Senate Economics Legislation Committee

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Supplementary Budget Estimates

2016 - 2017

Division/Agency: Tax Analysis Division
Question No: 494
Topic: Changes to negative gearing
Reference: Written
Senator: Rhiannon, Lee

Question:

1. On 9 February this year The Australian reported that it was told the government was closely considering changes to negative gearing along with cuts to superannuation tax concessions, given the problems with expanding the GST. The plan was said to include setting caps of $30,000 or $50,000 on the amounts that workers can claim on their investment properties. The Prime Minister on ABC's Insiders recently replied that everything was on the table in response to a question asking if Negative Gearing was on the table.
a. Has Treasury been asked to do modelling specifically on reforming negative gearing?
b. If yes, does it include modelling in order to allow tax cuts, and to which income groups?
2. It was reported early this year that Treasury made the rare admission that Australia's system of negative gearing is relatively generous compared to other developed nation. Please explain how this is so.
3. Considering the CGT discount is Australia's 6th largest tax expenditure – and will cost us about $6b this year – has Treasury been asked to provide modelling on any type of reform to Capital Gains Tax discounts?
4. What is the current cost of the Capital Gains Tax discount and how much has it increased year on year for the past ten years?
5. Considering 70% of the CGT benefit flows to the top 10% of income earners please explain the rationale for the CGT discount ?
6. What proportion of Australia's working population enjoy capital gains tax discounts?
7. The Australian Treasury's Tax White Paper discussion paper released last year noted the relationship between Negative gearing and CGT discount stating that:
Negative gearing does not, in itself, cause a tax distortion, but it does allow more people to enter the market than those who might have had the equity alone to do so. Purchasers can make bigger investments in property by borrowing, in addition to using their own savings. This behaviour is encouraged by the CGT discount, as larger investments can result in greater capital gains and therefore benefit more from the CGT discount.
a. Has the government modelled whether superannuation reforms on their own would actually increase the use of negatively geared properties? May I please have a copy of that modelling?
8. If the government pursues reforms to tighten up the tax breaks for superannuation, is there a risk that the money that was previously going into tax-advantaged super will go to the other most obvious tax favourable destination: investment properties?
9. What is the annual cost of the negative gearing and capital gains discount combined, and what is the annual amount the government spends on the entire housing and homelessness portfolio?

Answer:

1a. The re:think tax discussion paper contained material on negative gearing. The Treasury has considered negative gearing issues raised in response to re:think and other proposals put forward to Government. The Government took a policy to make no changes to negative gearing to the most recent federal election.

1b. No.

2. In the Department of the Treasury's submission of 18 January 2016 to the House of Representatives Standing Committee on Economics' Inquiry into Tax Deductibility, Treasury noted "Australia's tax system is relatively generous in respect of WRE [work-related expenses] deductions". Negative gearing arrangements were discussed in the same submission, including arrangements in other countries. However, direct comparisons are difficult due to differing tax systems.

As detailed in the submission, Australia "approximates a comprehensive income tax base and generally provides a full deduction for expenses and losses incurred in gaining tax assessable income". This allows the losses that occur due to mortgage interest repayments exceeding the net rental income from the property to be deducted against income from salary and wages. As detailed in the Government's Re:think tax discussion paper, in Australia's tax system negative gearing is not a tax concession. Negative gearing is simply an application of a fundamental principle of Australia's tax system – namely, that taxpayers can claim deductions for expenses incurred in earning income. These arrangements are not exclusive to property, and other assets such as shares can also be negatively geared.

This is not possible for taxpayers in countries that operate variants of a dual income tax system, which separates labour and capital income.

3. The re:think tax discussion paper contained material on the capital gains tax (CGT) discount. The Treasury has considered CGT issues raised in response to re:think and other proposals put forward to Government. The Government took a policy to make no changes to the CGT discount to the most recent federal election.

4. The 2015 Tax Expenditures Statement includes revenue forgone estimates for the capital gains tax discount for individuals and trusts between 2011-12 and 2018-19 (see p87). Revenue forgone estimates reflect the number of taxpayers utilising a tax expenditure and the notional amount of tax expenditure each taxpayer receives. These estimates do not indicate the hypothetical saving to the Budget should the tax expenditure cease (see 2015 TES, p4).

5. The Government's Re:think tax discussion paper details various rationales for concessional taxation of savings, and hence the CGT discount. Pages 58-59 of Re:think state:

> "The main argument against taxing income from savings is that this can effectively amount to a double taxation of saving (once when it is earned, then again when it earns a return). This can create a bias against saving for future consumption. There is also an argument that some of the return from savings simply reflects inflation, which is not 'income' in a real sense as it offsets the loss of value to maintain purchasing

power. Arguments of this nature are often used to suggest there should be little or no tax on income from savings.

Another argument, used in relation to taxing retirement incomes more lightly, is to address 'life-cycle myopia'. This is where individuals may not save enough for retirement because it is too far in the future for them to see clearly, and therefore they need encouragement to save to achieve a higher standard of living in retirement.

Taxing the income from savings more lightly than labour income is a way of striking a balance between these competing considerations. For example, it can help address the effects of inflation (by reducing tax on the part of the return that simply reflects the saved money maintaining its real value), while ensuring that some tax revenue is raised so that other tax rates can be lower."

6. As reported in the ATO Taxation Statistics, around 610,000 individuals reported a net capital gain on their tax return in 2013-14. Of these individuals, those who held their assets for greater than a year directly benefited from the capital gains tax discount.

7a. No.

7b. Not applicable.

8. Households make investment decisions on the basis of a variety of factors, of which tax settings are only one (others include their risk preferences and the underlying return of various assets). For most, the taxation of superannuation will continue to be concessional relative to their marginal tax rate.

9. The 2015 TES includes revenue forgone estimates for the capital gains tax discount for individuals and trusts (see p87). However, negative gearing is considered to be an application of a fundamental principle of Australia's tax system – namely, that taxpayers can claim deductions for expenses incurred in earning income. Consequently, it is considered part of the comprehensive income tax benchmark used in the TES and not reported as a tax expenditure.

Whilst the States and Territories have responsibility for the funding and provision of housing and homelessness policies, the Commonwealth Government provides significant funding to assist these services. In 2016-17 the Commonwealth will provide around $6.8 billion in funding under the housing and homelessness portfolios, including providing States and Territories with $1.3 billion in funding associated with the National Affordable Housing Agreement.