Australian Institute for Business and Economics (AIBE)

Negative Gearing’s Impact on Australia’s Housing Market

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Abstract

Based on the available research, negative gearing’s impact on Australia’s housing market is inconclusive. The paper aims to demonstrate that there is no substantial evidence to indicate that negative gearing is adversely affecting house prices, the supply of housing, cost of rent or supply of rent. As a result, the paper reinforces the position for the continuation of negative gearing and highlights areas for policy to be improved.

Introduction

Negative gearing plays a critical role in Australia’s rental market. The policy works by encouraging housing investment through tax incentives. Without negative gearing, there are fears that Australia’s rental market may collapse forcing people into public housing. Nevertheless, negative gearing has received a lot of criticism from Australian politics with the Australian Labor Party attempting to abolish the policy. The paper aims to break through the noise of political ideologies to gauge the actual impact of negative gearing and its effects on the Australian economy based on the available evidence.

Negative gearing occurs when the expenses of an asset exceed the revenue resulting in a loss which can be offset by other income (HIA Economics Group, 2011). This is predominately seen within the housing market but can occur in the share market. A negative gearing opportunity occurs when expenses (i.e. mortgage repayments, property maintenance and upkeep) outstrip revenue (i.e. rental income). Despite investment losses, negative gearing is viewed as a viable investment strategy as investors can gain tax benefits by deducting the net loss of the investment property from their other taxable income (Figure 1). Furthermore, if the investor can speculate the housing market successfully, they have the potential to offset their losses through capital gain. A formula has been developed below to help assist in conceptualising this idea:

\[
\text{Profit from Speculation} = \text{Capital Gain} - \sum (\text{Total Expenses})
\]

Figure 1: Tax Benefits of Negative Gearing

![Profit from Speculation formula](image)

Negative gearing is also viewed as a vehicle to increase the supply of houses in the rental market. Tax benefits incentivise investors to increase the supply of rental housing resulting in downward pressure on rent prices (Figure 2). If negative gearing was abolished the supply of rental properties may decrease forcing rental prices to increase. The rental price surge argument is commonly used to support negative gearing as exemplified by the following quote:

“Restricting negative gearing would worsen housing affordability problems for renters and hurt “mum and dad” investors” (Treasure Scott Morrison, 2017).

Figure 2: Negative Gears Effect on Rental Supply

![Negative Gears Effect on Rental Supply](image)

The paper will address key areas to determine whether negative gearing affects Australia’s housing and rental markets. Evidence within each section will
be examined to determine the potential impacts. Firstly, the paper will provide information regarding the history, global stance, political stance and current state of negative gearing within Australia. Secondly, the paper will draw inferences from secondary data to support the hypothesis that the impact of negative gearing on Australia’s housing market is uncertain. This will hypothesis will investigate the benefits of retaining negative gearing, the costs of negative gearing, insights into negative gearing and a home buyer’s strategy. Finally, the paper will summarise findings and provide possible recommendations.

History

Legislated in the Income Tax Assessment Act of 1936 negative gearing has been a controversial topic within Australia’s parliament. The debate around negative gearing was first sparked during the Hawke-Keating government (Putland, 2015). During this administration, numerous changes were made to Australia’s tax system including the quarantining of negative gearing in 1985. The Hawke government justified the quarantine on the following principals:

(i) taxpayers should not have to subsidise rental property investors;

(ii) negative gearing resulted in increased home prices to the detriment of ordinary home buyers; and

(iii) an estimated revenue gain of $55m in 1986-87, $100m in 1987-88, rising to $195m in 1990-91 and subsequent years.

(Hurford, House of Representatives, 1986)

However, the policy move proved to be unpopular with investors claiming that the quarantine caused rental accommodation to dry up and rise (RMIT ABC Fact Check, 2016). Political pressure ultimately caused Hawke to repeal the quarantine in 1987 only two years after the implementation.

Against this background, current literature often views the quarantine of negative gearing from 1985-1987 as benign. The policy failed to deliver increased housing affordability as seen in Figure 3 with no significant foreseeable impacts on Australia’s housing and rental markets. Furthermore, there is little to no evidence to suggest changes in real rents (Figure 4) or rental vacancies (Figure 5). The findings from the quarantined period disprove claims during the quarantine and contradict current arguments that restricting negative gearing will cause a surge in rental prices (Unconventional Economist, 2013). However, a different result may have been found if negative gearing was trailed over a longer period to account for economic lags. Potential economic lags during the quarantined period include the illiquidity of housing stock and stickiness of rental contracts.

Figure 3: Middle-Income Housing Affordability

![Middle-Income Housing Affordability](image)

Source: Graph shows Australian capital city housing markets 1981-2016 (Unconventional Economist, 2017).

Figure 4: Rental Vacancies

![Rental Vacancies](image)

Source: The graph shows the vacancy rate for rental properties across five capital cities, highlighting the period negative gearing was abolished (RMIT ABC Fact Check, 2016).

Figure 5: Real Rent Changes

![Real Rent Changes](image)

Source: The graph shows the changes in real rents in five capital cities between 1985 and 1989. (RMIT ABC Fact Check, 2016).
Global Stance on Negative Gearing

Around the world, various countries have adopted different strategies to regulate negative gearing. While most countries allow for investment properties to be negatively geared, countries including the United Kingdom and the United States have either abolished or limited negative gearing’s effectiveness (Figure 6). The following will be a brief examination of negative gearing policies comparing Australia to the United Kingdom and the United States.

The introduction of policy changes to negative gearing in both the United Kingdom and the United States appears to have not significantly impacted house prices. At a glance, it appears changes in negative gearing policy caused house prices to fall in the United States in 2008. However, when comparing house prices in the United Kingdom, the United States and Australia a direct relationship can be seen (Figure 7). From the data it is plausible to assume the decrease of house prices in the United States was more likely caused by global economic events. The Economist in 2016 also found that house prices within Australia and Great Britain were overvalued which explains why house prices in the United States are significantly lower (Figure 7).

The United Kingdom has one of the strictest tax policies with regard to negative gearing. In 2007 the United Kingdom changed negative gearing laws which quarantined losses made by investors. However, if the investor owns multiple investment properties, the loss from one asset can be applied to the profit of another within the same financial year. The United Kingdom’s policy eliminates the negative gearing tax shelter that incentivises Australians to invest in property. As a result, the policy results in downward pressure on housing prices making it easier for first home buyers to enter the market. Furthermore, the UK government can maximise its tax revenue as losses are unable to be offset by income (Pasqualina, 2012).

While negative gearing is not completely banned in the United States, significant limitations were introduced in the mid-1980s where passive income losses can only be offset by passive activity income. In the United States income from investment property is considered passive income. The United States does not permit rental property expenses to be deducted from labour income however rental property expenses can be deducted from passive income. If a passive income loss occurs this cannot be deducted from labour income (in effect preventing negative gearing), but the loss may be able to be carried forward into future tax years (IRS, 2017). The United States policy has the resultant effect of only permitting negative gearing to professional investors and property developers (Ellis, 2012). As a result, the United States government is able to limit the effectiveness of negative gearing as a tax shelter.

![Figure 6: World Taxation Systems](image)

The table displays the mortgage deductibility, capital gains tax (CGT), land property tax and negative gearing depreciation for various countries.

<table>
<thead>
<tr>
<th>Country</th>
<th>Mortgage deductible</th>
<th>CGT</th>
<th>Land property tax</th>
<th>Negative gearing depreciation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>No</td>
<td>No</td>
<td>½</td>
<td>Limited</td>
</tr>
<tr>
<td>Canada</td>
<td>No</td>
<td>No</td>
<td>½</td>
<td>Limited</td>
</tr>
<tr>
<td>France</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Limited</td>
</tr>
<tr>
<td>Germany</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Limited</td>
</tr>
<tr>
<td>Netherlands</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>Limited</td>
</tr>
<tr>
<td>Sweden</td>
<td>Yes</td>
<td>Yes</td>
<td>Limited</td>
<td>Yes</td>
</tr>
<tr>
<td>Switzerland</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>UK</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>Limited</td>
</tr>
</tbody>
</table>

Note: Under CGT, “limited” means homeowners may defer payment provided the proceeds of sale are reinvested in housing. Under land property tax, “limited” refers to property owner changes along the lines of council rates, which are linked to local services and used more proportionately with property values.

![Figure 7: House Price Index](image)

Source: Shows Features of Taxation Systems Relevant to Housing Markets (Ellis, 2006).

Source: Graph shows relative cost of houses across different countries (The Data Team, 2017).
Political Stance

Wealth inequality within Australia has been increasing since the 1980s. Recently, it has become more difficult to obtain the Australian dream of owning a property with drastic increases in house prices across all major cities. Frustrated by the increase, more Australians are turning to political parties to solve the housing affordability problem. The current party within government, the Liberal Party, has recognised housing affordability to be an issue. However, no firm plan exists to alleviate Australia’s housing crisis (Greens, 2017). Alternatively, the Australian Labor Party blames negative gearing for the crisis and has nicknamed the issue as the “Leaky Bucket” (ALP, 2017). The Labor Party metaphor resonates with many Australians who are petitioning against tax concessions for the wealthy. Present negative gearing policy allows for the permanent reduction and deferralment of personal tax liabilities. Furthermore, a tax discount is applied to the sale of the investment increasing the attractiveness of investment properties. The Grattan Institute (2013) summarises how these two effects are impacting the Australian housing market:

“The combination of capital gains tax rule changes in 1999 and negative gearing has strongly increased the demand for investment properties. Investors compete directly with potential homebuyers, particularly for established houses. This makes it harder for first home buyers to secure a property.”

Currently, the Liberal Party has no intention of changing the policy. A potentials reason why the Liberal Party is hesitant to fix the “Leaky Bucket” comes from the failed quarantine by the Hawke government. Furthermore, restricting negative gearing may be highly unpopular among voters with an estimated one in seven Australian’s owning a negatively geared property (ATO, 2017).

Current State of Negative Gearing in Australia

Negative gearing is rife within the Australian economy. ATO (2012) data shows that 1,811,174 individuals – or approximately 8% - negatively gear with 67% reporting a taxable loss against their income. Despite little change to positive gearing, since 1994, the Australian economy has seen a strong positive upward trend in the number of properties that are negatively geared (Figure 8). Proving that the capital gains tax and negative gearing continue to remain strong incentives for investors in property. Though, a misconception exists that negative gearing is equally distributed across all tax brackets. The following statement by the Property Council of Australia (2016) illustrates this argument:

“Two-thirds of property investors who benefit from negative gearing earn a taxable income of less than $80,000 a year”.

When analysing the quote, it is important to note that 82% of Australian taxpayers earn less than $80,000. The following data is further skewed with a large proportion of negative gear’s earning little to no income (Figure 9). There are three main reasons which make allow for this to occur. Firstly, an investor engaged in negative gearing may be a part owner of the negatively geared property. Secondly, a person who is negatively gearing may be living off another’s income (i.e. family or partner). Thirdly, major capital cities including Sydney and Melbourne have attracted international investors to add these cities to their portfolios. As a result, it is plausible to conclude that negative gearing is not equally distributed among all tax brackets as the top 18% earning over $80,000 make up one-third negative gearers (RMIT ABC Fact Check, 2017).

Figure 8: Negative Gearing Vs Positive Gearing

A potential reason why negative gearing is enticing to investors may be due to its ability to be easily exploited. Currently, Australia uses progressive tax system which aims to tax higher income earners at higher rates than lower income earners. Whereas negative gearing is a regressive tax, meaning that it benefits the wealthy at the expense of the poor. Furthermore, the policy is accessible to the wealthy as credit lines create a barrier to entry for the poor. The reason why credit lines exclude the poor is caused by financial regulation which favours steady income, job stability, credit history and risk of an investment (Lye, 2014). Household wealth is associated with income, job stability and credit history meaning wealthier individuals have a higher chance of successful loans. The risk is independently assessed by financial institutions to conclude whether an investment is risky or safe. Thus, it is justifiable to conclude that higher income equates to a greater chance of acceptance. This is represented by the fact that a majority of housing debt is comprised of the top 20% (Figure 10). Furthermore, the data connects the notion that negative gearing benefits higher household incomes (Figure 11) supporting the notion that negative gearing is a regressive tax by providing significant benefits for higher income earners.

In recent times, the high returns of Australia’s housing market have drawn the attention of both self-managed super funds (SMSFs) and private investors. The investment shift into property may be attributed to the resilience of housing Australia’s market when compared to the ASX200 during the GFC (Figure 12) and the potential tax benefits achieved through negative gearing (ACIL Allen, 2015). However, the trend for investors to negatively gearing in property market through SMSF has highlighted concerns for throughout the investment community:

“It is important for the health of the sector that SMSF trustees should avoid the temptation to borrow. By all means, play the risk game with non-superannuation assets, but leave the superannuation fund as an un-gaered safe harbour for retirement” (Robert Brown, 2013).

Furthermore, investing in property through SMSFs may significantly decrease a trustee’s portfolio diversification, in turn, increasing an investor’s exposure to a housing bubble (ASIC, 2017). Investor’s lack of diversification arises as many Australians
already depend heavily on their property as a safe vehicle for retirement (Place Project, 2016).

Figure 12: Housing Market Vs ASX200:

Source: Comparing ASX to Stock Market (Base=100 Jan 2008), (Lawless, 2012).

The Solution or Problem

To address Australia’s growing housing affordability issues, policymakers have turned to negative gearing and capital gains tax as a possible solution. Currently, there is little to no data to verify the effectiveness of negative gearing. However, a potential theory behind the pitfalls can be found when analysing the supply and demand of both the rental and housing market. The following supply and demand diagrams may provide a possible explanation for the rising house prices and rental prices experienced in cities such as Melbourne and Sydney.

Figure 13: Desired Impact of Negative Gearing:

Assuming negative gearing is successful, the cost of renting will decrease, and the supply of rental properties will increase (Figure 13).

Figure 14: Negative Gearing’s Impact on Housing Market:

The policy also encourages increased demand as it attracts more property investors to enter the market. As demand increases the supply of properties decreases and the price of a house increases (Figure 14). Cities that are already highly developed including Melbourne and Sydney have relatively inelastic supplies. As a result, the increase in house prices may be substantially greater than the increase in the supply of properties.

Figure 15: Overall Impact of Negative Gearing:

Note: Shifts of demand and supply are not representative of the real world and are only used for demonstration purposes.

The impact of higher house prices may force home buyers to opt out of the market and continue renting. As a result, the demand for renting also increases. The shift in demand for renting is shown in the final diagram as it accounts for the intentional and unintentional effects of negative gearing (Figure 15). Therefore, more research is required to examine market sensitivity on how much negative gearing affects demand and supply (i.e. households’ preferences and willingness to buy or rent). If the shift in demand is greater than the shift in supply the combined diagram may provide a possible explanation into the rising house prices and rental prices in Melbourne and Sydney.
Implications of Negative Gearing

The long-term impacts of negative gearing play a crucial role in determining its viability. Australia’s population has seen extensive growth over the past century. Treasury estimates Australia’s population will increase to 35.9 million by 2050 (RBA, 2015). The current state of Australia’s housing market is poorly placed to deal with the challenges faced by a growing population. Although, negative gearing is often criticised restricting its effectiveness could destabilise the economy. Two key arguments support this concept.

Firstly, if the Australian Government imposed significant restrictions on negative gearing a proportion of landlords within the rental housing market may choose to opt out (O’Donnell, 2005). In turn, the effect above may weaken Australia’s economy causing rents to increase. The shortage of rental stock may result in home values to depreciate as housing stock increases. If the value of homes decrease consumption will be affected detrimentally as:

“Consumption responds to predictable changes in house prices” (Campbell & Joao, 2004).

The phenomenon quoted above is commonly referred to as the wealth effect where consumption is correlated with assets prices.

Secondly, the current structure of Australia’s housing system relies on renting to assist in providing housing. In recent times, Australia has seen an upward trend in the number of people renting from 26.9% in 1991 to 30.9% in 2016 (ABS, 2016). This positively correlates with Australia’s average price to income ratio increasing from 4.30 in 2001 to 6.90 in 2016 (CoreLogic, 2016). The housing affordability problem is expected to worsen as Australia’s population continues to grow and dwelling commencements stagnate (Figure 16). If new dwelling commencements are unable to keep up with new housing demand Australia’s house price to income ratio may continue to increase forcing more Australian home buyers out of the housing market (Dodson, 2016).

Figure 16: Population Vs Dwelling Commencements

Source: Graph shows disconnect between population growth and dwelling commencements (Kusher, 2015).

Cost of Negative Gearing

Worldwide populism movements have put increasing pressure on Australian policy-makers to reform negative gearing. In light of this, researchers have been investigating the potential costs that are caused by negative gearing. There are two strong arguments that support the notion of policy change regarding negative gearing.

Wealth distribution has played a crucial role in impacting Australian’s view on negative gearing (Davidson, 2015). Current exploitation of negative gearing as a tax shelter for the wealthy has frustrated many Australians. Exploiting the tax system has caught the eye of researchers which have found:

“Churning patterns in and out of rental property investments by landlords, which maybe prompted by refinancing to more fully exploit negative gearing tax shelter benefits” (Ong and Wood, 2010).

This effectively allows the wealthy to bypass Australia’s progressive tax system which is designed to tax the wealthy at a higher tax rate than the poor. Despite capital gains tax intention to deter landlords from exploiting negative gearing, the Australian Housing and Research Institute (2011) found the tax to only exacerbate the problem:

“Tax shelter benefits are augmented by the accumulation of capital gains that are lightly taxed, because only 50 percent are included in assessable income, and the tax liability is deferred until the investment is realised”.

Additionally, by removing the negative tax shelter, the Australian government would see an increase in tax revenue. The actual cost of negative gearing is not
disclosed, however, Labor estimates that negative gearing costs taxpayers $5.5 billion per annum (Bill Shorten, 2016). This supports the Grattan Institute report which suggests the total cost of capital gains tax and negative gearing costing $11.7 billion (Dealy, 2016). Capital gains tax and negative gearing were both controversial issues during Australia’s last election:

“Spending more at the Commonwealth level on negative gearing and CGT discount than we are in child care or higher education” (Bill Shorten, 2016).

The above quote resonated with a large percentage of Australian’s opposed to negative gearing especially as the Australian Government looks to reduce funding for tertiary education.

Negative Gearing Bias

In recent times, negative gearing’s large-scale use has had a significant impact of $5.5 billion per annum on public revenue (Shorten, 2016). Reforms in 2001 under the Howard government introduced a capital gains tax concession which caused an asymmetric bias (Figure 17). The tax treatment of capital gains and negative gearing losses is asymmetric because capital gains are only taxed when realised and at a concessional rate. Whereas, negative gearing losses are fully deductible and deducted annually. Investors are encouraged to finance investment through borrowing due to the ability to reduce their overall tax liability (Eslake, 2015). Therefore, maximising tax deductions is essential to facilitating asset growth as investors essentially receive a free loan from the ATO (if the negative gearing deduction was not permitted it is likely that the loss would need to be funded from further borrowing or further capital injection). Without the permitted negative gearing deductions, the investor would have a higher taxable income resulting in a higher annual tax payable (Grattan, 2015). Together negative gearing and capital gains tax encourage a strategy that reduces an investor’s tax liability which causes a bias towards debt financing and higher leveraging.

The symbiotic relationship between negative gearing and capital gains tax treatment bias also stems into investment classes. As previously mentioned, negative gearing and capital gains taxation result in a higher leverage bias. However, bank finance disproportionately favours property investment as banks can lend at higher loan to valuation ratios for property compared to other asset classes such as shares. As capital gains are taxed at a concessional rate and losses are fully tax deductible this adds a further bias to asset class choice (The Henry Review, 2010). Assets with high growth while producing less income are more desirable due to larger annual negative gearing deductions while still achieving high capital gains which are taxed at a concessional rate. In effect, the investor sees the capital gain as more valuable than the rental income and can maximise the after-tax return on the investment.

Removing the tax investment incentive and prohibiting investors from deducting interest expenses would ultimately be more equitable from a tax standpoint. Furthermore, from an economic viewpoint, investment losses are unrelated to wage income, so there is no strong rationale for permitting these losses to offset wage income (Grattan, 2015). Both the concessional capital gain tax and negative gearing tax deductibility are likely to reduce taxation revenue while concurrently fostering a tax minimisation mindset for investors. The negative gearing and capital gains tax structure produce biases into the investment system leading to higher leveraging and biases in investment choices which may not result in the most efficient investment allocations. As a result, the economy experiences asset class booms, such as property, due to higher leveraging from the induced bias (The Henry Review, 2010).
Economic Variables Affecting Negative Gearing

The following will analyse key economic variables to determine their impact on negative gearing rental losses (Figure 18). Ideally, raw data would be preferred when analysing how these variables affect the Australian economy. However, the following statistical matrix of correlation coefficients is sufficient in providing a brief overview and determining statistically important variables. The table indicates whether there is a statistically significant or insignificant directional correlation between negative gearing and other economic variables.

Where the matrix displays a statistically significant correlation, it is reasonable to conclude that variables are associated. However, it is impossible to know if it is a causative association. The coefficient may show a positive, negative or no correlation. When a correlation approaches +1 this indicates a strong relationship, -1 indicates a strong inverse relationship and 0 indicates little or no correlations between the variables.

Intuitively, the data shows a strong correlation between negative gearers and negative gearing rental losses. As the number of people negatively gearing increases so does the overall negative gearing losses. The matrix shows that this relationship is very strong. It also demonstrates that overall negative gearing losses will decrease if the number of people negatively gearing decreases.

There is a strong inverse correlation between negative gearing rental losses and rental investors. As negative gearing rental losses increase this deters investors from the market - investors may leave the market or choose not to enter the market. When negative gearing rental losses increase, the opportunity cost of staying in the market becomes too high. This is due to the risk of default and makes investing in alternative assets more attractive.

Capital formation refers to the amount of net capital on hand. As the number of negative gearers increases capital formation decreases. This is expected as negative gearers need financial assistance to obtain additional capital resulting in investors with higher leverage and greater risk exposure. Corollary to this, as negative gearing rental losses decrease capital formation increases. This means that as the level of capital formation increases the negative gearing rental losses decreases moving some investors into neutral or positive gearing. In turn, this reduces the number of negative gearers as well as decreases leverage. These notions are reflected in the matrix.

Interestingly, the matrix was unable to show a strong correlation between negative gearers and house prices. The weak relationship between negative gearers and house prices contradicts earlier statements that negative gearing is having a significant impact on housing prices. However, due to the secondary nature of the data no firm conclusions can be drawn as more research is required.

Figure 18: Correlation Matrix factors effecting negative gearing

<table>
<thead>
<tr>
<th>CORRELATION</th>
<th>Negative gearing rental losses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Negative gearers</td>
<td>1.000</td>
</tr>
<tr>
<td>Rental investors</td>
<td>-0.729</td>
</tr>
<tr>
<td>House prices</td>
<td>-0.520</td>
</tr>
<tr>
<td>Dwelling approvals</td>
<td>-0.610</td>
</tr>
<tr>
<td>Capital formation</td>
<td>0.670</td>
</tr>
<tr>
<td>Inflation</td>
<td>0.563</td>
</tr>
</tbody>
</table>

Source: Matrix indicates variables that are associated with negative gearing (O’Donnell, 2005).

A Home Buyers Strategy

For many Australians owning a property plays a central role in the Australian dream. Despite some evidence indicating that negative gearing may be reducing Australia’s housing affordability, the mechanism can also assist in purchasing a home. A popular investment strategy adopted by some Australians is to rent to save money to purchase a property. The reasoning being that renting is significantly cheaper than buying due to the costs of owning a property (Commonwealth Bank, 2016). However, the principles of negative gearing can be applied to aid first home buyers.

Owning an investment property while continuing to rent can overcome many of the shortcomings of first home ownership. The ability to deduct expenses including mortgage interest, maintenance and depreciation can potentially save investors thousands of dollars which might not be achieved under conventional home ownership (Commonwealth Bank, 2016). Furthermore, there is the added benefit of deducting interest expenses before tax. While an owner-occupier of a home must make interest payments after paying tax. Paying interest before tax is substantially more beneficial than paying interest
after tax. Homeowners using the investment property strategy can purchase a more expensive home for the same interest payment by utilising pre-tax interest dollars rather than post-tax interest dollar. Additionally, losses on an investment property may be minimised due to negative gearing.

Nevertheless, when deciding to purchase an investment property, investors should be mindful of the associated costs. Tax and other expenses can significantly reduce the potential capital gains of an investment property. Land tax is often overlooked by investors and should be considered when analysing the property’s overall capital gain. Due to the complexity and differentiation of land tax between state to state, it is difficult to determine the tax’s overall effect. Capital gains are also reduced by Australia’s capital gains tax which is incurred on disposal of the investment property. Furthermore, negative gearing rental losses incurred by annual expenses such as council rates and property insurance may offset capital appreciation.
Conclusion

Australia’s housing market continues to be a viable alternative to shares with the ability for investors to negatively gear property in return for tax incentives. Low-interest rates and high capital returns have created a utopian housing market. However, there are growing fears that these conditions may be the catalyst for a potential bubble:

“The evidence is clear that the rate cuts the bank embraced last year in the face of low inflation fuelled house prices and household leverage” (Westpac chief economist Bill Evans, 2017).

Despite potential fears of a bubble, negative gearing may be beneficial to Australia’s rental market. The argument for the continuation of negative gearing arises as Australia housing supply fails to meet current housing demand expectations. However, more research is required to support the above hypothesis.

While negative gearing may assist in alleviating house prices, the policy has been criticised due to its potential costs. Firstly, the findings in ‘The Solution or Problem’ highlighted negative gearing as a potential issue to Australia’s high cost of housing and rent. ‘The Solution or Problem’ explored how negative gearing reduces the supply of properties for home buyers which may cause house prices to rise. If house prices increase too sharply, home buyers may opt out of the homebuyers’ market and into the rental market. In turn, the opting out of the homebuyers’ market increases the demand on the rental market which may lead to higher rental costs. Secondly, the paper found that negative gearing and capital gains tax created higher leveraging and biases in investment choices which may not result in the most efficient investment allocations. Lastly, the paper showed how abolishing negative gearing could help increase government revenue with findings during the last election estimate negative gearing costing taxpayers $5.5 billion per annum.

Negative gearing is a highly controversial topic affecting many areas of the Australian economy. An analysis of the quarantine period from 1985-1987 was unable to provide any clear insight into an Australian economy without negative gearing. The paper also recognises negative gearing to be a highly unpopular policy due to equity reasons. However, due to limited alternatives negative gearing should not be abolished but restricted. Imposing an upper limit on negative gearing reductions may reduce the exploitation of negative gearing as a tax shelter. Additionally, the Government should look into providing more tax benefits (i.e. the ability to deduct mortgage interest from wage) for first home buyers highlighting rather than encouraging investors to use the alternative ‘A Home Buyers Strategy’. Therefore, the paper recommends the above changes to be made to negative gearing policy until a more viable alternative is developed to solve Australia’s housing crisis.
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