The case against negative gearing

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There's never been a more exciting time to be a proponent of winding back Australia's long-standing 'negative gearing' arrangements. After decades of stubborn resistance from both sides of politics – Wayne Swan was no more willing to countenance any change in this area than John Howard, Peter Costello, Tony Abbott or (until his last day in Parliament) Joe Hockey – in the past two weeks the Labor Party has committed to curtailing negative gearing for all investments (other than new housing) entered into after 1 July next year, should it win the forthcoming election, while the Government has signalled that it, too, is considering winding back what it (now) regards as 'excesses or abuses' in this area. The ground is clearly shifting.

Proponents of negative gearing routinely assert that it is primarily used by taxpayers of 'comparatively modest' means to 'get ahead', that it makes a 'vital contribution' to ensuring an adequate supply of rental housing, and that without it rents would 'go through the roof', as they allegedly did between 1985 and 1987 when the Hawke Government temporarily abolished it.

None of these assertions withstands a moment's confrontation with the facts.

The latest available ABS data, which are for 2013-14, show that 72% of the total value of investment properties is owed by, and 50.7% of the total value of investment property debt is owed by, the richest 20% of households – many of whom use negative gearing, and other strategies, to reduce their taxable incomes. That's one reason why the assertion that nearly 80% of taxpayers who use negative gearing have taxable incomes of less than $80,000 is misleading. By way of illustration, the average rental interest deduction claimed by taxpayers with taxable income of $6,000 or less in 2012-13 was almost $16,000 – larger than the average deduction claimed by taxpayers in the second highest tax bracket. Clearly, those taxpayers' actual incomes are much higher than their taxable incomes – otherwise, no responsible lender would be lending to them.

Nor is it true that negative gearing makes an important contribution to growing the supply of rental housing. Over the past decade, more than 93% of the total amount lent to investors for the purchase of housing has been for the purchase of established housing. Conversely, investors have accounted for just one-fifth of the total amount borrowed for the purchase or construction of new housing over the past decade. Other countries with much less generous tax treatment of property investment borrowing costs have much higher rental vacancy rates than Australia.

Finally, the historical evidence clearly shows that while rents did rise in Sydney, and to a lesser extent Perth, when negative gearing was temporarily unavailable for a brief period in the late 1980s, that was because vacancy rates in those two cities had fallen to unusually low levels (notwithstanding the availability of negative gearing for 50 years prior to then) – so that rents would have risen there anyway. Elsewhere in Australia, rent inflation was either steady or declined during that period.

Overwhelmingly, the effect of negative gearing has been to inflate the price of existing housing – to the detriment of would-be home-buyers; to encourage Australians to take on more debt than they would have done otherwise; and to undermine, at a substantial cost in terms of revenue foregone, the efficiency and equity of the Australian tax system. It's hard to think of any single action a federal Government could take which would do more to improve the prospects of young people, in particular, attaining the goal of owning their own homes, than curtailing access to negative gearing.