study

In contrast to home ownership, popular share ownership is more recent. It grew in size rapidly during the 1990s, driven initially by the large-scale privatization of public assets, such as the Commonwealth Bank and Telstra (formerly Telecom). At the time, Australia had one of the largest privatization programs in the OECD; in terms of value, it was second only to the UK, and as a percentage of GDP second only to New Zealand. Total share ownership increased from 14 percent of the population in 1991, the first year for which data are available, to 54 percent in 1999 (Figure 1).

Share ownership peaked in the early 2000s, and thereafter has declined gradually to around one in three of the population.
In 1985 the Labor government introduced a capital gains tax which applied to all assets but excluded the family home. In order to make the new tax more palatable to the public, the government re-introduced the concept of ‘negative gearing’ in 1987. This allows an investor to claim a tax deduction for borrowing money to acquire an income-generating investment, often a residential property. Property investors represented 8.3 percent of the population in 2012, up from 6.7 percent in 2000. The AES estimate is higher, at 21 percent, and reflects the fact that while one person is often the registered owner of an investment property, the asset affects the overall wealth of the family household.

Changes in public policy towards superannuation have made it a fourth major economic asset that contributes to household wealth. In 1999 the Coalition government created the opportunity to self-manage a superannuation fund (SMSF) and since then this sector of the economy has grown rapidly. In 2001 there were 100,000 funds; by 2015 this had grown to 550,000 funds, covering more than one million individuals. In the 2016 AES, just over one in five voters reported owning a SMSF. Like the ownership of investment property, this is larger than the official estimate, due to its importance to the household.

Measured across the electorate, around one in four report not owning at least one of the four economic assets. Just over one in three report owning one asset, with the family home not surprisingly forming the most frequently owned asset within this group (77 percent). One in four said that they owned two assets, the most common again being the family home (91 percent), followed by shares (56 percent), investment property (30 percent) and a SMSF (24 percent). At the top of the scale, 4 percent of voters said that they owned all four assets.
Overall, asset ownership is widely distributed across the electorate; three quarters of voters possess at least one asset and four in 10 possess two or more. Only one quarter of voters do not possess at least one asset. Among home owners, by far the most numerous group, 40 percent, also possessed shares, 27 percent an investment property, and 22 percent a SMSF.

2. Who Owns Assets?

The very large numbers of voters who possess at least one economic asset suggests that there will be relatively few social or economic differences in the background of owners. While a reasonable level of household disposable income is required to purchase an asset, for most of the last 30 years the purchase of assets such the family home was well within the reach of the vast majority of voters.

As we would expect, asset owners tend to be older, better off and concentrated in particular types of work. However, the differences are relatively minor. For example, the mean age of an investment property owner is 50.9 years and a SMSF owner 50.6 years, just slightly older than the mean age of the electorate as a whole (48.6 years). Similarly, 39 percent of home owners have a university education, compared to 37 percent of the electorate. For the most part, asset owners are a representative cross-section of the broader electorate.

Table 2 The Social Background of Asset Owners

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<thead>
<tr>
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<th>Family home</th>
<th>Shares</th>
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<th>(All)</th>
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<tr>
<td>Age (mean years)</td>
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<td>Immigrant (percent)</td>
<td>21</td>
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<td>University education (percent)</td>
<td>39</td>
<td>46</td>
<td>49</td>
<td>41</td>
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<td>Self-employed (percent)</td>
<td>18</td>
<td>19</td>
<td>24</td>
<td>26</td>
<td>(15)</td>
</tr>
<tr>
<td>Trade union member (percent)</td>
<td>20</td>
<td>20</td>
<td>18</td>
<td>16</td>
<td>(17)</td>
</tr>
<tr>
<td>Household income (mean $’000s pa)</td>
<td>94.4</td>
<td>107.9</td>
<td>123.2</td>
<td>94.4</td>
<td>(87.9)</td>
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</table>

Source: 2016 Australian Election Study
There are, of course, some notable exceptions. Owning an investment property or shares is more likely to attract those with a university education, reflecting the skill required to manage them. The self-employed are more likely to own investment properties and SMSFs, a consequence of their employment which is not accompanied by employer superannuation and entitlements. Immigrants are more likely to own an investment property, with the rate among those born in Asia (36 percent) being notably high.

A regular income is required to purchase an asset or to gain a loan to acquire one, so not surprisingly 55 percent of those owning an investment property are in full time employment, compared to 41 percent for the electorate as a whole (Table 3). An asset can be used to provide a regular income, particularly in retirement. This is particularly the case with shares, and 27 percent of those who own shares are retired compared to 20 percent of the electorate.

Table 3: Labour Force Participation

<table>
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<tr>
<th>Family home</th>
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<th>(All)</th>
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<tr>
<td>Working full-time</td>
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<td>55</td>
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<td>3</td>
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<td>Retired</td>
<td>27</td>
<td>27</td>
<td>16</td>
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<td>Other</td>
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<td>100</td>
<td>100</td>
</tr>
<tr>
<td>(N)</td>
<td>(1,762)</td>
<td>(832)</td>
<td>(550)</td>
<td>(545)</td>
</tr>
</tbody>
</table>

The ‘other’ category combined home duties, studying at school or university.

Source: 2016 Australian Election Study

This group of share owning retirees represents 8 percent of the total electorate. The median voter in this group reported owning shares in between two and five companies, and their mean annual household income was just $62,300 per year compared to $87,900 for the electorate as a whole, a significant difference. Within this group, around half (47 percent, or 4 percent of the electorate) said that they owned their own home and shares, but not any other economic asset. Their mean age was 72.3 years and their mean income $46,300 per year, almost half the mean income for the electorate. This is the group who would be unduly affected by any change to the rules on franking credits for shares.
3. Assets and Voting

Economic assets bring with them different levels of risk. The lowest risk assets are those such as money in the bank, where there is a high level of security and little risk of a policy change that will negatively affect the value of the asset. Home ownership conveys more risk, insofar as market changes will affect the value of the property, but successive governments have avoided policy changes that will affect the family home. By contrast, the ownership of shares, and investment property or a SMSF carry considerably risk, not only from market changes, but from changes to tax policy.

The higher the level of risk to an asset from changes in government policy, and the higher the value of the asset, the more likely it is to influence a person’s vote. In general, asset owners are more likely to vote for the Coalition than Labor, although the differences are not large (Table 4).

Those owning a family home voted 32 percent for Labor in 2016, at about the level for the general population. The Coalition gains more support among those owning shares and investment property.

Table 4: How Assets Owners Voted in 2016

<table>
<thead>
<tr>
<th></th>
<th>Family home</th>
<th>Shares</th>
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<th>(All)</th>
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<td>26</td>
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<td>Liberal-National</td>
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<td>50</td>
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<td>(39)</td>
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<td>Green</td>
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<td>(N)</td>
<td>(1,762)</td>
<td>(832)</td>
<td>(550)</td>
<td>(545)</td>
<td></td>
</tr>
</tbody>
</table>

The ‘other’ category combines home duties, studying at school or university.

Source: 2016 Australian Election Study

More important in determining the vote is the number of assets that a person owns. Figure 3 shows that among those with no assets, Labor has an advantage over the Coalition of about 9 percentage points. Thereafter, the Coalition gains more votes, and among the small proportion of the electorate who own all four assets, 71 percent reported voting for the Coalition in 2016 and just 16 percent for Labor.
Figure 3: Levels of Asset Ownership and Voting in 2016
References


## APPENDIX 2: Negatively geared taxpayers by electorate

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<tr>
<th>Rank</th>
<th>Seat</th>
<th>State</th>
<th>Neg-geared taxpayers (%)</th>
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</thead>
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<td>WA</td>
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<td>Fenner</td>
<td>ACT</td>
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Source: Australian Parliamentary Library