DLK ADVISORY

HOW MUCH DOES NEGATIVE GEARING REALLY COST THE NATION?

Since the government's announced changes to the Stage 3 tax cuts to give lower income earners more benefits, the chorus of voices advocating for changes to other aspects of the tax system, such as negative gearing, has grown steadily stronger. So how much does negative gearing actually cost the nation each year? The answer to this can be gleaned from the 2023-24 Tax Expenditures and Insights Statement (TEIS) which confusingly contains figures relating to the 2020-21 financial year.

Put simply, a tax expenditure arises where the tax treatment of a class of taxpayer or an activity differs from the standard tax treatment or the tax benchmark. These expenditures include tax exemptions, some deductions, rebates and offsets, concessional or higher tax rates applying to a specific class of taxpayers, and deferrals of tax liability.

The figures contained in the TEIS are estimates provided on a "revenue forgone" basis which reflects the existing utilisation of a tax expenditure and does not incorporate any behaviour response which might result from a change in or removal of the existing tax treatment. Therefore, the figures cannot be used as estimates of the revenue impact on the Federal Budget if the tax expenditure were to be removed (ie due to a policy or legislative change).

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Keeping that in mind, the TEIS contains detailed breakdown of various categories including rental property deductions. It is estimated by the ATO that some 2.4m rental property investors claimed deductions for expenses associated with maintaining and financing property interests, including interest, capital works and other deductions. Collectively for the 2020-21 financial year, $48.1bn worth of rental deductions were claimed, resulting in a total tax reduction of $17.1bn.

However, not all deductions are considered equal! Only around half, or 1.1m, of these rental property investors had a rental loss (ie negative gearing), which added up to total rental losses of $7.8bn and provided a tax benefit of around $2.7bn for the 2020-21 income year. Drilling down into the specifics of the deductions, the other rental deductions category (eg property maintenance, council rates etc) accounted for more than 50% of the amount claimed, with the next largest deduction being interest expenses, coming in at 39%.

The fact that only half of rental property investors are currently engaging in the practice of negative gearing, while the other half are presumably paying tax on the income they derive from investment properties, could perhaps lead to the conclusion that getting rid of negative gearing may not have as large of an impact on the nation's Budget as proponents hope.

Further analysis of the $2.7bn negative gearing tax benefit (or tax reduction) reveals that 80% went to individuals with above median income (ie those earning above $41,500) and 37% went to individuals in the top income decile (ie those earning over $128,000). While a single individual earning over $128,000 could be classified as a high-income earner, that same individual's income would not be considered high where they are the sole income earner of a family.

Although the TEIS does not provide data on the status of those claiming rental deductions, this can be somewhat inferred by the ages of those claiming the deduction. According to the ATO, more than half of the total negative gearing tax reduction went to individuals between the ages of 40 and 59 years old. Presumably a majority of individuals in this cohort have families and a good proportion may be either the sole income earner or the primary income earner in their family. This means the bulk of the commentary regarding negative gearing benefiting the rich may be on shaky ground.

However, these contentions aside, with the tax reduction on rental deductions expected to blow out to $28.2bn by the 2026-27 income year (from $17.1bn in the 2020-21 income year) and it being the second largest tax expenditure (second only to concessional taxation of employer super contributions), the call for changes to negative gearing will only grow stronger in time.

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