Negative gearing crackdown not worth the risk

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But the change of a tax policy can have a dramatic short to medium term effect. Three years ago, I opposed Labor's proposed changes to negative gearing. Today I do so again. The changes, and the short-term risks, are not worth the rewards.

(Long-term proponents of negative gearing reform, like economist Saul Eslake, would ask: Well Rob, when is a good time to change?)

With more than 2.1 million Australians reporting a property investment to the Australian Taxation Office in 2016-17, negative gearing reform is the substantive housing issue of this election.

Labor leader Bill Shorten says negative gearing is an "intergenerational scam" which subsidises the wealthy and discriminates against first-home buyers.

Shelved plans

Prime Minister Scott Morrison says a change would depress house prices and increase rents.

Each view comes with a helping of hype.

Labor argues that Australia has the "most generous property tax concessions" in the world. Which seems a bold call when New Zealand has no capital gains tax and the Ardern government has just shelved plans to introduce one.

Labor policy also argues that the "generous property tax concessions mean that first-home buyers are being locked out of the housing market and having to compete with investors looking for their fifth, sixth and seventh homes."

The market has changed since those boom-time days. In 2016-17, around 22,500 investors were negatively gearing five or more properties. They would be pretty busy outbidding the 110,000 first-home buyers who bought last year.

(I have seen a claim on Twitter that last year more people bought their seventh house than bought their first. It is class-envy nonsense.)

And the "intergenerational scam"? Twenty-six per cent of those with rental properties in 2016-17 were under 40.

Net rental loss

Vast amounts of research has been undertaken to prove that (a), most of those using negative gearing are average mums and dads, and (b), the biggest cash benefit goes to the wealthy. Both are true.

On the 2016-17 tax statistics, 1.5 million Australians had one rental property. Six hundred thousand of them were positively or neutrally geared, and paying their own way. Another 400,000, 60 per cent of them negatively geared, owned two properties. That is 90 per cent of all property investors. They cannot all be wealthy.

The average net rental loss reported to the ATO in 2016-17 was $8800. Of course the wealthy would invest more and claim more. In Julie Bishop's former electorate of Curtin the average rental loss was $14,000.

Importantly, that figure, the average net rental loss, is not what the government loses. The average net rental loss is the amount by which the taxpayer reduces taxable income. The actual loss to the government depends on the taxpayer's marginal tax rate.

Assume that the average taxpayer in Curtin is on the top tax bracket, excluding the Medicare levy. The lost tax is actually $6300. In less wealthy electorates the figure would be a lot less. And as interest rates fall, so does the cost. In 2011-12, the average net rental loss was $10,900.

By comparison, the ALP's much-heralded proposal to create 250,000 new affordable homes for low and middle income earners at rents 20 per cent below market has embraced a subsidy of $8500 a year for each unit for 15 years.

Labor would allow negative gearing on new homes to help grow the supply. But it is a concession unlikely to have much impact. Investors are already wary of paying too much for new product. They know that the same concession will not be available to their end buyer and they know they will pay increased capital gains tax.

Apply to all assets

I am surprised that the proposal to increase capital gains tax, effectively by 50 per cent, has gained so little coverage. Because it would apply to all assets, including shares and technology start-ups.

So what would all that change do to house prices, rents and new development? The modelling is difficult and pretty sketchy.

The Grattan Institute, taking a top-down approach which balances the cost of negative gearing against the value of the overall housing market, estimates that prices would settle 2 per cent lower than otherwise. Rents wouldn't change much, nor would the rate of new development.

SQM Research has taken a more bottom-up approach. Managing director Louis Christopher says investors will require higher yields – between 85 to 120 basis points higher – to compensate for the loss of tax concessions and the increased capital gains tax. The figure will vary depending on the fall in mortgage rates but will be achieved over the next three years through lower prices and higher rents.

The higher rents are the most contentious part of the model. Veteran property investors remember the surge in Sydney rents when negative gearing was briefly removed in the 1980s. Economists like Eslake argue that it was a Sydney phenomenon, caused by a pre-existing accommodation shortage and not replicated in Melbourne or Brisbane.

At the moment accommodation is not in short supply. But it will become tighter if the population continues to grow and new construction is choked further by the lack of finance, the shortage of foreign off-the-plan buyers and, yes, a strike by investors.

That is when a Labor government would start wondering if those changes to negative gearing and capital gains tax, embraced back in 2019, were the wrong move.

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