Homes for living, not wealth creation

Tax and expenditure reforms to improve housing affordability and equity

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About ACOSS

The Australian Council of Social Service (ACOSS) is a national voice in support of people affected by poverty, disadvantage and inequality and the peak body for the community services and civil society sector.

ACOSS consists of a network of approximately 4000 organisations and individuals across Australia in metro, regional and remote areas.

Our vision is an end to poverty in all its forms; economies that are fair, sustainable and resilient; and communities that are just, peaceful and inclusive.

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Key points

- Two tax breaks, the 50% capital gains tax discount (CGT) and negative gearing, have contributed to the housing affordability crisis. The CGT discount means only 50% of capital gains are taxed when an asset is sold. Negative gearing means investment expenses are deductible from annual taxable income such as wages.

- They do so by encouraging speculative investment in housing, driving up prices and excluding people from home ownership. They also contribute little to the supply of rental housing – over 80% of investor home purchases are for existing homes.

- Policies that focus exclusively on boosting housing supply, while needed, will not resolve the crisis on their own – we also need to contain excess demand, including by reducing the speculative investment encouraged by these tax breaks.

- We recommend curbing these tax breaks – by halving the CGT discount and ending negative gearing – which economic modelling suggests would reduce home prices by 1-4% and increase the home ownership rate by 2-5%. The impacts are likely at the higher end of these ranges as modelling often does not account for the disproportionate impacts of investor tax breaks on demand for housing.

- These improvements may appear modest but are significant. The resulting home price reduction would be of similar magnitude to the estimated impact of the Government's commitment to build 1.2 million new homes over five years on reducing home prices (around 4%). Any increase in home ownership in this range would be significant in the context of the 4% reduction in home ownership rates over the past two decades.

- The tax breaks forego significant federal government revenue, which could be spent on fixing rather than worsening housing affordability. Annual revenue foregone from the tax breaks for investment property (around $11 billion in 2023-24) has for a few years been greater than annual federal expenditure on all other housing assistance combined (around $10 billion in 2023-24), including on social housing and Commonwealth Rent Assistance.

- We recommend investing the revenue raised from our proposed tax reform in social and affordable housing to further improve housing affordability, especially for people on lower incomes. We estimate our proposed tax reforms would raise around $19 billion over the forward estimates, which could fund 32,000 to 49,000 additional social and affordable dwellings over time, though these would take some years to complete (not all within the estimates period). While this may reduce the extent to which our proposed reforms increase home ownership, it would improve housing security and affordability for people with low or modest incomes.

- This investment approaches a magnitude similar to all existing federal government housing commitments (to build 55,000 social and affordable dwellings by 2029). Thus our package would increase federal dwelling commitments by 1.5 to 2 times (though likely over a longer timeframe).

- This investment would also meet a significant portion of current and projected unmet housing need. Around 47,000 additional social and affordable dwellings are required each year for 20 years to meet need, at an average cost to all governments of $19-29 billion annually, in addition to existing funding (around $10 billion per year since 2017-

18 on average). If the federal government were to cover half of this additional cost (around $9-14 billion per year on average for 20 years) alongside States and Territories, the cost would be almost covered by the annual revenue raised from our tax reforms by the fourth year of implementation (estimated $9 billion raised in 2028-29).

- Our recommended tax reforms are phased in over 5 years to avoid sudden shifts in housing investment, prices and rental supply. Claims that curbing the tax breaks would worsen vacancy rates and rental affordability are often overexaggerated – despite claims to the contrary, the removal of negative gearing in 1985 did not increase rents nationally and nor did the threat of doing so when the Labor Opposition proposed it in the late 2010s. In addition, any short term reduction in private rental housing during the transition to our reforms is likely to be offset over time by reduced demand for rentals, as more renters either buy their own homes or transition into low-cost rental housing funded by our proposed tax reforms.

- Our recommendations would also improve security of tenure for renters. By curbing the tax breaks, landlords may be incentivised to hold rental properties for longer in pursuit of recurrent positive income streams, rather than selling once positively geared or to avoid cashflow issues if they are highly leveraged. Social and affordable housing, boosted by investing the revenue raised from tax reforms, tend to have greater tenure security than private rental.

- There are also compelling reasons to curb these tax breaks beyond improving housing affordability and security of tenure. The tax breaks are bad tax and economic policy, privileging speculation in assets (e.g. land and shares) over more productive investment in businesses and services that boost future jobs and incomes, contributing to high household debt levels, and amplifying economic booms and recessions through home price 'bubbles'.

- The housing tax concessions are also deeply inequitable. They overwhelmingly benefit the top 10% of taxpayers, who receive 82% of revenue on the CGT discount and 39% of revenue on rental deductions (2023-24). It is a myth that they support middle-class 'Mum and Dad' investors – rather, they contribute to growing wealth inequality, with two thirds of investment housing owned by the top 10% of households ranked by wealth.

- Compared to alternative tax reform proposals, our recommendations are simpler and provide greater improvements to wealth equity and home affordability, especially in relation to negative gearing. For example, proposals to limit negative gearing to investors with one rental property wrongly prioritise reducing inequality among landlords (who are typically drawn from the wealthiest 10%) and would dilute the positive affordability and equity impacts of our recommendations (since around half of negatively-geared dwellings are owned by landlords with one rental property).

- We recommend that:
   - The CGT discount for individuals, trusts and super funds is halved from 50% to 25% over five years (reduced by 5% per year).
   - Negative gearing is ended immediately for all new investments, and phased in over five years for existing investments – that is, losses from passive investments attracting CGT (including housing and shares) are no longer deductible against income from outside the asset class (such as wages).
   - The revenue savings should be invested in social and affordable housing (around $19 billion over the forward estimates: $3-4 billion raised after 2 years, $6 billion raised in year 3, and $9 billion in year 4, and rising substantially in later years).

Summary[1]

Tax concessions and underinvestment in social housing have lifted home prices and worsened housing stress

Housing is one of life's essentials, but in Australia, it is too often treated as another form of wealth creation while people go without secure housing. Our tax system contributes to this. Tax concessions for property investment – namely the 50% Capital Gains Tax (CGT) discount and negative gearing – have accelerated housing prices over the past two decades to unprecedented levels of unaffordability.

These tax concessions drive up the price of homes by encouraging investment in property in pursuit of concessionally taxed capital gains upon sale, while allowing yearly deductions on taxable income for investment property losses, which also increase investor borrowing capacity and incentives to invest. They contribute little to the overall supply of housing since around 81% of investor loans are for purchasing existing dwellings. By lifting home prices, these tax concessions make it harder for people to transition from renting to home ownership.

At the same time, sharp declines in public investment in social housing over the last 30 years have also contributed to severe shortages of affordable rental homes and high levels of homelessness. The quickest way to overcome the current shortage of affordable rental housing is direct public investment.

To improve housing affordability, governments should curb speculative investment as well as boost supply

Much of the recent policy discussion of reforms to make housing more secure and affordable has focussed on efforts to boost supply: for example, by easing local development restrictions, funding enabling infrastructure, and subsidising and reducing the cost of building. When the government sought advice from Treasury last year on housing tax reform, media reporting suggested the government's evaluation of potential reforms focused mainly on the impacts on housing supply.

Yet any serious attempt to improve affordability must tackle *both* supply and demand for housing. As we have seen over the last three years, sudden changes in demand (whether from population growth, low interest rates, or speculative investment fuelled by tax breaks) lift home prices rapidly, but it takes time for new home construction to catch up due to lags in development and construction.

It's vital that governments take steps to curb excessive *demand* for housing, especially as official interest rates are eased and home prices grow more strongly. Many policies to 'support first home-buyers' – such as public subsidies or early access to superannuation for home purchase – would make matters worse by adding to demand and thus growth in home prices.

On the other hand, reducing tax concessions that encourage speculative investment in housing cycle upswings is an important part of the solution. This would reduce demand and thus modestly reduce home prices (or the extent to which they would otherwise increase) and increase home ownership. The impact of curbing these tax breaks is likely to be close to the upper end of previous independent estimates (that home prices would fall by 1-4% and home ownership would increase by 2-5%), since these models do not appear to fully account for the role of the tax breaks in disproportionately accelerating growth of home prices, especially during speculative housing booms. Our tax reform proposals are likely to reduce home prices to roughly the same extent as government commitments to boost the supply of homes by 1.2

[1] See body text for summary citations.

million homes over 5 years. It is also likely to improve security of tenure for people who rent their homes by shifting investor incentives from quick capital gains to a regular stream of rental income.

These tax breaks (the CGT discount and negative gearing) have adverse impacts beyond housing

The CGT discount and negative gearing are bad tax policy as well as bad housing policy. They generate serious inequities and inconsistencies in the taxation of investments, and between the taxation of investments and earnings from employment. These distortions in the tax system increase income and wealth inequality and undermine economic growth and development.

The tax breaks encourage inefficient and unproductive investment and heighten economic risks

The CGT discount and negative gearing also have broader negative impacts beyond housing. They distort investment towards speculation in asset values (such as land and shares) and away from more productive purposes (such as building new homes or investment in new technology and services). They make it more difficult for the Reserve Bank to manage the business cycle as large shifts in asset prices driven by speculative investment amplify economic booms and recessions.

High and growing levels of borrowing for investment in housing (including owner occupied and investment properties) is the main reason that Australia's household debt is the fifth-highest in the OECD. This brings risks for those who are highly leveraged, and for the wider economy.

They increase income and wealth inequality

Income and wealth inequality are deepened by these tax concessions, since high income investors pay less tax per dollar of income than lower income earners:

- A worker on an average fulltime wage of around $80,000 pays tax on their next dollar of earnings at 32% including the Medicare Levy;
- An investor whose overall income is $200,000 a year pays tax on capital gains from sale of property or shares at the rate of 23.5%;
- A negatively-geared investor effectively pays tax on investment income at a *negative* rate of up to 47% – since they can offset their investment losses against their wages.

Since they invest more in property and shares, the highest 10% of individuals ranked by taxable income receive 82% of the benefit of the CGT discount and 39% of the benefit of negative gearing. It is a myth that tax breaks benefit 'mum and dad investors' with modest incomes as many claim, since two thirds of the value of investment property is owned by the wealthiest 10% of households.

They reduce public revenue

Annual federal government revenue foregone to these tax concessions for investment properties (estimated around $11 billion in 2023-24) has for a few years been greater than all direct government expenditure on housing (around $10 billion in 2023-24). This includes expenditure on social housing and Commonwealth Rent Assistance. Without reform, around $169 billion in federal government revenue will be foregone due to the tax breaks for investment properties over the next 10 years (2025-26 to 2034-35). Instead, revenue raised by reforms to these tax concessions could over time fund a substantial portion of the public investment in social and affordable housing required to meet the needs of people with low and modest incomes struggling in the rental housing market.

A package of tax reform and social housing investment is needed

Housing unaffordability and inequality are problems long in the making, becoming especially acute following the pandemic, and they are not expected to improve unless governments take bolder action to intervene. During the pandemic, annual growth in rents peaked at 13% in the year to September 2021, while home prices surged by around 25% over 18 months (September 2020 to February 2022). Growth in rents has since slowed to 4% in the year to January 2025, and home price increases have subsided under pressure from higher interest rates, rising more modestly by 4% in the year to January 2025. However, official interest rate reductions are expected to drive home price increases later in 2025.

Reform the taxation of rental housing

Reforms to limit the CGT discount and negative gearing are essential components of a package of policies to ease the housing crisis, improve affordability for people with low and modest incomes, as well as to reduce inequality and address economic risks. The key elements of this package should be to:

- Substantially reduce or replace the CGT discount
- End negative gearing – that is, restrict deductions for passive investment in appreciating assets to income from the same asset class

Reinvest the revenue raised to fund quality social and affordable housing.

In the past, direct investment by governments in public housing put a floor under housing supply for people with low incomes. Regrettably, the share of households in public and community homes fell from 5.8% in 1991 to 3.8% in 2023 while the annual number of social housing lettings has declined from 52,000 to 32,000 over the same period.

Around 47,000 additional social and affordable dwellings are required each year for 20 years to meet need, at an average cost to all governments of $19-29 billion annually (lower in this range, the more funding is provided up front). This is in addition to existing funding (around $10 billion per year since 2017-18 on average), which has only been enough to maintain existing stock or marginally increase it (by less than 2000 dwellings per year since 2017-18 on average). Reinvesting revenue raised from reforms to the CGT discount and negative gearing would provide a substantial portion of the additional funding needed to meet this need.

The detail matters when reforming housing taxation: keep it focussed, simple and fair

Many proposals have been advanced over the last decade to reform CGT and negative gearing. Reforms in this difficult area of policy are effective if they have clarity of purpose and are simple to administer.

Some alternative housing tax reform proposals are limited to housing investments, to the exclusion of other assets that appreciate in value and attract CGT, such as shares. They address the housing affordability challenge but not the wider inequities and distortion of investment caused by concessional treatment of capital gains. They are likely to shift speculative investment from housing to shares and other assets subject to CGT.

Other proposals fine tune these tax breaks, especially negative gearing, in pursuit of diverse goals beyond improving housing affordability. For example, proposals to exempt landlords with a single investment property from curbs on negative gearing conflate two goals – to improve housing affordability on the one hand, and to reduce wealth inequality among landlords (by supporting 'small' investors) on the other. These proposals are excessively complex and are unlikely to effectively achieve either of those goals. The majority of rental housing investments are owned by the highest 10% of households ranked by wealth. It is not clear why circumstances of renters would be improved by increasing the share of rental properties owned by 'smaller' investors – indeed this may reduce the quality of rental housing and security of tenure. In any event, the impact of the reform would be greatly diluted since around half of all negatively-geared rental housing is owned by landlords with one rental property only.

Other problems arise with proposals to use negative gearing tax concessions for other social and environmental purposes such as improving the energy efficiency of homes or targeting investment towards affordable homes for people with low incomes. However, whether these social or environmental benefits are delivered by negative gearing, and for how long, depends on many factors unrelated to affordable, energy efficient housing, such as the investor's level of debt and current interest rates, making the magnitude and timing of the scope of benefits less certain. It would be simpler, fairer, more certain and more effective to achieve these goals through well-targeted direct public expenditures or tax incentives like the former National Rental Affordability Scheme (NRAS). One alternative reform proposal that is more attractive is to restrict negative gearing to newly built rental properties (like those advocated by recent Labor Opposition), which may help boost overall rental housing supply.

Ensure a smooth transition – phase in changes to CGT and negative gearing

Since capital markets are sensitive to changes in taxation, care must be taken with the transition to the new tax regime. The aim is to achieve substantial changes in investor behavior to improve housing affordability, strengthen public revenue and improve equity, without triggering large and sudden shifts in investment, home prices or rents. While these risks should be avoided, they should not be exaggerated.[2] Over time, any reduction in the supply of private rental housing and subsequent impact on rent levels is likely to be offset by a fall in demand for rentals as more tenants can afford to buy their own homes or transition into low cost rental housing funded by revenue raised by our proposed tax reforms.

At the same time, the transition to the new tax treatment of rental housing should be managed to avoid any sharp decline in supply which could reduce vacancy rates in the short term. So rather than reduce CGT concessions and the tax deductions available to investors instantly, we propose that these tax reforms be phased in.

Changes to the tax treatment of investment should commence as soon as possible after announcement (even if the reforms are then phased in) to minimise opportunities for arbitrage, where investors exploit differences in the tax treatment of assets before and after reforms. Introducing reforms before home prices and investment increase, which is likely to occur once interest rates fall later this year, would help to take some heat out of the market and improve affordability.

Overview of recommendations

Capital Gains Tax

Large discrepancies in the tax treatment of investment income and earnings from employment are unfair, especially to younger people and people on modest incomes who lack income to invest. At the same time, the tax system should take account of the compounding effect of annual income taxes on returns from longer-term investments.

Introduced in 1999, the 50% CGT discount, halves the value of capital gains (profit from sale of an asset such as shares or investment property) subject to tax at an investor's marginal tax rate. In effect, they pay tax on capital gains at half their normal marginal rate. Superannuation funds pay two thirds of the standard 15% tax rate on investment income for capital gains on

[2] For example, as discussed in this report there is no evidence to suggest that the negative gearing changes in the 1980s or the Labor Opposition's CGT and negative gearing proposals in 2019 resulted in large-scale withdrawal of investors from the market.

the sale of assets held by the fund (i.e. a discounted tax rate of 10%). This provides an incentive for short-term investment in housing and other assets in search of quick capital gains, whether through direct personal investments, trusts, or self-managed superannuation funds.

Before the CGT discount, capital gains were adjusted downwards for inflation (between purchase and sale of an asset) before they were taxed at each investor's marginal tax rate. This ensured that returns due solely to the effects of inflation were not taxed. While in theory the 50% CGT discount also compensated for inflation, at current rates of inflation it usually is far more generous, especially for more speculative shorter-term investments. In contrast, a 25% discount is broadly equivalent to inflation adjustment for an investment held over ten years when annual inflation is 2.5% (the Reserve Bank's inflation target).

We propose that a lower 25% CGT discount be phased in over five years, reducing the existing 50% CGT discount by 5% per year. Alternately, a system of inflation adjustment (with standard personal tax rates) could be phased back in. The latter is a more accurate and less arbitrary way to adjust for inflation than a CGT discount – but its main disadvantages are the inconsistency that other forms of income are not adjusted for inflation for tax purposes, and that the transition would be more complex.

To ensure consistent income tax treatment of capital gains for personal investors and superannuation funds, the CGT discount for superannuation funds should also be halved (from one third to one sixth), lifting the tax rate on capital gains from 10% to 12.5%. In addition, the use of superannuation funds to borrow for investment, and avoidance of CGT by placing assets in self-managed superannuation funds and disposing of them in the pension phase (when the tax rate on capital gains is zero), should be curbed. Otherwise, there is a risk that if the benefits of the CGT discount and negative gearing are curbed, speculative investors would shift assets into superannuation to take advantage of the generous tax treatment in that environment. This would dilute any positive impacts of revenue raising and equity from reforms to the CGT discount and negative gearing.

Recommendation 1:

From 1 July 2025, the exemption of 50% of capital gains from CGT for investment in appreciating assets (including rental housing, shares and collectables) by individuals and trusts should be halved to 25% over five years, by 5% per year.

Budget impact: $1.2 billion in 2026-27 ($2.8 billion in 2027-28, rising substantially in later years).

Recommendation 2:

(i) The tax discount for capital gains of superannuation funds should be halved (from one third to one sixth of the 15% tax rate), so that accumulation accounts are taxed at around 12.5% rather than 10%;

(ii) Self-managed superannuation funds (SMSFs) should be prohibited from borrowing to invest in housing or other assets; and

(iii) Measures should be introduced to prevent avoidance of CGT on assets in SMSFs by disposing of them when in pension phase (when the CGT rate on investment income is zero).

Budget impact: Not estimated.

Negative Gearing

Individuals who make losses on investments in a given year (where investment costs exceed income) can legitimately claim some deductions against their other taxable income (such as wages). However, people who borrow to invest in assets that yield capital gains (such as rental housing) are not making overall economic losses even if their costs (such as interest, maintenance and State taxes) exceed their income from rents in a financial year. In most cases the annual increase in asset values (capital gain) exceeds any such 'losses' – otherwise people would not negatively-gear in the first place.

In these cases, there is a mismatch between the taxation of income (since only half the capital gain is taxed and is taxed only when the asset is sold) and the taxation of deductions (which can be offset against other income every year at standard tax rates). One solution to this mismatch would be to tax capital gains each year at standard marginal tax rates, rather than when the asset is sold, but that raises problems with asset valuation and cashflow.

A better solution, which we recommend, is to 'quarantine' losses from each investment class of assets (e.g. rental property or shares) so they can only be offset against income from those investments, and not for example from wages earned by the investor, and losses would be carried forward so that they can be offset against CGT once the asset is sold – 'disallowing negative gearing'. Many countries, including the United States and United Kingdom, quarantine losses from passive (non-business) investment so they cannot be offset against other income.

We propose that this new tax treatment (disallowing negative gearing) apply immediately from the date of implementation of these tax reforms to *new* investments in assets attracting CGT (noting that most housing investments affected would be *existing* dwellings).

To avoid excessive and sudden shifts in rental property investment behaviour and cashflow problems for recent investors, restrictions on deductions for *existing investments* in property or other assets should be introduced gradually. One option is to 'grandfather' existing investments so that full tax deductions can still be claimed. This would encourage investors to retain their existing rental properties for longer and may temporarily *increase* investment in the period immediately before the introduction of the tax reform. However, 'grandfathering' is inequitable (since the tax treatment of investments depends on their timing) and would significantly delay the home price reductions and public revenue benefits of the reform.

A better option, which we recommend, would be to progressively phase out negative gearing for *existing* investments over five years from the date of implementation of the new tax regime. This timeframe would help avoid cashflow problems for highly leveraged investors, since rental properties are typically no longer negatively geared after around five years (as rents eventually exceed interest on borrowings and other costs). It is also consistent with the five-year timeframe for phasing in of the above reform to CGT, making the reform simpler and easier to understand. This phasing out of negative gearing could be done by progressively reducing the proportion of investment losses that can be claimed against other income. Negative gearing would be disallowed for *new* investments from the date of implementation of the reform.

Recommendation 3:

Restrict deductions for personal passive investment expenses so they can only be offset against income from the same class of investments (e.g. rental housing or shares), including capital gains realised on sale:

(i) This should apply immediately to all investments of this type entered into after 1 July 2025.

(ii) For negatively-geared investments entered into prior to that date, the proportion of losses that can be claimed against other classes of income would be progressively reduced to zero over five years.

Budget impact: $2.3 billion in 2026-27 ($3.4 billion in 2027-28, rising substantially in later years).

Social and affordable housing investment
Revenue raised from these tax reforms should be invested in social and affordable housing to help meet unmet housing need. We estimate that the annual revenue raised by our proposed reforms to the CGT discount and negative gearing is around $19 billion over the forward estimates: $3-4 billion in the first two years (2025-26 and 2026-27), around $6 billion in the third year (2027-28), around $9 billion in the fourth year (2028-29), and rising substantially in the years beyond.

We estimate this $19 billion in revenue raised over the forward estimates could fund 32,000 to 49,000 additional social and affordable dwellings, though these would take some years to complete (not all within the estimates period). This approaches the magnitude of all existing federal government housing commitments, which they estimate would build 55,000 social and affordable dwellings by 2029 if delivered on time. Thus our recommended package would approach increasing such dwelling output from federal commitments by around 1.5 to 2 times (though likely over a longer timeframe).

If the federal government were to cover half of the additional cost of social and affordable dwellings needed to meet unmet housing need (around $9-14 billion per year on average) alongside States and Territories, the cost would be nearly entirely covered by the annual revenue raised from our recommended tax reforms by the fourth year of implementation or shortly after (estimated $9 billion raised in 2028-29, and rising in the years after).

Recommendation 4:

Increase Commonwealth government direct investment in social and affordable dwellings to meet existing and projected unmet need of around 47,000 additional dwellings per year over 20 years (940,000 dwellings in total), using savings from tax reforms (recommendations 1-3), combined with additional Commonwealth funding.

Budget impact: -$9 to $14 billion on average per year, assuming the Commonwealth contribution is equal to that of the State and Territories combined – to be offset by the revenue raised from tax reform in earlier recommendations.[3]

Impact of recommendations
Based on previous modelling of the impact of similar reforms, our recommended package of tax reforms and social and affordable housing investment would likely have the following impacts.

Housing impacts:

- Reduce home prices by up to 4% once fully implemented years (compared to any increase or reduction that would otherwise occur), which is of similar magnitude to the impact of the federal government's commitment to boost housing supply by 1.2 million homes over 5 years (which may not be realised).
- The tax changes taken on their own would increase the proportion of households that own or are purchasing their homes by up to 5%, with particular benefits for first homebuyers. Any increase home ownership in this range would be significant given the 4% reduction in home ownership rates over the past two decades. The proposed investment in social and affordable rental housing may offset this to a degree, noting our goal is to improve housing affordability and security for all regardless of tenure).
- Investment of the revenue raised from tax reforms in social and affordable housing could fund an estimated 32,000 to 49,000 dwellings (though these would take some years to complete), while careful phasing of the tax reforms would avoid any large, sudden withdrawal of investors from the private rental market. These additional dwellings are significant in comparison to existing federal government housing commitments

[3] See section 'Impacts of the package of reforms and investment' below for details.

estimated to build 55,000 social and affordable dwellings by 2029 if delivered on time (increasing such output by around 1.5-2 times, though likely over a longer timeframe).
- Improve security of tenure for renters by shifting tax incentives for private landlords investors from quick capital gains towards a regular stream of positive rental income, and boosting direct public investment in social and affordable homes.
- These housing market adjustments are likely to be gradual rather than sudden, due to the transitional arrangements and time needed to construct dwellings.

Broader economic impacts:

- Reduce the discrepancy between the tax treatment of earnings and (much lower-taxed) investments.
- Greatly reduce wealth inequality over time, since the revenue savings from tax reform will be drawn mainly from people with high income and wealth.
- Substantially boost federal government revenues, by tax reforms raising around $19 billion over the forward estimates (around $3-4 billion after two years, around $6 billion in year three, around $9 billion in year four, and rising substantially in later years), which we recommend is invested in social and affordable housing.
- Help shift investment from speculation in asset values (e.g. land and shares) towards more productive purposes that grow jobs and incomes.
- Reduce risks for individual investors and the wider economy due to excessive borrowing for investment and the impact on the business cycle of speculative asset price 'bubbles'.

We also note that a range of other measures would improve housing affordability and equity. While the focus of the paper is major reform of CGT and negative gearing and social and affordable housing investment, other beneficial measures would include:

- Planning and building reforms together with investment in related public infrastructure to increase housing supply;
- Replacing stamp duty with a broad-based land tax: Progressively broaden State and Territory land taxes to owner-occupied housing while removing stamp duties for housing, with deferred payment arrangements for people with low incomes. See ACOSS (2016), *The case for tax reform: stamp duties and land tax*. Available: https://tinyurl.com/296u75h3.
- Strengthening rental rights and standards, including protections against excessive rent increases, and protections against no cause evictions including at the end of fixed-term leases. See National Shelter & National Association of Renters' Organisations (2024), *The rental report: A performance report on the progress of A Better Deal for Renters.* Available: https://tinyurl.com/54upsr7f.
- Accelerating home energy upgrades by boosting investment in energy efficiency, electrification and solar upgrades for low-income housing, to cut emissions, reduce energy bills, improve health, and create jobs. See ACOSS (2024), *Funding and financing energy performance and climate-resilient retrofits for low-income housing*. Available: https://tinyurl.com/yxy2dwpx.
- Increasing income support to parity with pensions (at least $82 on current rates), increase the Commonwealth Rent Assistance maximum threshold by 60% (resulting in a 110% increase in the payment), and ensuring ongoing indexation to wages, prices and actual rents. See ACOSS (2024a), *Raise the Rate survey 2024 "I wouldn't wish this life on anyone".* Available: https://tinyurl.com/merrrmn2.
- Tightening APRA restrictions on loans to property investors to limit speculative property investment.
- Administrative changes to restrict tax deductions in respect of rental housing to homes currently rented on a long-term lease (rather than only 'available for rent') so that deductions cannot be claimed for holiday homes or short-term tourist accommodation.

A. Problems: Capital Gains Tax discount & negative gearing

1. How the tax breaks work

Capital Gains Tax Discount
A capital gain is the progressive increase in the value of an asset since its purchase, such as an increase in the value of an investment property or shares. Capital gains accrue every year but for practical reasons they are only taxed when an asset is sold. This avoids the need to value assets every year and recognises that investors may not have sufficient cash available to pay each year.

The Capital Gains Tax (CGT) discount for individuals and trusts provides that only 50% of capital gains are taxed when an asset held for more than one year is sold. Capital gains for individuals and trusts are taxed by reference to marginal income tax rates. In effect, the CGT discount is equivalent to providing that capital gains from selling an asset held for more than one year are taxed at 50% of the marginal tax rate for an individual or trust. The taxing of capital gains only upon sale also provides a tax deferral benefit akin to an interest free loan and allows people to avoid tax by selling when income is otherwise low (such as after retirement).[4]

The full diversity of tax treatments of capital gains in different circumstances are beyond the focus of this report, which focusses on the CGT discounts for personal investors, trusts and superannuation funds. However, it is important to note that the CGT discount does not generally apply to owner-occupied housing as gains from the sale of people's homes are usually not taxed in Australia, and home-owners cannot generally claim deductions for interest and other costs associated with the dwelling.

For superannuation funds the CGT discount is one third (so the standard 15% tax rate for accounts in the 'accumulation phase' before retirement is effectively reduced to 10%). In the case of superannuation accounts in the drawdown or 'pension' phase (after retirement), investment income is not taxed so CGT does not apply. This creates a tax avoidance opportunity for people with self-managed superannuation funds.

The CGT discount for personal investment was introduced in 1999 by the Howard Government, implementing recommendations of the 'Ralph Review' of Business Taxation, with the purported intent of improving competitiveness for domestic and international investment in assets yielding capital gains, including in the information technology sector.[5] ACOSS warned at the time that it would cause a significant increase in property investment and drive up property prices.[6]

The CGT discount replaced the previous CGT system of 'inflation adjustment' existing from 1985 to 1999, under which capital gains for individuals and trusts were taxed at full marginal tax rates, but only after reducing the taxable capital gain by reference to the cumulative increase in the Consumer Price Index from purchase to sale. Thus, only *real* rather than nominal capital

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[4] OECD (2025), *Taxing capital gains, Country experiences and challenges*, Paris. Daley J & Wood D (2016), *Hot Property: Negative Gearing and Capital Gains Tax Reform,* Grattan Institute, Melbourne, p.9. Available: https://tinyurl.com/3sjj82j2.
[5] John Ralph (1999), *Review of Business Taxation – A Tax System Redesigned: More Certain, Equitable and Durable,* p.77. Available: https://tinyurl.com/mpwfdntf.
[6] ACOSS (2015), *Fuel on the fire: negative gearing, capital gains tax and housing affordability.* Available: https://tinyurl.com/3ft39ycm.

gains were taxed.[7] Instead of only compensating investors for the erosion in the real value of an asset due to inflation, the 50% CGT discount went further. With low inflation, it was much more generous than inflation adjustment for most assets held for less than a decade. This encouraged speculative investment for quick gains in the value of property and shares.

While there is a case for taxing long-term investments at lower effective rates to avoid a compounding of tax or to take account of the erosion of the real value of assets by inflation, the 50% discount is excessively generous compared to the taxation of wages. This is especially problematic given that most capital gains accrue to people who already enjoy very high incomes and wealth. As discussed later, they pay less tax on their passive investment income than a fulltime worker pays on their wages.

Negative Gearing

Individuals can deduct from their taxable income expenses resulting from investments. In doing so, the individual reduces the tax they pay by lowering their taxable income, sometimes also by bringing their taxable income into a lower marginal tax bracket. Tax-deductible expenses include payments of interest accrued on money borrowed for investment in an asset (such as an investment property), capital works, depreciation of fixtures and State taxes such as land tax. Where an individual's investment expenses exceed their taxable income from that investment (for example from rents), they are said to be making a loss. They can then deduct these losses from their taxable income from other sources such as wages. They are then said to be 'negative gearing' or 'negatively geared'.[8] Most deductions relate to interest costs from borrowings to purchase the asset.

The ability to deduct from taxable income the expenses incurred in investments generating taxable income, including negatively geared investments, has been a feature of uniform personal income taxation in Australia since at least 1936.[9] Under a comprehensive income tax system, tax is applied to the sum of an individual's gross income from all sources minus all deductions, though as discussed later losses from one source of income cannot always be deducted from income from another source.

The problem with negative gearing is not that deductions are available for the costs associated with securing an income, or that people can apply deductions associated with one source of income against another. It is the mismatch between deductions for investment expenses and the treatment of capital gains from the same investments.

There have been previous attempts to limit the ability of investors to offset investment losses against other income. In 1983 for some months, the Victorian Deputy Commissioner of Taxation denied taxable income deductions of interest expenses to the extent they exceeded rental incomes (due to a differing interpretation of, rather than a change in, the law). From 1985 to 1987, the Hawke government made legislative changes that meant taxable income deductions for rental property expenses were restricted to income from the same class of investments.[10]

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[7] John Clark (2019), *Capital Gains Tax: Historical Trends and Forecasting Frameworks*, Australian Treasury, p.37. Available: https://tinyurl.com/zeunmhc8; Daley J & Wood D (2016), op cit p.8. Before 1985, most capital gains were exempt from income tax. The intent of introducing general capital gains tax in 1985 was to improve consistency in the taxation of income and prevent tax avoidance through classification of otherwise taxable income as non-taxable capital gains.

[8] Tilley P (2024), *Negative gearing: Is it a tax concession?* TTPI Policy Brief 6/2024. In contrast, where an individual's taxable income from an investment exceeds its tax-deductible expenses from the investment, the individual is known to be 'positively geared' in relation to that investment.

[9] O'Donnell J (2005), 'Quarantining Interest Deductions for Negatively Geared Rental Property Investments', *eJournal of Tax Research* 3(1), pp. 68-70. Available: https://tinyurl.com/y8u23jpe; Rami Hanegbi R (2002), 'Negative Gearing: Future Directions', *Deakin Law Review* 7(2).

[10] O'Donnell J (2005),op cit.

Combination of CGT Discount and Negative Gearing

Negative gearing and the CGT discount together provide a significant tax advantage to people who invest in assets that appreciate in value, including property, shares and collectables, in the following way:

- Each year, investors who make a 'loss' (for example where interest and other costs exceed rental income) can deduct these losses from their other unrelated income (such as wages). However, when annual capital gains are included in their income from the investment, they are in most cases (especially for housing) not making a 'loss' overall. Otherwise, there would be no point in negative gearing – why would people invest to make an overall loss?
- Current tax settings encourage investors to make deliberate 'losses', including by using interest-only loans (some with flexible repayment options to ensure expenses always exceed income), or through buying an additional investment property when the previous one(s) become positively geared (income exceeds expenses).
- Upon sale of the property, investors take advantage of the CGT discount so are only taxed at half their normal marginal tax rate. Taxation of gains only upon sale also delays taxation for years, in itself a substantial benefit. It also means that investors can time the sale of the property when capital gains are high and their income tax rate is low, for example after retirement.

In short, people can claim deductions for the costs of investment each year against their current fully-taxed income but a large part of the income from the same investment is not taxed until many years later, and then at half the normal rate. This mismatch gives rise to major tax avoidance opportunities which are widely promoted. As the Treasury's Financial System Inquiry said:

> *'For leveraged investments, the asymmetric tax treatment of borrowing costs incurred in purchasing assets (and other expenses) and capital gains, can result in a tax subsidy by raising the after-tax return above the pre-tax return. Investors can deduct expenses against total income at the individual's full marginal tax rate. However, for assets held longer than a year, nominal capital gains, when realised, are effectively taxed at half the marginal rate. All else being equal, the increase in the after-tax return is larger for individuals on higher marginal tax rates'.*[11]

An example of how a property investor makes use of these tax breaks is below.

Example: Tax Advantages of CGT Discount and Negative Gearing for Property Investment[12]

Richard earns $300,000 per year and so is subject to the highest marginal tax rate of 47% (including the Medicare levy). Richard borrows $800,000 to purchase an investment property worth $1,000,000. For simplicity, his interest payments remain at 6% of the loan per year (i.e. an interest-only loan), other annual investment costs (e.g. land tax) are $40,000 increasing by 5% per year, annual rental income is 2.5% of the property value (at year end), and the property value increases by 5% per year.

After one year, Richard makes a loss of $61,750 ($48,000 interest payments, $40,000 investment costs, $26,250 rental income). By negative gearing, he deducts this loss from his taxable wage income and reduces his taxable income from $300,000 to $238,250. Richard reduces the tax he pays from $107,138 (without deductions) to $78,116 (with deductions) – a tax saving of $29,023.

[11] Australian Treasury (2014), *Financial System Inquiry Final Report* Canberra, p. 278.
[12] Adapted from Daley, J and Wood, D (2016), op cit. Box 5, p.21.

After five years, negative gearing allows Richard to reduce the tax he pays on his wage income by $148,509 (accounting for increasing rental income as the property value increases, and assuming a constant wage). Richard now sells the property, and applying the annual 5% appreciation in the property value, he realises a nominal capital gain of $276,282. By way of the CGT discount, Richard only pays tax on half of this gain – reducing his capital gains tax from $129,852 to $64,926, resulting in a tax saving of $64,926, and an after-tax profit of $211,355.

If the tax breaks were not available, Richard would have paid $535,690 in tax on his wage income (assuming constant tax rates over the years) and $129,852 in capital gains tax from the sale of the home – totalling $665,542. But having made use of negative gearing and the CGT discount, Richard instead paid $387,181 in tax on his wage income and $64,926 in tax on his capital gains – totalling $452,107 in tax paid.

By using the tax breaks, Richard reduces his tax by $213,436 over 5 years (in nominal terms), in addition to receiving a $211,355 after-tax gain on his investment, compared to if the tax breaks were not available.

A key rationale for tax deductions for interest costs is to promote neutrality in the tax incentives for investment through debt and equity financing.[13] If capital gains were taxed but investment losses were not deductible then higher-risk debt-financed investments would be less attractive.[14] Rather than maintaining tax neutrality for debt and equity financing, negative gearing instead encourages excessive reliance on debt-financing and contributes to our high level of household debt (discussed later).

The combined effect of the CGT discount and negative gearing encourages highly leveraged investment in assets that are expected to grow in value yet yield low recurrent income. This is in stark contrast to direct investment in an active business, which generally attracts standard income tax rates. While the CGT discount and negative gearing apply to a range of investments, in practice they have encouraged greater investment in property over other assets, with property investors tending to borrow more often and in greater amounts.[15] One reason for this is that lending rules have historically allowed investors to borrow more money to invest in property compared to other assets as explained below. The effect of the tax breaks means a property investor will enjoy a lower effective tax rate by financing an investment property through borrowed money, instead of using existing savings, with greater borrowing resulting in greater tax savings. As a result, in contrast to other countries where earning rental income is the key reason for investing in property, there is evidence that most property investors are more motivated to invest by capital.[16]

Up until financial deregulation in the 1980s, banks were reluctant to lend for investments that made losses year after year. After controls over bank lending were eased, competition among banks for loans to personal investors led to the widespread use of 'interest only loans' which enabled property investors to borrow more and increased their annual 'losses' thus facilitating negative gearing strategies to avoid income tax. This contributed to growth in household debt and home prices in the late 1980s. It distorted investment decisions, so that investors on the highest marginal tax rate were encouraged to buy properties that yielded capital gains rather than rental income.[17]

[13] Fane, G. and Richardson, M. (2004) 'Negative Gearing Redux', *Agenda*, 11(3), pp.211-222.
[14] Daley J & Wood D (2016), op cit, p.22.
[15] See eg Daley J & Wood D (2016), op cit, p.22.
[16] Seelig T et al (2009), *Understanding what motivates households to become and remain investors in the private rental market*. AHURI Final Report No. 130. Available: https://tinyurl.com/2j3emc6e.
[17] Daley J & Wood D (2016), op cit.

Incentives to borrow to invest in property were further enhanced in 2003 when self-managed superannuation funds were allowed to do so through 'limited recourse loans', despite the fact that superannuation is supposed to encourage long-term saving rather than borrowing. Further, as noted above, once a superannuation account is in the 'retirement phase' (and begins paying a pension to the member) any capital gains from sale of the property are tax free - including gains that have accrued for decades.

2. Impacts on home ownership

Home prices have risen much faster than wages over the last 25 years
Since 1999, home prices have increased by 142%, while wages have only increased by 44% (Figure 1). Since 2001, the median home price has almost doubled from 4.4 to 8.6 times the median income.[18] Home prices began to rise much faster than wages in the early 2000s, after the CGT discount was introduced and interest rates were lower and more stable than in the past.

Figure 1 reveals three episodes of steep growth in home prices (shaded areas):

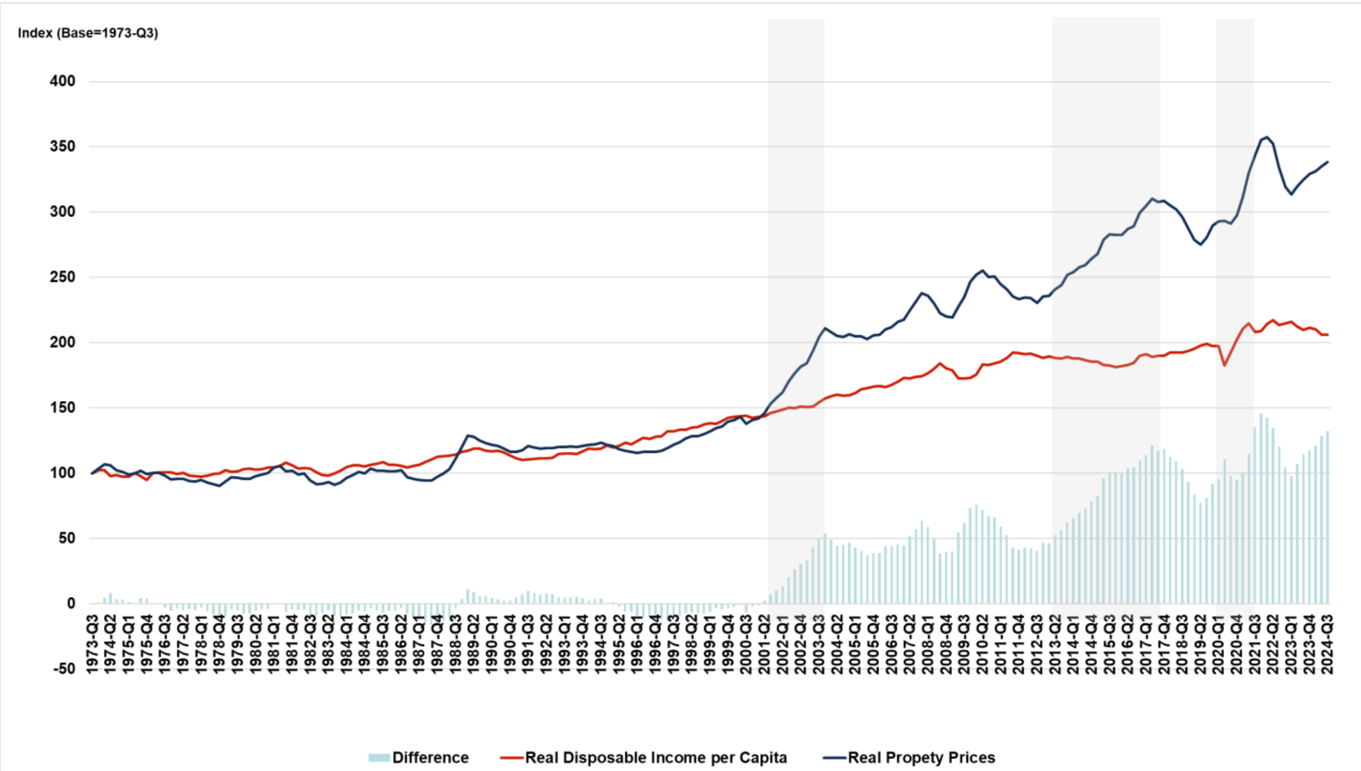
(1) from 2001 to 2003;

(2) from 2013 to 2017;

(3) from 2020 to 2021.

As discussed later, the first two of these home price 'surges' were associated with strong growth in negatively geared rental housing investment, most of which was for the purchase of existing homes rather than new ones. These periods are also shaded in grey in relevant graphs throughout the paper.

Figure 1: Growth in home prices and wages

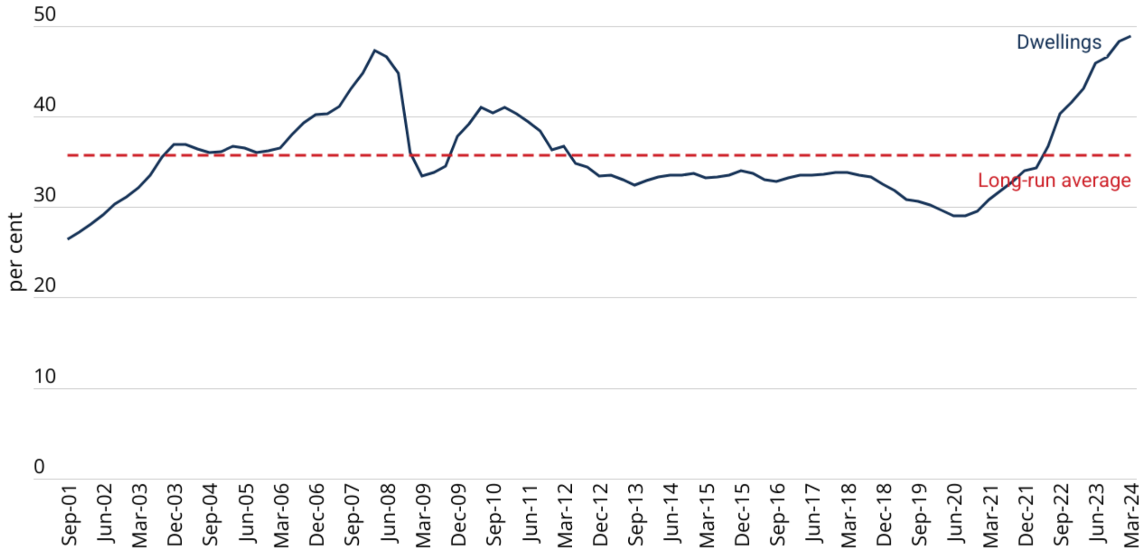


[18] ANZ CoreLogic (2024), *Housing affordability report April 2024*, p.5. Available: https://tinyurl.com/56ya4zyb. Data is from September 2001 to September 2024.

Source: BIS *Selected Residential Property Prices*; ABS *National Accounts*, Real Net Disposable Income per Capita. Note: Prices and wages are adjusted for inflation using the CPI. Shading represents surges in home prices.

Since the early 2000s, there have been significant increases in the income required to pay a home deposit and meet mortgage costs. The time needed for a median income household to save a 20% home deposit for a median value dwelling has increased from around 8 years in 2004 to nearly 11 years in 2024.[19] Meanwhile, there has been an increase in the proportion of homeowners with a mortgage from 32% to 37% from 1999 to 2019-20 and an increase in the proportion of income needed to meet mortgage payments from 27% in 2001 to 49% in 2024 (Figure 2).[20] Since 2001, the steepest increases in mortgage costs were in the early and mid-2000s, and from 2022 (reflecting home price or interest rate increases).

Figure 2: Share of income to service new housing loans



Source: Australian Government (2024), *Budget paper no. 1 Budget strategy and outlook* Commonwealth of Australia, 2024. Note: Income refers to median disposable household income. Data is for national dwellings, reported quarterly.

Home ownership has declined

Home ownership has declined from 31% in 1999 to 27% in 2019, and first home buyers have been at record low shares in the market.[21] Since the late 1990s, there has been a marked decrease in the proportion of homeowners without a mortgage (Figure 3).

Figure 3: Change in proportion of home ownership and renters 1994-95 to 2019-20

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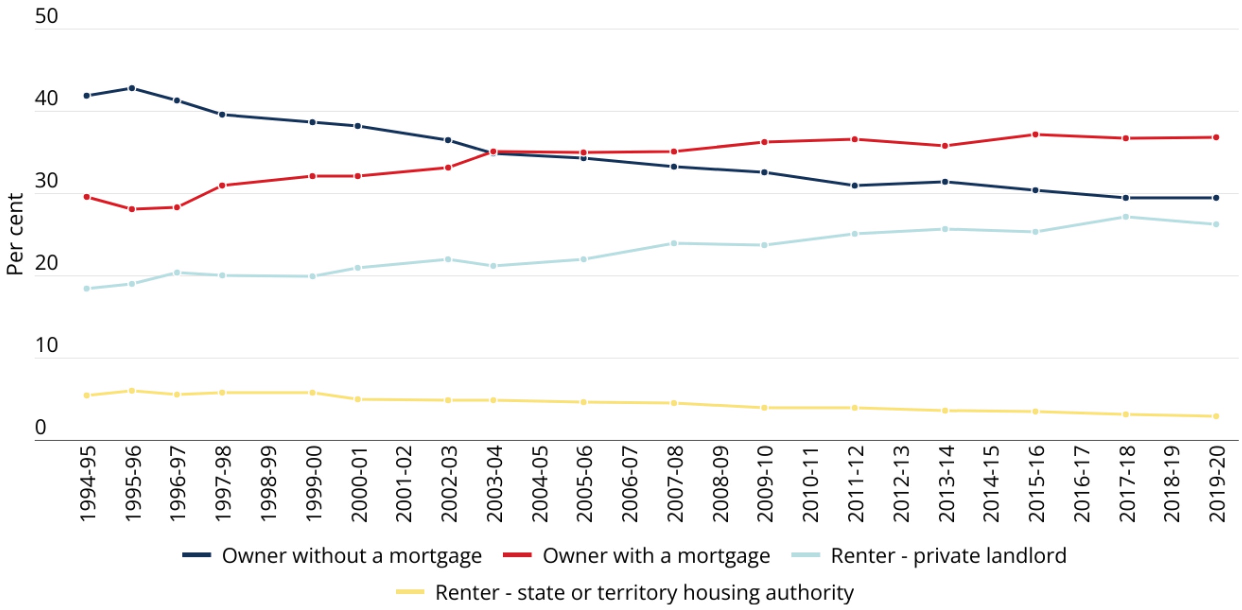
[19] Ibid, Figure 1. Assuming a 15% savings rate on annual income. Data is from September 2004 to September 2024.

[20] Australian Bureau of Statistics (2022), *Housing Occupancy and Costs, 2019-20 financial year.* Available: https://tinyurl.com/5x8tnncp.

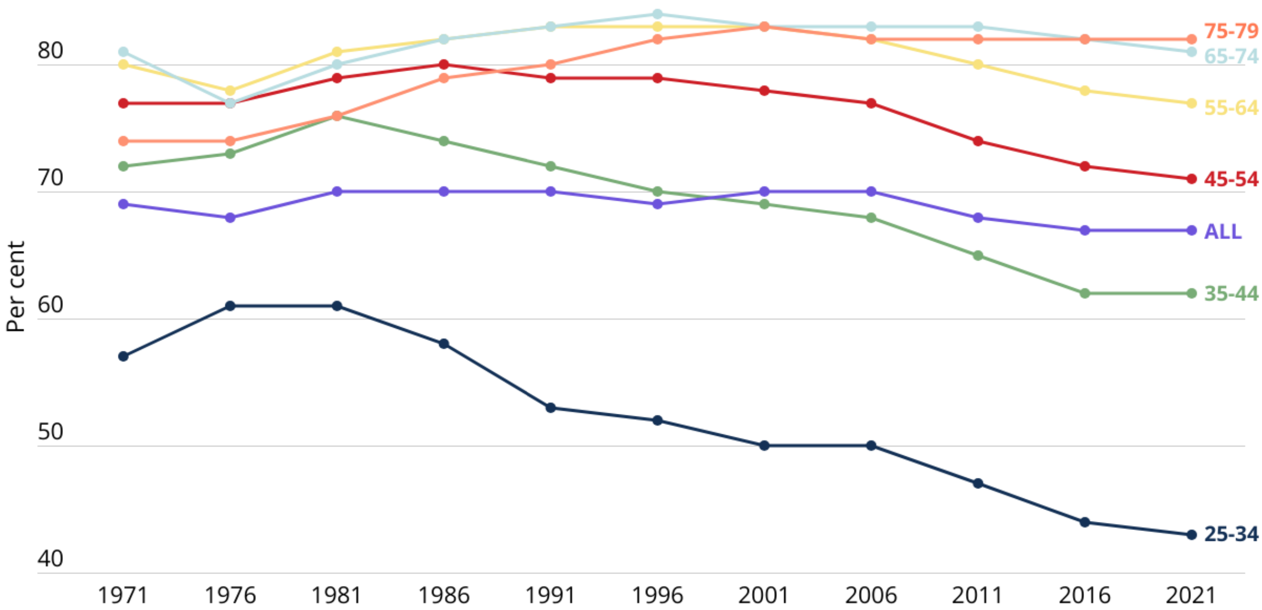
[21] Australian Bureau of Statistics (2022), ibid.



Source: AIHW (2024a), *Home ownership and housing tenure*. Webpage, available https://tinyurl.com/bdabwmhy. Note: values have been interpolated for non-survey years.

The fall in home ownership has been steepest among young people, though it has impacted all age groups up to 65 years (Figure 4).

Figure 4: Change in home ownership rate by age



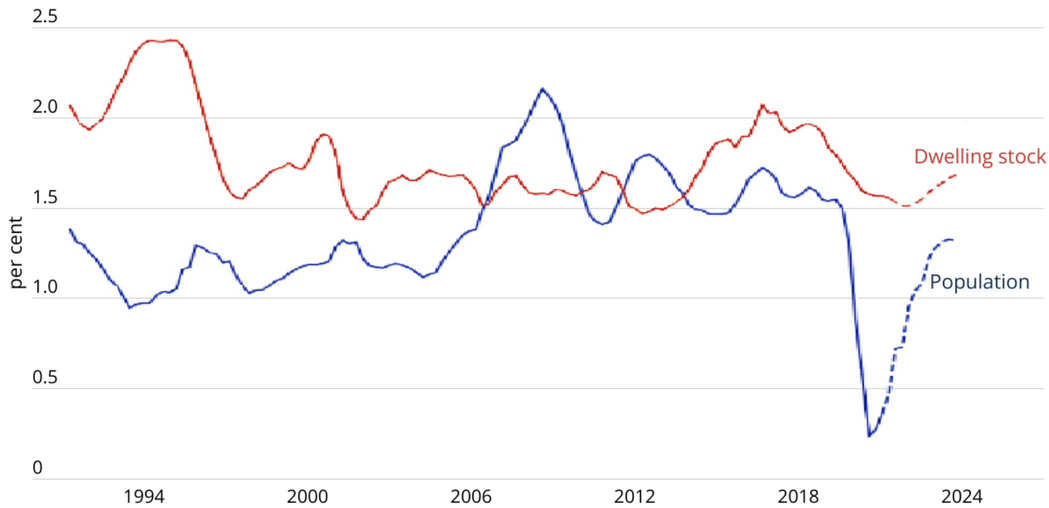
Source: AIHW (2024b) *Home ownership and housing tenure*. Webpage, available: https://tinyurl.com/bdabwmhy; ABS Census data.

The housing affordability crisis is not just about supply
Much of the recent policy discussion of reforms to make housing more secure and affordable has focussed on efforts to boost supply: for example, by easing local development restrictions, funding enabling infrastructure, and subsidising and reducing the cost of building. When the

government sought advice from Treasury on housing tax reform, media reporting suggested the government's evaluation of potential reforms focused on the impacts on housing supply.[22]

Yet any serious attempt to improve affordability must tackle both supply and demand for housing. Over the long term, growth in supply has generally matched or exceeded growth in population, but with a lag (Figure 5). Growth in housing supply has not always fallen behind population growth. There were periods in the late 1990s and mid 2010s when there appeared to be 'excess' supply. However, it takes time for new home construction to catch up with sudden spikes in demand, whether due to population growth, an easing of credit or speculative 'bubbles' in home prices. For example, it takes much longer to develop and build new homes than it does for homebuyers and landlords to invest in existing dwellings (which comprise the vast majority of home purchases), so home prices may surge for a number of years before housing supply catches up.

Figure 5: Growth in population and dwellings (% per year)

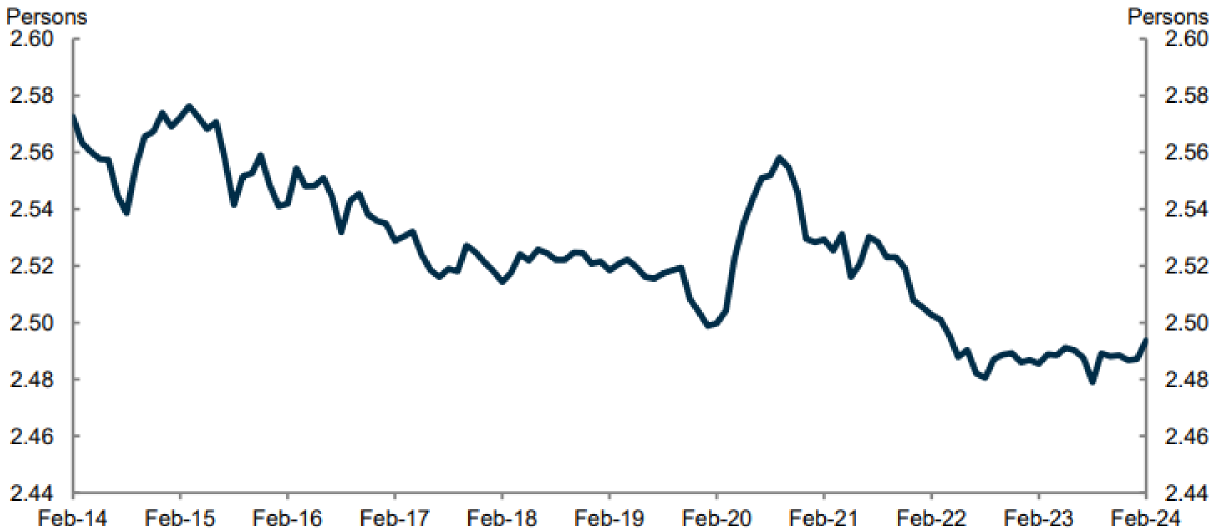


Source: Reserve Bank of Australia (2022), *Housing in the endemic phase.* Available: https://tinyurl.com/3utzendb. Note: Dashed lines represent forecasts; the population growth forecast is broadly in line with the profile set out in the Australian Government Budget 2022-23.

Many factors affect demand for housing. For example, in recent years demand for housing has been exacerbated by declines in the average number of people in each home, especially during and immediately after COVID lockdowns when more people worked from home (Figure 6).

Figure 6: Average household size (persons)

[22] McIlroy T (2024), 'Chalmers digs in on negative gearing advice' *Australian Financial Review* 30 September 2024. Available: https://tinyurl.com/3sc3bky4.



Source: National Housing Supply and Affordability Council (2024), *State of the Housing System*. Australian Government, Canberra. Chart 3.29.

Housing affordability policies that focus exclusively on supply are doomed to fail, at least during periods when demand is elevated. Successful housing affordability policies such as those adopted recently in New Zealand, target both supply (for example by investing in social and affordable housing and easing zoning restrictions) and demand (for example by restricting negative gearing and curbs on borrowing).[23]

The tax breaks discussed in this report are not the only cause of worsening housing affordability, but they are an important one. Housing prices are also driven by several other factors that raise demand for housing faster than supply:

- Factors adding to demand include population growth (natural increases and migration), wage growth and access to credit (in turn affected by official interest rates and lender policies and practices), and consumer preferences (such as for larger dwellings and fewer people per dwelling);

- Factors affecting supply include the cost of financing (including official interest rates, and minimum rates of return banks required from investors, or the availability of low-cost finance from government), costs of development (workforce and cost of materials), availability of land and planning policies, and critically the availability of social housing.[24]

Since the CGT discount commenced in 1999, surges in rental housing investment have been associated with surges in home prices

As well as strengthening supply, it is vital that governments take steps to curb excessive *demand* for housing, especially as official interest rates are eased. Reducing tax concessions that encourage speculative investment, especially during housing cycle upswings, is not the whole answer to the housing affordability crisis but is an important part of the solution.

[23] AHURI (2021), New Zealand housing investment tax changes explained; Greenaway-McGrevy P & Phillips C (2023), 'House prices and affordability', *New Zealand Economic Papers*, Vol 55 No1, pp1-6, available: https://tinyurl.com/mv8jwcsh; International Monetary Fund (2018), *Housing affordability in New Zealand and policy response*.
[24] Abelson P & Joyeaux R (2023), *Housing prices and rents in Australia 1980-2023: Facts, explanations and outcomes.* TTPI - Working Paper 14/2023; Saunders T & Tulip P (2019), *A Model of the Australian Housing Market*. RBA Research Discussion Paper No 2019-01.

Over the last decade, economic modelling of Australian housing markets has yielded few independent, peer-reviewed estimates of the impacts of investor tax incentives on housing markets, including home prices, home ownership rates and rents. We discuss these in Part B of this report.

In the remainder of this section of the report, we describe trends in rental property investment since the introduction of the CGT discount in 1999, especially during two periods when home prices surged.

(1) The first episode was between 2001 and 2003, immediately following the introduction of the CGT discount in September 1999. At that time, real home prices grew at a rate of 13% per year, well above the long-term average of 2.4% (from 1955 to 2014).[25] Credit for investor housing rose by 69% per year during the same period compared with 26% for owner-occupiers (Figure 7). Fox and Tulip found that the very rapid growth in home prices shortly after the CGT discount commenced (in the two years to December 2003) was mainly due to higher expectations of capital gains.[26] In a separate report the RBA concluded that much of the increased demand for housing at this time came from investors as opposed to owner-occupiers, offset to a limited extent by a minority of rental property investment in new dwellings (which increased supply).[27]

Rapid growth in home prices triggered a review of home ownership policies by the Productivity Commission which recommended that the CGT discount (introduced just four years previously) and negative gearing arrangements be reviewed by the government. The Productivity Commission said:

> *'The Australian Government should, as soon as practicable, establish a review of those aspects of the personal income tax regime that may have recently contributed to excessive investment in rental housing. The focus of the review should be on the Capital Gains Tax provisions. However, it should also assess 'second best' options for addressing distortions in incentives to invest in housing and other asset markets, including: restrictions on negative gearing and changes to the capital works deduction provisions for buildings.'* [28]

(2) During the second episode between 2013 and 2017, when home prices rose by 6% per year in real terms, investors also led the charge to purchase dwellings. Credit for investment housing rose by 14% per year compared with 8% for owner occupiers (Figure 7). By 2015, investors comprised more than 50% of new housing loans (mainly to purchase existing dwellings), up from 27% of new housing loans in 1999.[29]

As discussed previously, other factors influencing demand for housing include changes in interest rates, population, and growth in incomes.

(3) There was a third key surge in home prices after 1999, from 2020 to 2021. This was during the pandemic, where home prices grew by about 25% in around 18 months from September

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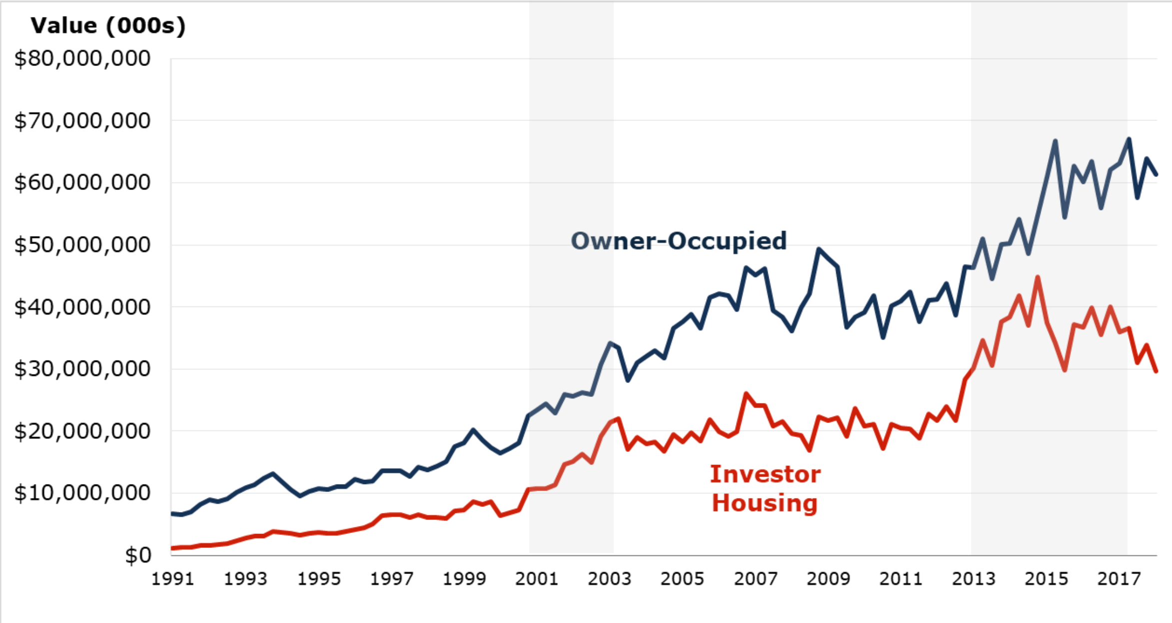
[25] Fox R and Tulip P (2014), *Is Housing Overvalued?*, RBA Research Discussion Paper, 21. See also Otto G (2021), *'Accounting for Longer-Run Changes in Australian House Prices'.* Australian Economic Review, vol. 54, no. 3, pp. 362–374. While home prices rose sharply in some other wealthy nations in the early 2000s such as the United Kingdom, those countries were recovering from a recession (which did not occur in Australia at that time).
[26] Fox R and Tulip P (2014), op cit.
[27] Bloxham, Kent & Robson (2010), *Asset Prices, Credit Growth, Monetary and Other Policies: An Australian Case Study.* RBA Research Discussion Paper No 2010-6, p.17. Available: https://tinyurl.com/5b4uk652.
[28] Productivity Commission (2004), *First home ownership, Inquiry report*. Canberra, p121.
[29] ABS (2018), *Housing finance 5609.0.* Available: https://tinyurl.com/yd39ksby. Investors comprised 45% of the value of new housing loans by June 2015, up from 28% in September 1999.

2020 to February 2022.[30] Unlike the above episodes, those increases were largely driven by 'homeowner' purchases.[31] In the highly unusual circumstances following pandemic lockdowns, demand was stoked by a combination of historically low interest rates (the RBA's cash rate target was slashed to 0.1%), COVID income support payments (such as the JobKeeper wage subsidy), and pent-up demand following COVID lockdowns.[32] Unusually low interest rates at that time sharply reduced opportunities for investors to negatively gear (though increases in interest rates since 2022 have facilitated it).

Figure 7: Credit for owner occupied and rental housing



Source: ABS *Housing Finance*, November 2018

Most of these surges in rental housing investment were negatively geared

The introduction of the CGT discount was particularly associated with a surge of *negatively geared* rental housing investment as investors took advantage of the discrepancy between the tax treatment of deductions and income from capital gains, as explained previously. Figure 8 shows that the value of 'losses' from negatively geared investments rose markedly from 2000 to around 2012. After that, the share of negatively geared investors declined due to reductions in interest rates and clamps on credit for rental housing investment introduced by the Australian Prudential Regulation Authority (APRA).[33]

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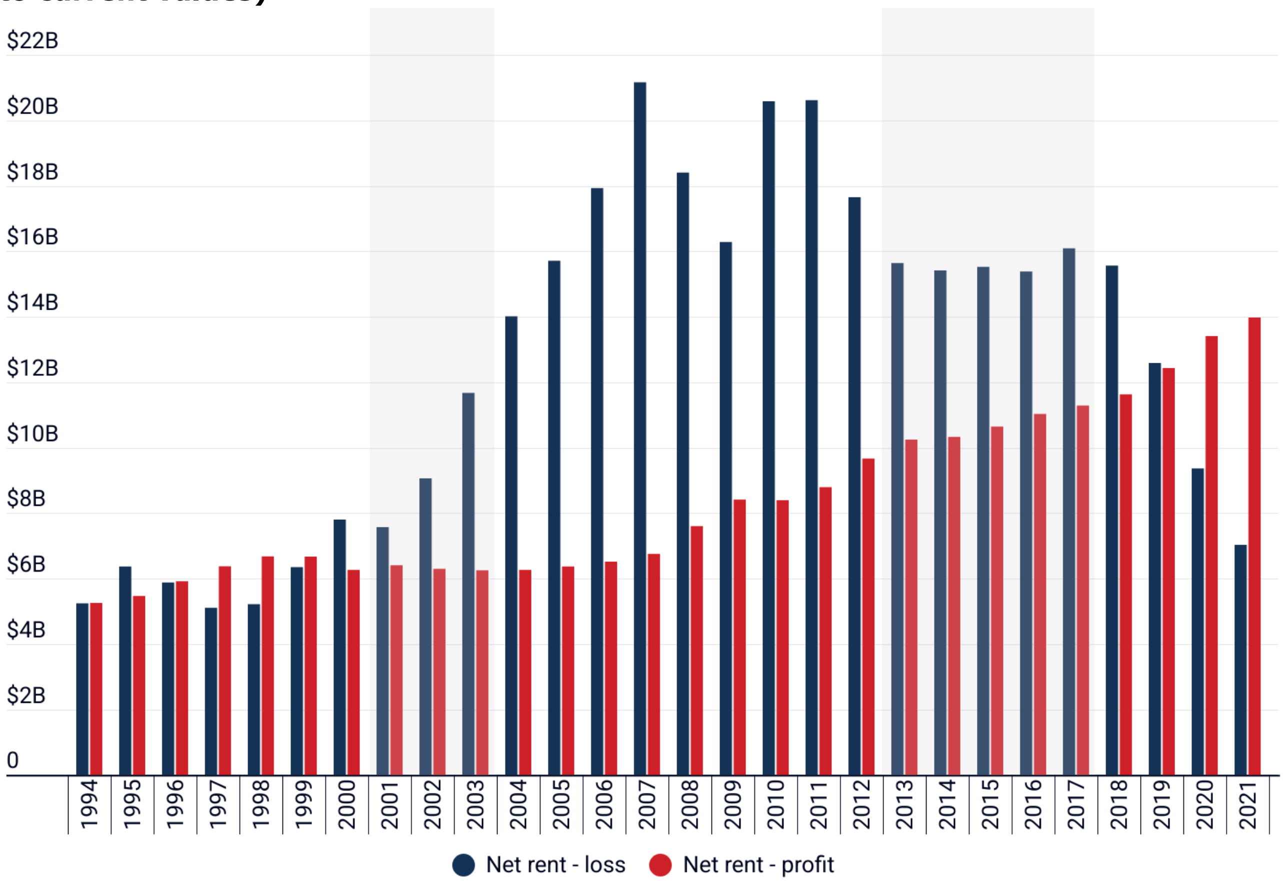
[30] AHURI (2023), *How Australian housing patterns changed during COVID: the new normal?* Available: https://tinyurl.com/yc73e4bp.

[31] Between calendar year 2020 and calendar year 2021, credit for owner occupied housing rose by 10% compared with -1% for investor housing (RBA 2025, *Bank lending by sector*).

[32] Davidson, P. & Bradbury, B., (2022) *The wealth inequality pandemic: COVID and wealth inequality* ACOSS/UNSW Sydney.

[33] Eslake S (2021), *Submission to House of Representatives Tax and Revenue Committee inquiry into housing affordability in Australia*, Corunna Economic Advisory.

Figure 8: Profits and losses of rental housing investors (dollars, adjusted for inflation to current values)



Source: ATO Taxation Statistics 2021-22. Note: 'Net Rent – Neutral' omitted due to small size

The vast majority of rental housing purchases are existing dwellings

As explained earlier, the CGT discount encourages the purchase of property in pursuit of concessionally taxed capital gains upon sale. In practice, property investors have overwhelmingly used the tax breaks to purchase *existing* dwellings, rather than newly constructed dwellings (Figure 9). In 1999, around 16% of the value of new housing investment loans were for construction of new dwellings, falling to 5-6% during 2012-2014, and then rising slightly to 9% in 2018.[34]

As of December 2024 (latest figures), 15% of new housing investment loans (or 14% of new housing investment loans by value) were for construction of new dwellings and around 81% of new housing investment loans (by numbers and value) were for purchase of existing dwellings.[35]

This added competition from investors drives up the price of homes. As explained later, it also reduces home ownership rates and turnover, since first home buyers and other owner-occupiers lose out in auctions to investors.

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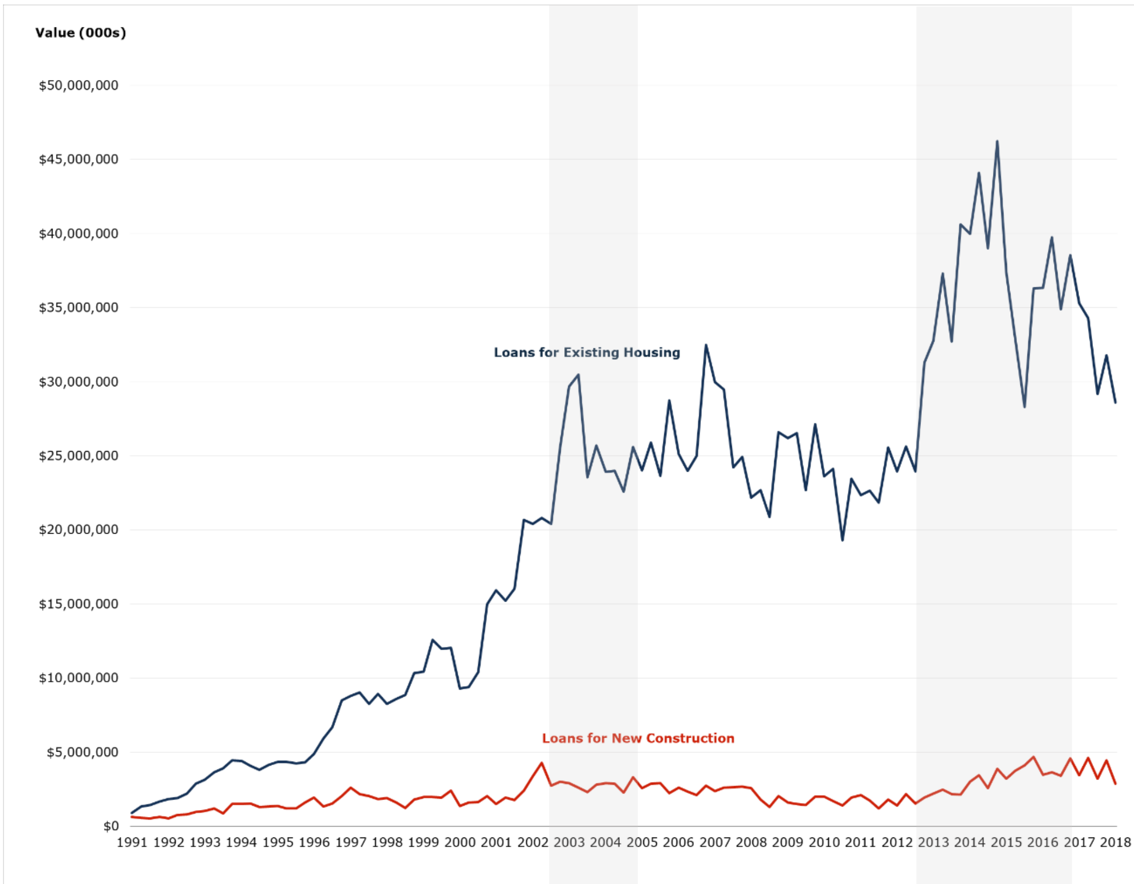
[34] ABS (2019), *Housing Finance, Australia 5609.0*. Table 11. Available: https://tinyurl.com/y6259tsn.

[35] ABS (2024), *Lending indicators*. Table 13 (560113). Available: https://tinyurl.com/25r782yw. This is up from a recent low in the quarter to December 2021 of 9.6% of new investor housing loans (and 8.2% of their value) being for construction of new dwellings. Note that ABS reporting on purposes of new loan commitments changed to the following as of September 2019: construction of dwellings, purchase of newly erected dwellings, purchase of existing dwellings, purchase of residential land, alterations, additions and repairs. Before then, ABS reporting on loan purpose was in three categories: purchase of existing dwellings by individuals, construction of dwellings, and purchase of existing dwellings by others (see previous footnote).

Figure 9: Value of Investor Loans for Existing Housing and New Construction



Source: ABS Housing Finance Commitments by Purpose, CPI Adjusted to Q2 2022 Prices as Per Capita (2024).

Housing tax breaks contribute to home price 'bubbles', increasing the volatility of home prices

The RBA, several government reviews and others have argued that the tax breaks exacerbate volatility in housing markets.[36] There is evidence that growth in housing finance is generally more volatile for investment properties than for owner-occupiers.[37]

Australia has long been prone to asset price 'bubbles', mainly (though not exclusively) driven by housing prices. The housing cycle has amplified the business cycle, exaggerating the impact of booms and recessions (a problem we discuss later). This is due in part to strong growth in household incomes during booms and people's preferences to invest much of that increased income in housing. However, during asset price bubbles, prices rise well above levels consistent with the fundamentals of demand and supply such as income, population and the availability of dwellings.[38] Contributing factors include the ready availability of finance, less sophisticated

[36] See eg RBA (2014), *Submission to the Financial System Inquiry*, pp.88-89. Available: https://tinyurl.com/yb65d3bn Australian Treasury (2014), *Financial System Inquiry Final Report*. Australian Government, Canberra, p.288. Available: https://tinyurl.com/ykxb8tnc; Duncan et al (2018), *The income tax treatment of housing assets: an assessment of proposed reform arrangements*, AHURI, p.10. Available: https://tinyurl.com/ykcfsd38.
[37] *Australia's Future Tax System Review Final Report.* Australian Government, Canberra. Chart E4-4, 418. Available: https://tinyurl.com/37wx928e.
[38] Shi S et al (2024), '*Dating the Timeline of House Price Bubbles in Australian Capital Cities*'. Economic Record, Vol. 92, No. 299, December 2016, pp.590–605. Critics of the concept of asset price bubbles argue that it is difficult to identify and distinguish between the impact of fundamentals and speculation (See Fox & Saunders 2014, op cit, but note that in their model increased expectations of future capital gains accounts for much of the surge in home prices in the early 2000s).

investors and 'fear of missing out'. The concessional tax treatment of capital gains, negative gearing, and the tax avoidance 'industry' that has grown to take advantage of them, have also contributed to asset price bubbles. As the RBA observed:

> *'The market works, but with long lags during which people are encouraged to take decisions based on little more than optimistic extrapolation of what happened in the past. Developers will continue to put up new apartment blocks while there are investors willing to precommit to buy. These are the investors who turn up at seminars where they are told by the developers how they can become very rich if they highly gear themselves and buy an apartment.'*[39]

As discussed, since the introduction of the CGT discount in 1999 there have been two episodes in which both negatively-geared rental housing investment and home prices surged. Analysis of the causes of these surges in home prices suggests that they were not simply driven by 'fundamentals', though this varies among different urban housing markets. As Shi and others observed:

> *'Overall, two 'bubble' episodes are identified. The first is in the early 2000s after the capital gains tax reform, in Brisbane Adelaide and Hobart. The second is more recent, starting in 2016 in Sydney and 2017 in Melbourne and lasting until the end of the sample period in 2017.'*[40]

3. Impacts on rental affordability, security and homelessness

Rents have risen as a proportion of income, with sharp growth in rents over the last four years

Renters are now currently paying a higher proportion of their income on rent than ever before, with around 33% of median income required to pay median rent in 2024, up from around 26% in 2004.[41]

Advertised rents have more than doubled since the mid-2000s (Figure 10). Annual growth in rents was particularly strong during the pandemic, reaching a peak of 13% in the year to September 2021.[42] In the last four years, median national rents rose by 39% (August 2020 to June 2024).[43] Rent increases have subsided somewhat more recently, rising by 4% in 2024.[44] Demand for rental properties is high, and supply is struggling to keep up, as demonstrated by record-low vacancy rates, as explained below.

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[39] (RBA Governor Macfarlane in testimony to a Senate Committee in 2002, cited in Bloxham P et al (2010), *Asset Prices, Credit Growth, Monetary and Other Policies: An Australian Case Study*. RBA Research Discussion Paper No 2010-06, p28).

[40] Shi S et al (2024), op cit, p.395.

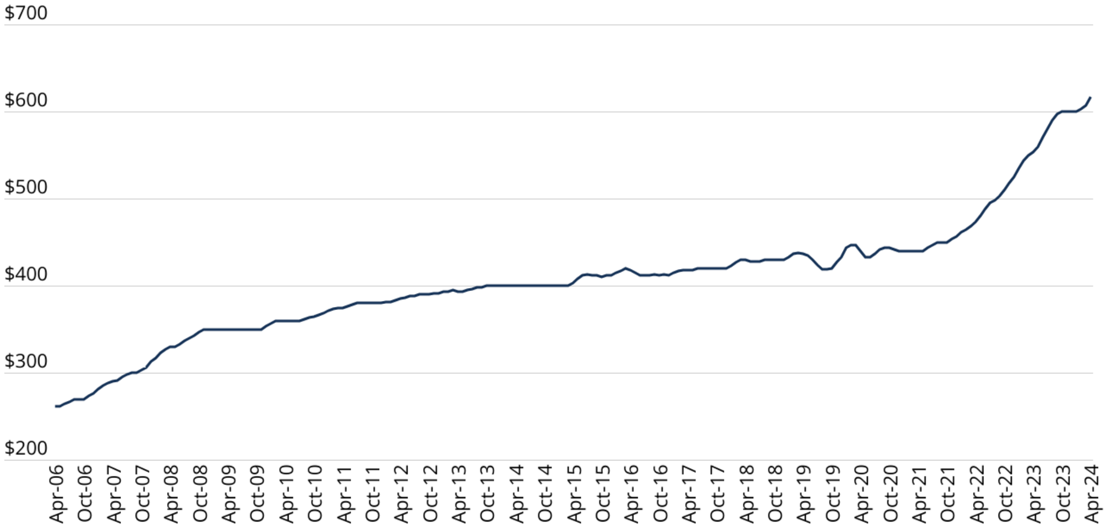
[41] See ANZ CoreLogic (2024), *Housing affordability report April 2024*, Figure 1. Available: https://tinyurl.com/56ya4zyb.

[42] CoreLogic (2024), *Australia's median rent hits new record, surpasses $600 per week.* Figure 4. Available: https://tinyurl.com/3965sbn8.

[43] Lawless, T (2024), *The end of the rental boom is in sight.* CoreLogic. Available: https://tinyurl.com/5y4e66vp. Median rents increased by an average of 9.1% per year in the 2021-2023 calendar years: CoreLogic (2024), *Australia's median rent hits new record, surpasses $600 per week*. Available: https://tinyurl.com/mupc9tu7.

[44] CoreLogic (2025), *Monthly Housing Chart Pack, February 2025.* Available: https://tinyurl.com/wdkd686x CoreLogic (2025a), *National rental market passes peak of the recent rental boom*. Available: https://tinyurl.com/4c9bfjxr.

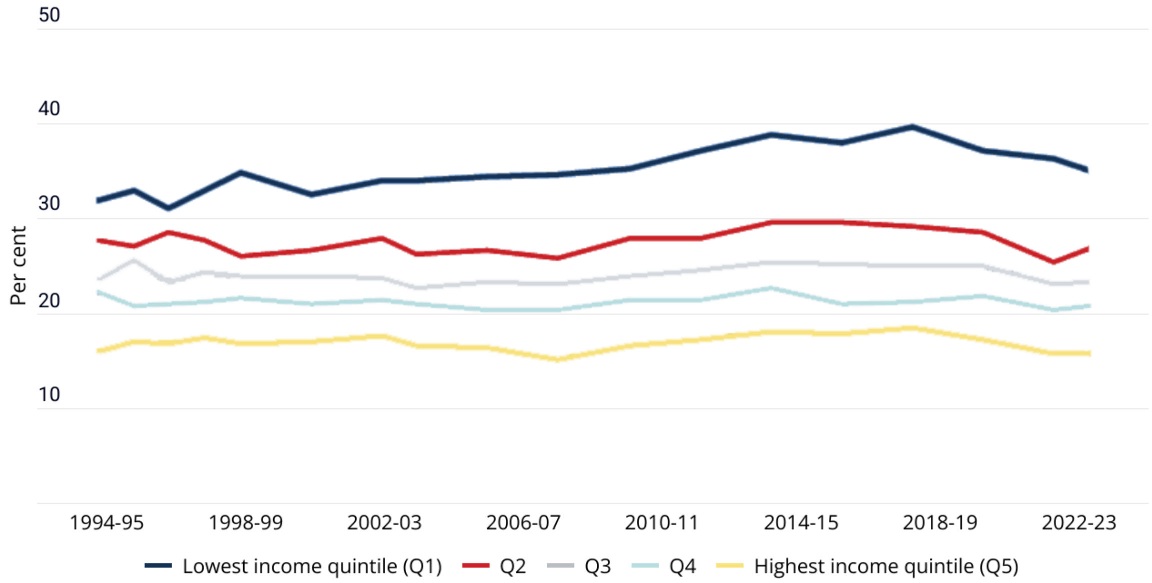
Figure 10: Median rents ($pw adjusted for inflation to current values)



Source: Treasury (2024), *Budget paper no 1: Overview*. Australian Government, Canberra. Chart 4.10.

People with low incomes are in housing stress, paying over a third of income on rent
People who are on low incomes or unemployed are particularly impacted, with the lowest income quintile (20%) of renters spending on average around 35% of their income on rent (Figure 11), making it difficult to cover other essential needs with remaining income.

Figure 11: Rent as a proportion of income for five income groups (%)



Source: National Housing Supply and Affordability Council (2024), *State of the Housing System*. Australian Government, Canberra. Chart 5.15.

Commonwealth Rent Assistance (CRA) is not enough to lift people out of housing stress, with those receiving CRA still paying on average over 30% of their income on rent.[45] An ACOSS

[45] National Housing Supply and Affordability Council (2024), ibid p.108, chart 5.22.

survey found that 52% of respondents on income support payments reported paying more than half of their income on rent.[46]

Investor tax incentives have contributed little to rental housing supply and may reduce the security of tenancies

In theory, increased investment in rental housing should boost its supply and reduce rents over time. However as indicated previously, the contribution of investor loans to new rental supply is only around 14% of as a proportion of all housing investment loans by value (15% by numbers of loans), and was previously as low as 5-6% of housing investment loans by value during 2012-14. Further, to the extent that higher investor demand for existing dwellings drives up prices, fewer tenants can transition to home ownership and demand for rental housing increases. Some have suggested that the tax advantages of the CGT discount relative to negative gearing in some circumstances may contribute to incentivising property investors to keep their properties vacant.[47]

Some argue that the removal of negative gearing during 1985-87 increased rents, but there is little evidence to support that claim. In fact, rental increases only happened in Sydney and Perth, and lending to property investors increased by 42% nationally, suggesting there was no mass exit of investors from the market.[48] The main reasons for rent increases in the two capitals were higher interest rates and a sharemarket boom which diverted investment from rental property.[49]

A further problem associated with negative gearing strategies is that they may reduce housing security for tenants, which is also relatively weak in Australia due to tenancy laws in most jurisdictions which allow no grounds evictions and lack protections against excessive rent increases.[50] As discussed previously, since the combined operation of the CGT discount and negative gearing from 1999, there has been a marked increase in negative gearing as a proportion of all property investment (Figure 8 above).[51] Highly leveraged investors are more likely to sell their investment properties when there is a sharp increase in interest rates or reduction in their incomes. In addition, negative gearing encourages landlords to sell their property as it becomes positively geared (as rental income increases and interest payments decrease).

Rents are directly determined by a separate set of factors to home prices and follow their own price cycle, but the underlying causes are similar

Rent levels are directly determined by a combination of the rental vacancy rate and the incomes of people renting or seeking to rent (Figure 12). Where the vacancy rate is too low (e.g. less than 2%), rents are likely to be unaffordable for many people on the lowest incomes. Vacancy rates are in turn influenced by population growth and consumer preferences (e.g. decreased household size) on the demand side, and cost of financing rental property investment, and public investment in social housing on the supply side.

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[46] ACOSS (2023), *"It's hell": how inadequate income support is causing harm*. Available: https://tinyurl.com/35s3d2sv

[47] Helm T (2024), Prosper Australia, *Speculative Vacancies 11: A window into the economics of waiting*, p.14.

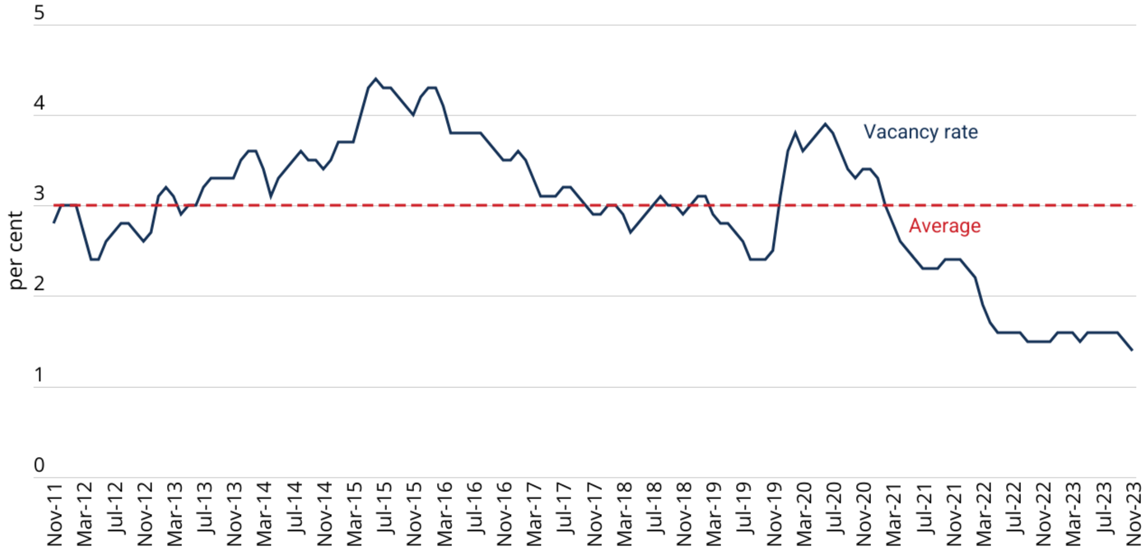
[48] Badcock B & Browett M (2010), *The responsiveness of the private rental sector in Australia to changes in commonwealth taxation policy.* Housing Studies, 6:3, 182-192

[49] ibid.

[50] National Shelter and National Association of Renters' Organisations (2024), *The Rental Report: A performance report on the progress of A Better Deal for Renters,* pp.6-7. Available: https://tinyurl.com/y43nvufk.

[51] Morgan, R & Ryan, E (2024), *'Recent drivers of housing loan arrears'*, RBA Bulletin July 2024. Available: https://tinyurl.com/c9hkhfp2.

Figure 12: National rental housing vacancy rate (%)



Source: Treasury (2024), *Budget paper no 1: Overview*. Australian Government, Canberra. Chart 4.5.

Rents are usually more stable over time than home prices, and do not appear to adjust quickly to changes in home prices or interest rates.[52] As in the past, recent increases in rents reflect greater competition for available dwellings together with the ability of many people with 'middle incomes' who are locked out of home ownership to pay higher rents. In this way, the impacts of declining home ownership levels cascade down into the rental market, locking many people on the lowest incomes out of secure housing altogether.

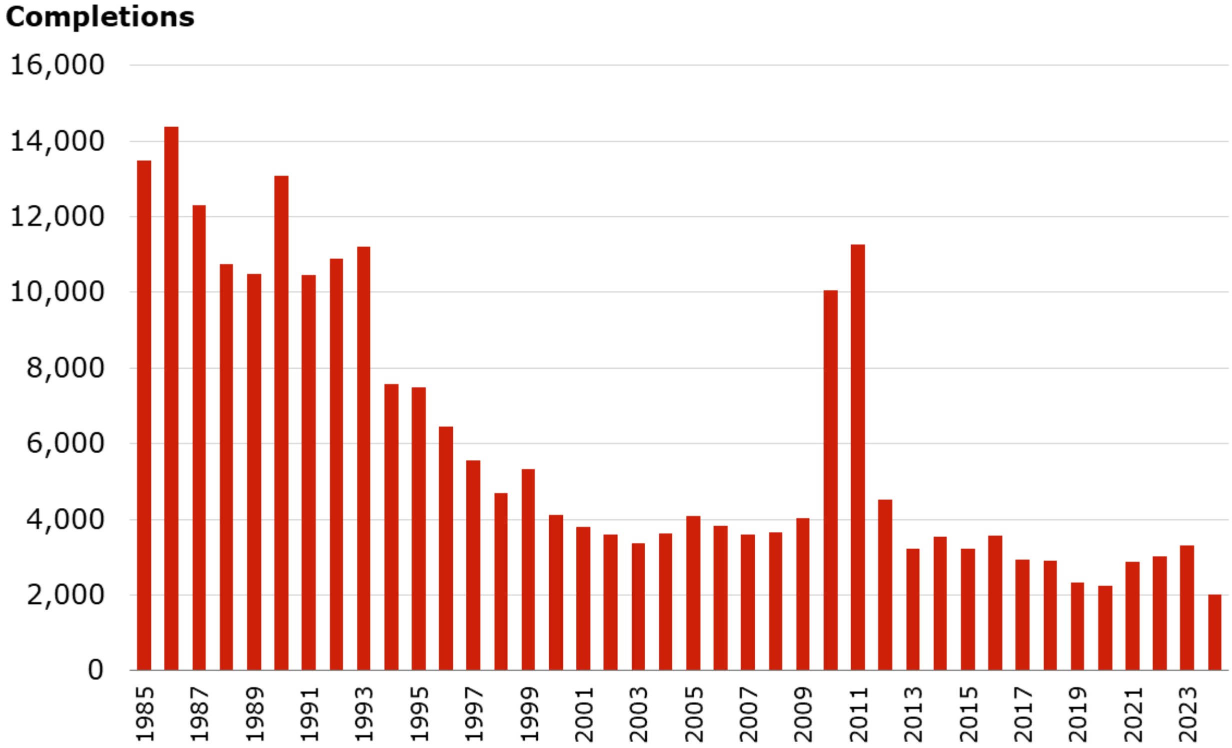
Public investment in low-income homes boosted supply when private investment failed to do so, but its impact is now greatly diminished

Private investment in new, low-income rental housing is currently weak and is likely to remain so for some time even if development restrictions are eased. The quickest way to overcome the current supply shortage is direct public investment, as Australia has successfully done in the past at times of severe housing shortage.

From World War II to the 1990s, direct public investment in rental housing for people with low and modest incomes – led by the Commonwealth – played a vital role to in averting housing shortages and keeping housing affordable for all.[53] Since the 1990s, construction of social (public and community) housing has sharply diminished (Figure 13).

[52] Twohig D et al (2024), *Do Housing Investors Pass-through Changes in Their Interest Costs to Rents?* RBA Bulletin October 2024.
[53] Troy, Patrick (2012), *Accommodating Australians: Commonwealth Government Involvement in Housing.* Federation Press, Canberra.

Figure 13: Public housing completions (thousands)



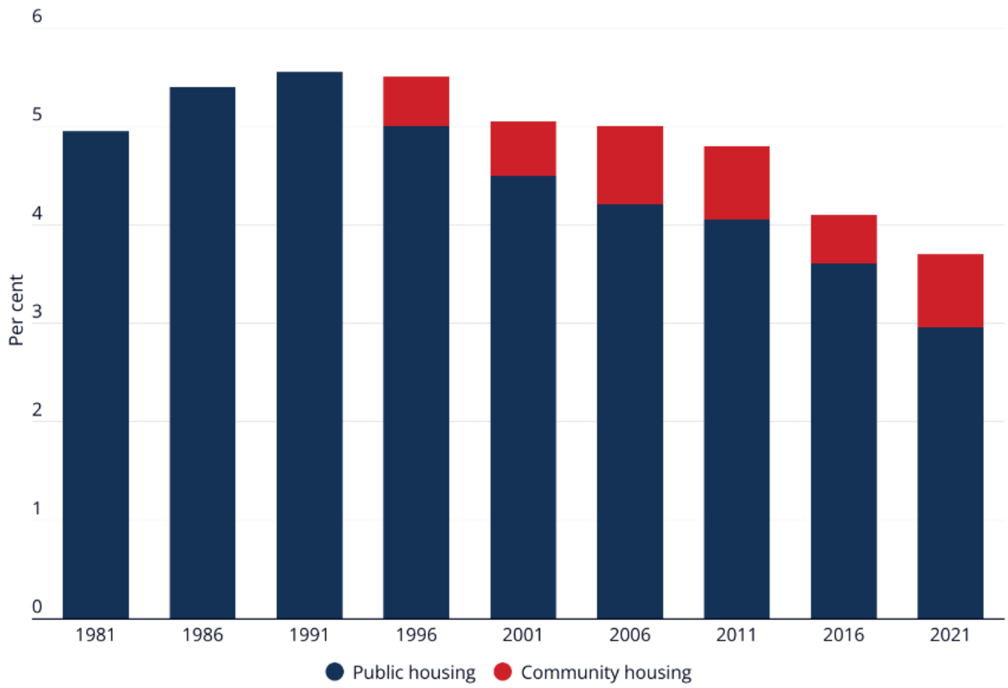
Source: ABS *Building Activity.* Note: Public Housing constructed as the residual of total approvals and private housing approvals.

As a result of declining investment, the share of public and community housing fell from 5.8% of all homes in 1991 to 3.8% in 2023 (Figure 14). In the same period, the annual number of social housing lettings generated has declined from 52,000 to 32,000, which accounting for population growth, represents a reduction of more than 58%.[54] Between 2013 to 2023, the number of social housing households grew by just 3.5% compared to a 17.6% increase in the number of all households.[55]

[54] See Pawson, H. and Lilley, D. (2022), *Managing Access to Social Housing in Australia: Unpacking policy frameworks and service provision outcomes*. Available: http://tinyurl.com/yeyn3rdv. See also Australian Institute of Health and Welfare (2024), *Housing assistance in Australia 2024,* Table HOUSEHOLDS.10. Available: https://tinyurl.com/29mxty2y.

[55] Australian Institute of Health and Welfare (2024), *Housing assistance in Australia 2024,* Table SOCIALSHARE.1. Available: https://tinyurl.com/29mxty2y.

Figure 14: Social housing share of all dwellings (%)



Source: National Housing Supply and Affordability Council (2024), *State of the housing system* Australian Government, Canberra. Note: Social housing as a share of occupied private dwellings

Public investment in social housing no longer ensures that people on the lowest incomes and those who cannot manage in the private rental market are securely housed.

This decline in social housing, while housing and rental affordability increases, has led to an increasing number of people who are homeless. Australia has one of the highest homelessness rates in the OECD, with 122,000 people homeless on latest census figures in 2021.[56] Demand for homelessness services has increased by 24% from 2017 to 2023, but homelessness services cannot meet around a third of requests for support (33.9% as of 2021-22).[57] These services are forced to turn away around 295 people seeking support each day (108,000 people each year), and two-thirds of these people are women (66%).[58]

Current homelessness service funding falls well short of meeting the increasing demand for services, with unacceptably high turn away rates, and limited funding being largely absorbed by crisis response work, leaving insufficient resourcing for effective homelessness prevention.[59]

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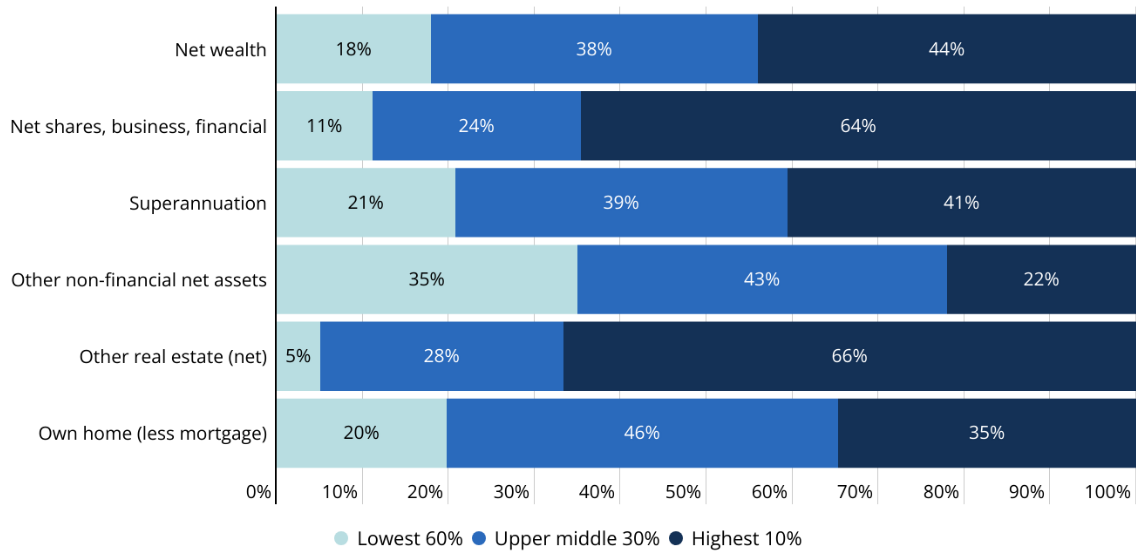
[56] National Housing Supply and Affordability Council (2024), *State of the Housing System*, p.115.
[57] National Housing Supply and Affordability Council (2024), ibid, p.119.
[58] AIHW (2023), *Unmet demand for specialist homelessness services in Specialist homelessness services annual report 2022–23.* Available: https://tinyurl.com/4t76tc6j.
[59] See Pawson, H. et al (2024), *Australian Homelessness Monitor 2024*.
Available: https://tinyurl.com/3w4jzy2k; Angela, J. and Blane, N. (2024), *Call Unanswered: Unmet demand for specialist homelessness services*. Available: https://tinyurl.com/3xy2vyd6.

4. Impacts beyond housing: The tax breaks deepen wealth inequality

The tax concessions for property investment are a contributor to growing wealth inequality in Australia. In 2022-23 the wealthiest 10% of households held two thirds of the value of investment property (Figure 15).

Figure 15: Distribution of wealth by source across wealth groups in 2022-23



Source: Davidson P, Bradbury B & Wong M (2023), *Inequality in Australia 2023: Overview*, ACOSS and UNSW Sydney, Figure 25. Note: Households are ranked according to wealth rather than income.

As well as holding more wealth in a form that attracts tax breaks (e.g. shares and property), people with the highest incomes obtain more benefit from them per dollar of income received. For example:

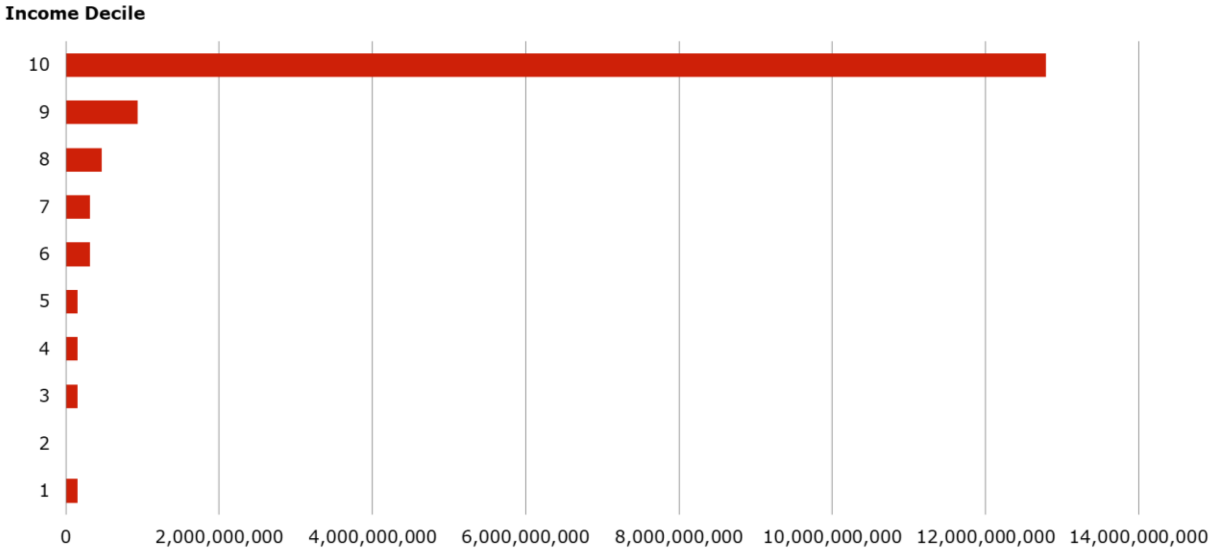
- A worker on an average fulltime wage of around $80,000 pays tax on their next dollar of earnings at 32% (including Medicare Levy);
- An investor whose overall income is $200,000 a year pays tax on capital gains from sale of property or shares at a marginal tax rate of 23.5%;
- A negatively-geared investor effectively pays tax on investment income at a negative rate of up to 47% – since they can offset their investment losses against their wages.

Thus the revenue foregone by government on these tax breaks overwhelmingly benefits people on higher incomes. Based on the latest data for the 2021-22 financial year, the highest 10% of taxpayers ranked by income receives:

- over four fifths (82%) of the $16 billion in annual public revenue foregone due to the CGT discount for investment property, shares and other assets – that is, around $13 billion (Figure 16), and
- nearly two fifths (39%) of the $17 billion in tax reductions from deductible expenses from rental property investments (positively and negatively geared) – that is, around $7 billion (Figure 17).[60]

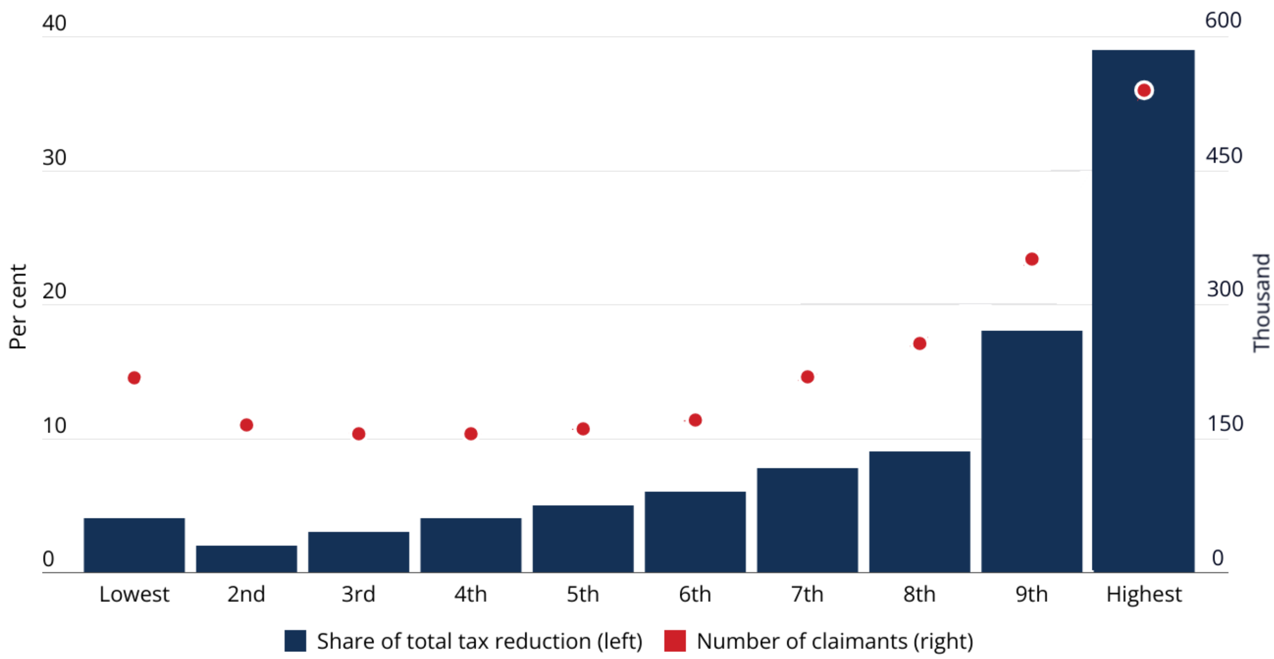
[60] Treasury (2024) *Tax Expenditure and Insights Statement*. Available: https://tinyurl.com/2s3nfx3y.

Figure 16: Total value of CGT discount received by income decile ($000s in 2021-22)



Source: Treasury (2024) *Tax Expenditure and Insights Statement.* Note: Includes taxes on gains from property, shares and other assets.

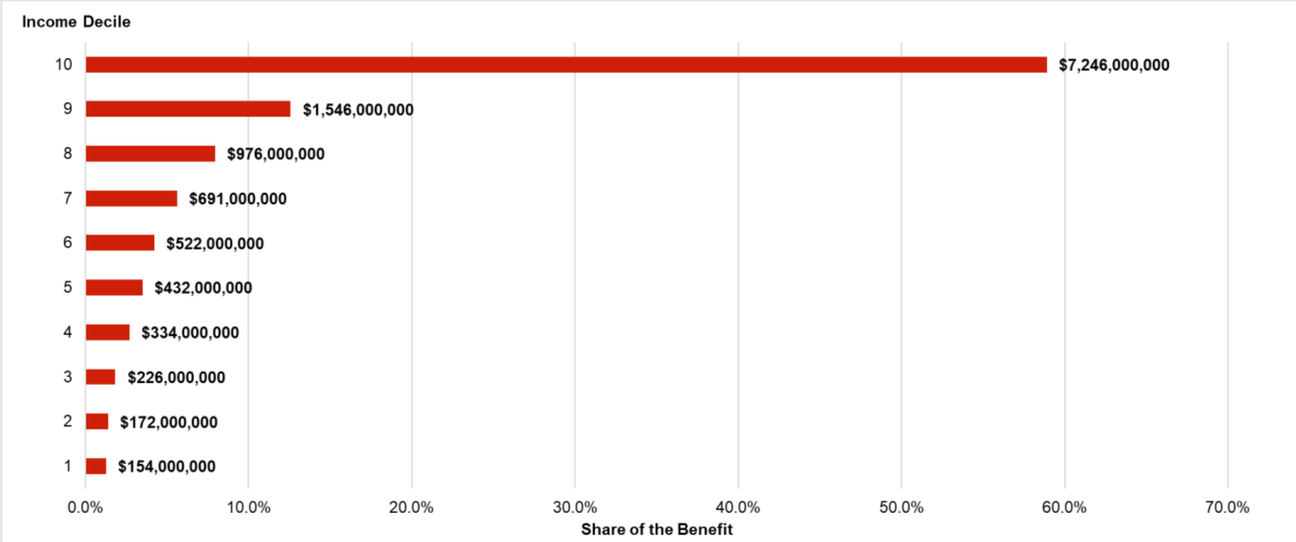
Figure 17: Distribution of rental housing tax deductions received by taxpayers with different incomes ($000s in 2021-22)



Source: Treasury (2024) *Tax Expenditure and Insights Statistics*. Note: This figure shows tax reductions for all rental deductions from any income source whether positive or negative. The tax reduction for rental deductions that were losses was $2.2 billion in 2021-22.

The highest 10% of taxpayers ranked by taxable income are estimated to save a total of $7 billion in tax from the CGT discount and negative gearing for investment properties in 2024-25. This is shown by Figure 18 which combines the value of the CGT discount and negative gearing concessions for rental housing investors only.

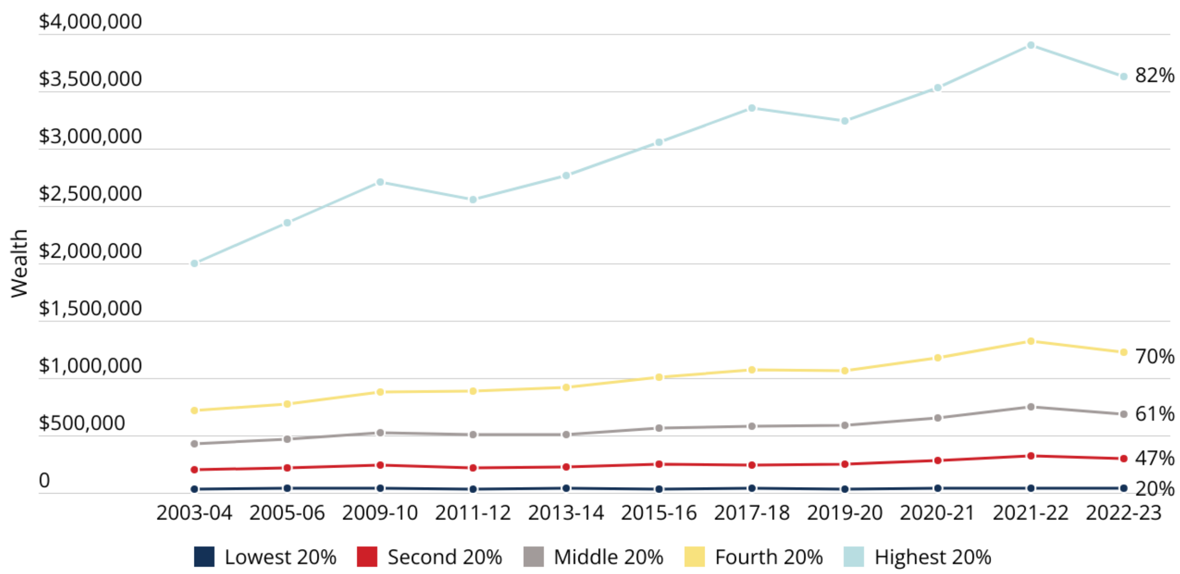
Figure 18: Overall value of tax benefits (CGT discount and negative gearing) accruing to rental housing investors, ranked by income (dollars in 2024-15)



Source: Parliamentary Budget Office (2024), *Policy Reform Options for Negative Gearing and Capital Gains Tax, Costings prepared for Senator David Pocock and Senator Jacqui Lambie*, Australian Government, Canberra.

Figure 18 shows that the CGT discount and negative gearing are used significantly more by people on higher incomes. This is because they have the wealth to purchase an investment property in the first place and can then benefit from negative gearing while they hold the asset, and from the CGT discount when they sell it. Higher income earners also get more value from their use of the tax breaks, due to the much greater value of their asset holdings and a greater tax benefit per dollar invested (as they have higher marginal tax rates). These tax breaks have contributed to a marked increase in wealth inequality since the early 1990s (Figure 19).

Figure 19: Trends in average real wealth by wealth group from 2003-04 to 2021-22 (in thousands of 2019 dollars)



Source: Davidson P, Bradbury B & Wong M (2023), *Inequality in Australia 2023: Overview*, ACOSS and UNSW Sydney.

Revenue foregone on these tax concessions for rental property investment is projected to continue disproportionately benefiting higher income earners in coming years. Around $169 billion in federal government revenue will be foregone due to the tax breaks for investment properties over the next 10 years (2025-26 to 2034-35).[61] The highest 10% of income earners would receive around 55% (or $101 billion) of the cost of both tax breaks, comprising around 84% (or $52 billion) of the $62 billion cost of the CGT discount, and around 39% (or $42 billion) of the $108 billion cost of tax reduction from negative gearing.[62]

5. Impacts beyond housing: The tax breaks distort investment and increase economic risk

The CGT discount and negative gearing have increased the economic risks associated with booms and recessions and high levels of household debt.

The CGT discount and negative gearing amplify booms and recessions
As discussed previously, the tax breaks increase the volatility of home prices, amplifying the housing cycle and contributing to home price bubbles. This in turn amplifies the business cycle, exaggerating the impact of booms and recessions and making macroeconomic management more difficult.[63] In the years following the introduction of the CGT discount in September 1999, a sharp rise in home prices was triggered by a surge of leveraged rental property investment. This was a significant factor in the RBA's decision to lift official interest rates at this time. As an RBA research paper explains:

> *'If imbalances in the housing market could pose a threat to medium-term economic stability, it made sense to tolerate a higher policy rate than that which was justified by shorter term inflation pressures.'*[64]

Years later the RBA Review cited evidence suggesting that in response to asset price inflation in the late 2010s, interest rates were kept higher than required to maintain the Bank's 2-3% inflation target, crimping growth in jobs and incomes in the years before the pandemic.[65]

Unnecessarily high interest rates are undesirable because they can lead to higher unemployment and lower incomes, especially impacting people with the least resources in the first place. The recession of the early 1990s was triggered by high official interest rates imposed to curb inflation, including in asset prices (though mainly in the business sector).[66] Importantly, the challenge of debt-fuelled asset price inflation extends beyond housing to investments in shares, collectables and other assets that grow in value over time. Therefore reform of these tax concessions should not be limited to housing investment alone.

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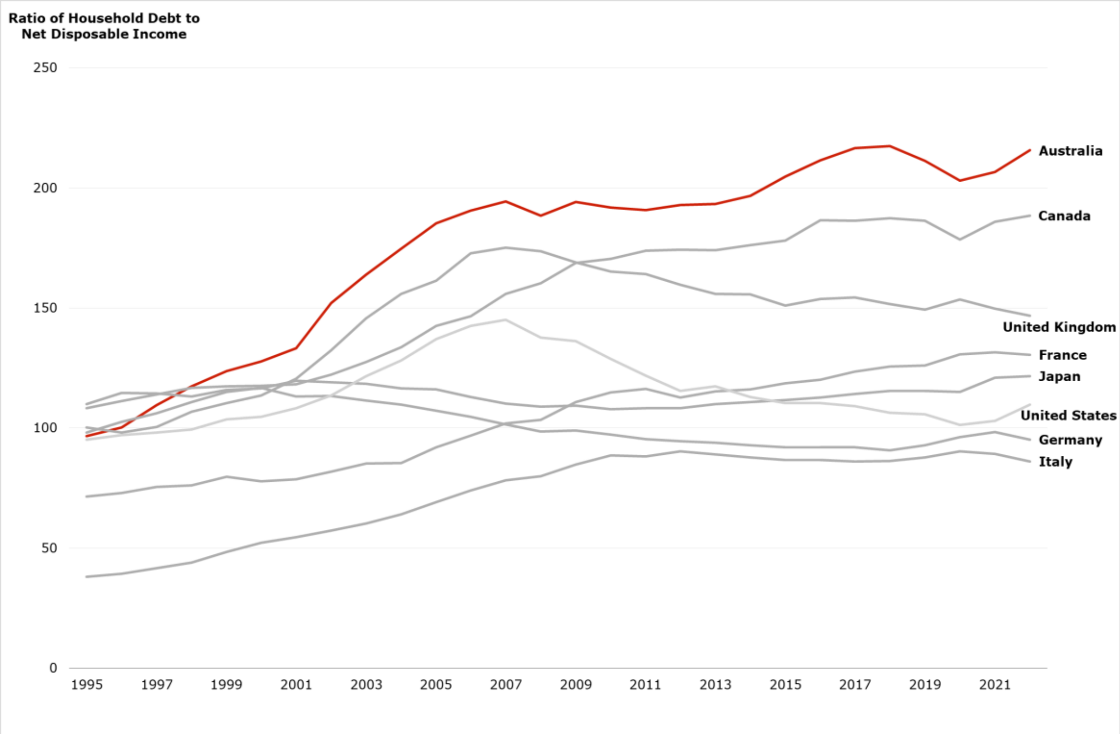
[61] ACOSS analysis of Parliamentary Budget Office (2024), *Cost of Negative Gearing and Capital Gains Tax Discount.* Available: https://tinyurl.com/2wy4euyv.
[62] ACOSS analysis of Parliamentary Budget Office (2024), *Cost of Negative Gearing and Capital Gains Tax Discount.* Available: https://tinyurl.com/2wy4euyv.
[63] The Global Financial Crisis of 2008 is a good example of the contribution of excessive borrowing for housing and home price cycles to macroeconomic instability. Crowe C et al (2011), *Policies for macro-financial stability, options to deal with real estate booms.* IMF Staff Discussion Note 11/02.
[64] Bloxham Kent & Robson (2010), *Asset Prices, Credit Growth, Monetary and Other Policies: An Australian Case Study.* RBA Research Discussion Paper No 2010-6, p29. Available: https://tinyurl.com/5b4uk652.
[65] Australian Government (2023), *An RBA fit for the future: Review of the Reserve Bank of Australia.* Available: https://tinyurl.com/yy9cwu6h. The role of monetary policy in 'leaning against' asset price inflation is much debated (Saunders T & Tulip P (2020), op cit). An alternative strategy to curb home price bubbles is through macroprudential regulation. This was successfully adopted by APRA in 2017 when it tightened access to credit for rental property investors and home prices fell by an average of 9% nationally (Eslake S (2021), op cit.).
[66] Blundell-Wignall A & Bullock M (1992), *Asset Price Inflation, Borrowing and the Business Cycle*. December 1992, RBA Research discussion paper No RDP 9212.

The CGT discount and negative gearing contribute to high household debt

While public policy discussion often focusses on public debt, Australia's high level of household debt poses the greater risk to our ongoing prosperity. Australia has some of the highest levels of household debt among OECD countries, being 5th highest by share of indebted households and 6th highest by share of households with a debt-to-income ratio above three.[67] Figure 20 shows that from 1995 to 2023, household debt doubled from around 100% to over 200% of household disposable income.

Figure 20: Ratio of household debt to annual income – comparison with G7 nations.



Source: OECD *Household Debt*. Available: https://tinyurl.com/26z6wtta.

While most of those with high debt currently have high incomes and wealth, high levels of debt mean people will be more detrimentally impacted by economic shocks such as loss of jobs, income streams or the value of assets. This may in turn amplify the impact of recessions. [68]

Most household debt is for owner-occupied or investor housing. Financial liberalization and investor housing tax breaks have contributed to the sharp growth in household debt since the late 1990s shown in Figure 20.[69]

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[67] OECD (2024), *OECD Wealth Distribution Database – Key Indicators*. Available: https://tinyurl.com/477mfe9e. Note this is using latest data available as of March 2022, but latest data varies between countries (for example, 2018 is the latest data available for Australia).

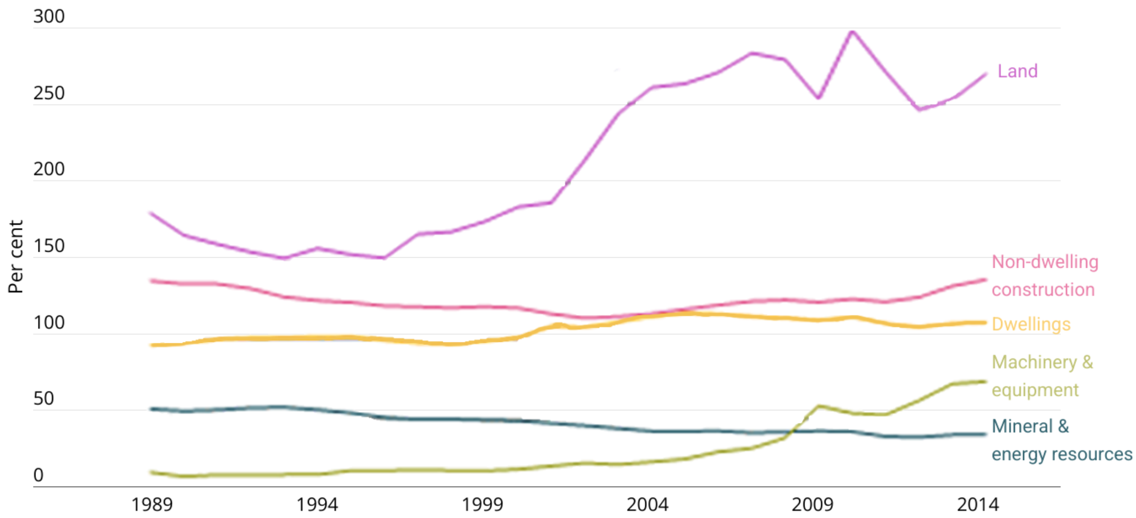
[68] Kearns J et al (2020), *How Risky is Australian Household Debt?* RBA Research Discussion Paper, No 2020-05.

[69] Morgan, R & Ryan, E (2024), op cit.

The CGT discount and negative gearing distort investment, shifting it away from productive purposes

These tax breaks amplify the tendency of Australian investors to concentrate on property at the expense of more productive investments.[70] The CGT discount also encourages speculative investment in sharemarkets which is often disconnected from investments by companies to innovate or expand production of the goods and services we need. After the CGT discount was introduced in 1999, the value of land increased sharply, driven mainly by investment in housing (Figure 21). Former RBA Governor Lowe (then Head of Research at the Bank) raised concerns about the opportunity cost of high levels of investment in land while more productive investments fell behind and productivity growth languished. [71]

Figure 21: Net wealth by asset (% of GDP in current prices)



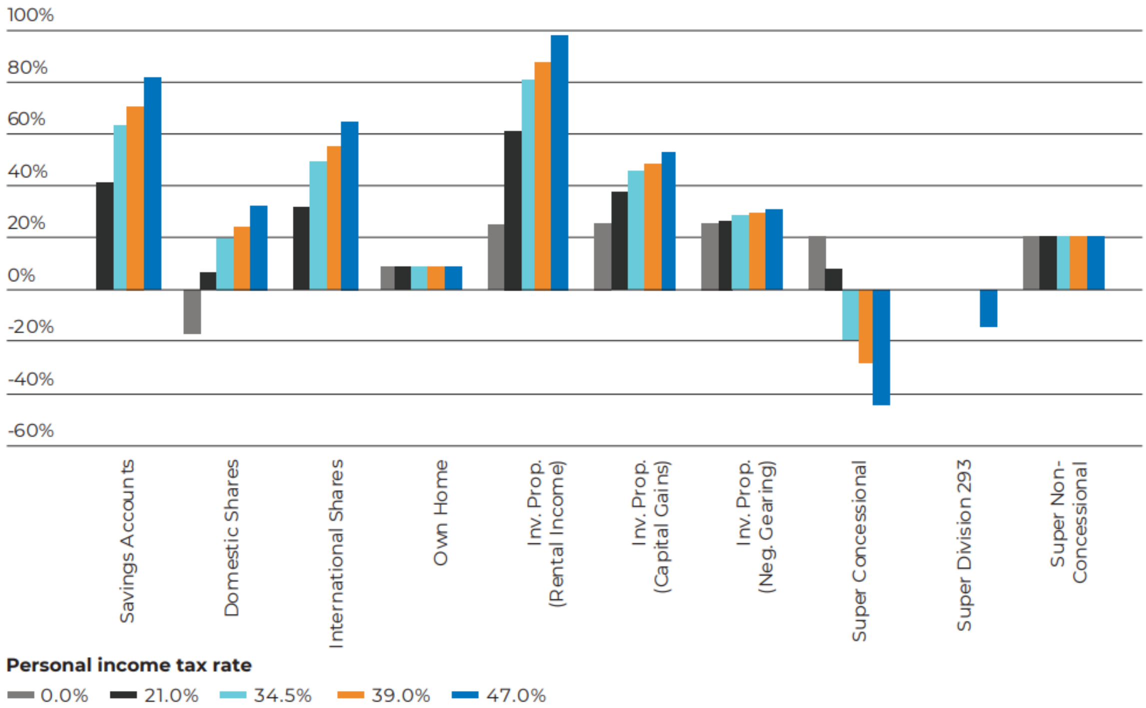
Source: Lowe P (2015), *National Wealth, Land Values and Monetary Policy*, Shann Memorial Lecture, Perth 12 August 2015. Note: The 'CGT 50% discount' was introduced in September 1999.

Over the longer-term, capital gains from housing investment have been high in Australia relative to other wealthy nations while returns from housing rent were relatively low. Our high level of personal investment in rental housing has probably contributed to this.[72]

Since the 'Henry' Review of taxation reported over a decade ago, tax experts have pointed to the harms caused by inconsistent tax treatment of returns from different investments (Figure 22). The Henry Report advocated fundamental reform of personal income tax to tax investment incomes more consistently. Lifting effective tax rates on capital gains and reducing incentives to borrow for personal investments were among its recommendations.[73]

[70] OECD 2025, op cit.
[71] Lowe P (2015), *National Wealth, Land Values and Monetary Policy*, Shann Memorial Lecture, Perth 12 August 2015.
[72] Jorda O et al (2019), The rate of return on everything 1870–2015. NBER Working Paper 24112 Table IX. http://www.nber.org/papers/w24112
[73] Treasury (2010), op cit.

Figure 22: Marginal income tax rates on different investments (%)



Source: Varela, P., Breunig, R., and Sobeck, K. (2020), *The Taxation of savings in Australia: Theory, current practice and future policy directions*, Tax and Transfer Policy Institute (TTPI) Policy Report No. 01-2020, Canberra, Australia.

6. Impacts beyond housing: Less public revenue to fund essential services and safety nets

A significant and increasing amount of public revenue is foregone through the CGT discount and negative gearing, which presents a major social opportunity cost as it could be used to improve housing affordability or achieve other socially or economically desirable ends.

In each year from 2021-22 to 2023-24, revenue foregone on these tax concessions for investment housing exceeded all direct expenditure on Commonwealth housing assistance combined (Figure 23).

For example, in 2023-24, Commonwealth government expenditure on housing assistance was around $10 billion, including Commonwealth Rent Assistance (around $6 billion) and the housing 'sub-function' mainly comprising funding for social housing under national housing agreements (around $4 billion).[74] In contrast, around $11 billion in Federal Government revenue was foregone from the tax breaks for investment properties comprising around $5 billion for the CGT discount and around $6 billion for negative gearing.[75] Around $169 billion in

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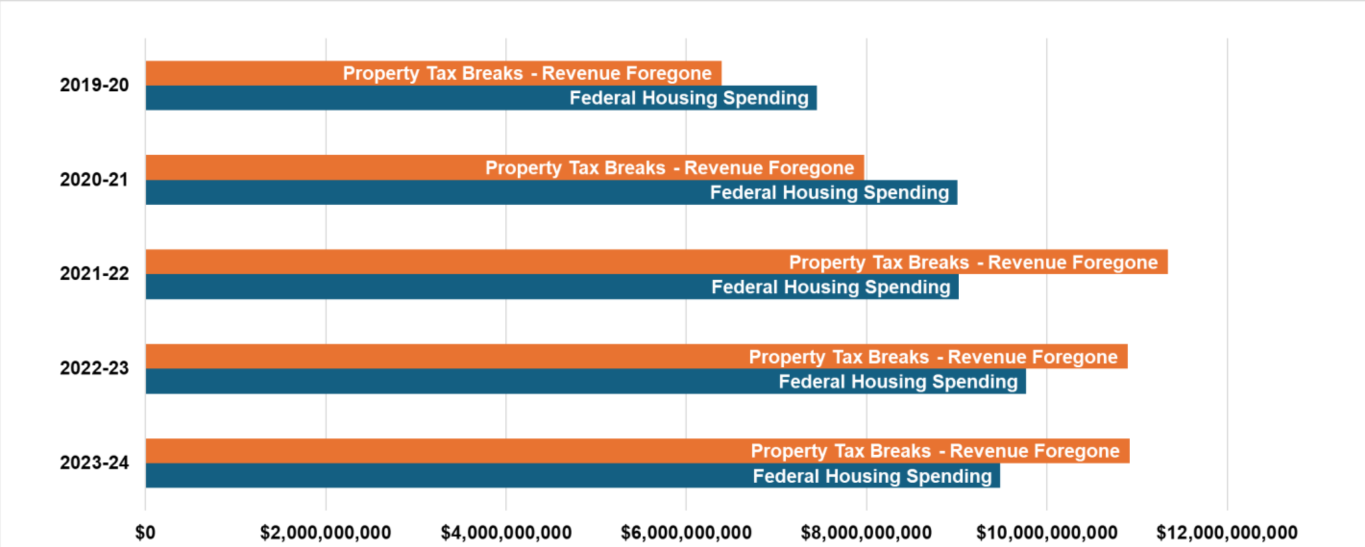
[74] Parliamentary Budget Office (2024), op cit; Productivity Commission (2025), *Report on Government Services – Housing;* following the approach of Per Capita (2024), *On Whose Account Government Spending on* Housing. Available: https://tinyurl.com/hu63wvn6. These numbers exclude funding of disbursements from the Housing Australia Future Fund (HAFF), expected to be a minimum of $500 million per year to social and affordable housing, starting from 1 July 2024. Even with these disbursements included in total Commonwealth expenditure on housing assistance, the revenue foregone on these tax concessions for investment properties is still greater.

[75] Parliamentary Budget Office (2024), *Cost of Negative Gearing and Capital Gains Tax Discount*, Advice to the Australian Greens. These estimates do not include the additional cost of the CGT discount or negative gearing in respect of other assets such as shares.

federal government revenue will be foregone due to the tax breaks for investment properties over the next 10 years (2025-26 to 2034-35).[76]

Figure 23: Revenue foregone on NG/CGT for investment properties compared with federal housing expenditure (current dollars, 2023-24)



Source: Parliamentary Budget Office (2024), op cit; Productivity Commission (2025), *Report on Government Services – Housing.;* Parliamentary Budget Office (2024), *Historical Fiscal Data 2024-25 MYEFO.* Note: Federal Housing Spending is the sum of spending on CRA and the Housing Subfunction from the Budget aggregates, following the approach in Per Capita (2024) op cit in the construction of Federal Housing Spending.

Revenue foregone could instead help meet housing need

Although the revenue gains from reform of CGT and negative gearing will be less than the overall revenue foregone without reform (as estimated below), the revenue raised from curbing these tax breaks could help fund a substantial portion of direct expenditure on social and affordable housing to cover unmet housing need.

Analysis of census data shows that around 47,000 additional social and affordable dwellings are needed each year over the next 20 years (940,000 dwellings in total) to meet the housing needs of the bottom two income quintiles.[77]

As explained in more detail later, the cost to all governments of providing these additional dwellings has been estimated to be around $19 to $29 billion per year (lower in this range the more that government funding is provided up front, rather than as payments over time), in addition to the funding required to maintain existing dwellings.[78] If the cost was shared equally with States and Territories, the Commonwealth contribution to meet this unmet social and affordable housing need would need to be approximately $9 to $14 billion a year, in addition to existing funding.

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[76] ACOSS analysis of Parliamentary Budget Office (2024), *Cost of Negative Gearing and Capital Gains Tax Discount.* Available: https://tinyurl.com/2wy4euyv.
[77] van den Nouwelar R, Troy L & Soundararaj B (2022), *Quantifying Australia's unmet housing need: a national snapshot*. Available: https://tinyurl.com/8rcbdrws.
[78] Troy, L & van den Nouwelant R (2023), *Costing social and affordable housing delivery across Australia*, Figure 13. Available: https://tinyurl.com/3ppsm3aa. See Figure 13, 'capital grant model' and 'operating subsidy model'.

B. Solutions: A package of tax reform, social and affordable housing, and other measures

Objectives and choices in design of tax reform

In designing our proposed package of tax reform and social and affordable housing investment, our main objectives are as follows:

- Improve housing affordability and rental tenure security, especially for people with lower incomes by:
    - Reducing speculative demand while maintaining or boosting supply of social and affordable housing using revenue raised from tax reform; and
    - Reducing volatility in housing markets, in the transition to reforms and over the longer term.
- Contain growth in wealth inequality and improve the fairness of the tax system.
- Improve consistency and reduce complexity in the tax treatment of investment incomes.
- Strengthen public revenue that can be used to create more social and affordable housing.
- Grow incomes and jobs by moderating the 'boom and bust' cycle and encouraging more productive investment.

We use these objectives to guide our choices in the design of the substance and transitional arrangements of our proposed reforms to the CGT discount and negative gearing. The key design choices as we see them are as follows.

Tax break	Design choice	Reform options
CGT Discount	Reduce or replace the discount	- Reduction (whether by percentage or value cap) and by how much, or - Replacement by a principles-based tax treatment for investment incomes, (such as the 1985-99 system of inflation adjustment)
Negative Gearing	Limits on income from which deductions can be made	- Incomes from any source (current situation) - Incomes from all investments subject to CGT - Incomes from investments in the same asset class - Incomes from investment in the same asset
	Limits on expenses that can be deducted	- Caps on deductible expenses (e.g. up to an annual amount or ratio) - Limit to a maximum number of rental properties - Limit to new dwellings - Restrict to socially or environmentally desirable purposes (e.g. affordable or energy efficient homes)
Both: CGT Discount & Negative Gearing	Speed and timing of the transition	- How quickly to phase in (e.g. immediately or gradually), at what pace (e.g. constant/linear or variable) - When to announce vs implement
	Dealing with previous and future investments	- Whether to retain the tax concessions for existing investments ('grandfather'), and under what conditions, relative to future investments - If so, for how long to grandfather, and if time-limited then the speed and timing of transition

Reforms to the taxation of capital gains

Purpose of concessional tax treatment
Broadly speaking, concessional tax treatment of investment income is a trade-off between two goals:

- Equity and robustness (curbing avoidance) of the comprehensive income tax system

  This suggests that all income, whether from labour or investment, should be taxed equally. It is not fair for an individual (typically an older male) with investment income of $150,000 to face a lower marginal rate of tax than their neighbour on a fulltime wage of $75,000. This is one outcome of the 50% CGT discount.

- Encouraging patient investment and compensating investors for the compounding impact of taxes over time

  While we reject the view that only income above a 'normal rate of return' (the 'reward for waiting') should be taxed (as this would depart from core principles of income taxation) there is a principled case for taxing long-term investments at lower annual rates, at least to take account of the erosion of investment returns by inflation. [79]

Scope of CGT concessions
The CGT discount currently exempts 50% of capital gains from tax, applying to investments in all assets that yield capital gains. Any reduction to the CGT discount should apply to all assets subject to the CGT, including shares, other forms of property and collectables. Otherwise, there is a risk that investment decisions would be further distorted. For example, if the CGT discount was reduced to 25% for housing investments, but remained at 50% for shares, then speculative investment could shift from housing to the share market.

Size of CGT concessions
Compared to inflation adjustment, the 50% discount is far more generous overall and it privileges shorter-term over longer-term investment. In addition to encouraging speculation in property and entrenching wealth inequality, the introduction of the 50% discount may have helped entrench 'short-termism' in business investment driven by quarterly returns. [80]

If the discount was halved to 25% it would be broadly equivalent to inflation adjustment for an asset held over ten years when annual inflation is 2.5% (the Reserve Bank's inflation target). We propose that a 25% discount be phased in over five years.[81]

As discussed previously, before the 50% CGT discount was introduced in 1999 a balance between these goals was struck by adjusting capital gains for inflation before they were taxed at each investor's marginal tax rate. An alternative option to reducing the 50% discount that should be considered is to restore inflation adjustment of capital gains, which still applies in the minority of cases, such as where investors who purchased assets before September 1999 chose

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[79] OECD (2025) op cit. Another purely pragmatic argument for lower taxes on investment incomes is that capital is more mobile than labour so the risk that investment will be impacted or tax avoided is greater. However, this 'mobile capital' argument does not apply to property investments and taxing different investments in accordance with the risk that investment would decline or that assets would be sold would increase complexity and inequity.
[80] For example, CEO remuneration packages in large companies typically include a large component of employee shares.
[81] One of the objectives underpinning the reforms advocated by the 'Henry' tax review was to reduce discrepancies in the tax treatment of different investments by applying a common 40% discount to returns from various investments (Treasury (2010), *Australia's Future Tax System Review Final Report*, Australian Government, Canberra). However this would still be more generous than inflation adjustment for most investments.

this over the 50% discount.[82] Inflation adjustment of capital gains is a more accurate and less arbitrary way to adjust for inflation than a CGT discount. The main drawback of inflation adjustment is that other forms of investment income (and indeed wages) are not adjusted for inflation. This means that investing in assets yielding capital gains would still be privileged over investing in savings accounts. The transition back to inflation adjustment would also be more complex than a halving of the 50% discount.

Speed and timing of reform

We recommend a gradual phasing in of a lower CGT discount by 5% each year so that it reduces from 50% to 25% over 5 years. A constant or linear phase-in for each year would be relatively simple to understand and be more likely to encourage investors to gradually depart the market and shift investment to more productive purposes as the concession gradually reduces. A phase-out that is slower than this would delay the desired improvements to housing affordability, tax equity and raising of public revenue.

On the other hand, a sudden withdrawal of the discount may lead to an overly fast sale of assets including investment properties to take advantage of the highest available CGT discount, and a sharp reduction in asset prices.

While some consultation on proposed reforms will be important, we recommend that little time be allowed between the announcement of the final design of the reform and its implementation. Previously, changes to the taxation of capital gains are in force within days of the announcement, so that people don't take advantage of the opportunities for arbitrage that arise, where investors exploit differences in the tax treatment of assets before and after reforms. A prolonged delay between announcement and commencement of the reform would encourage investors to dispose of assets immediately to make use of the full discount, which could drive down prices unnecessarily. This could disrupt housing and other asset markets.

An impactful time to change these tax settings is when home prices are rising. Under those conditions, the tax breaks are more likely to reduce the rate of increase in home prices than to reduce prices that are already falling – stabilising the housing market and smoothing the transition to a new tax treatment for housing. Home prices are likely to increase late in 2025 if official interest rates are reduced further in the first half of the year,[83] and so this year may be an opportune time for reform.

Treatment of existing investments

We recommend that the phased reduction in CGT discount should apply to existing as well as new investments, rather than retaining (or 'grandfathering') the discount for existing assets, as previously proposed by the Labor Party when in Opposition. This is because grandfathering has 'lock in' effects, where investors are encouraged to delay sale of assets to maximise the benefit of the existing tax concessions as the value of their assets increases. This reduces the efficiency of investment – for example shares are held for longer than market conditions warrant. Grandfathering also raises issues of time-based and inter-generational inequity as it arbitrarily favours investors who are older and purchased property prior to the reduction of the CGT discount.

Compared to the proposed five-year phase-in of this reform, grandfathering would also dilute the beneficial impact of the reform on housing affordability, equity and public revenue. The gradual phase-out of the CGT discount allows investors to benefit from the capital gains accrued

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[82] We do not support a choice of concessions, however, as this would be inequitable and open up opportunities for people to minimise tax.

[83] Core Logic estimates that on average, a 1% reduction in official interest rates increases home prices by around 6.1%, all things equal (Owen E (2025), *Which housing markets get the biggest boost from rate cuts?* CoreLogic. Available: https://tinyurl.com/yph9sh82) .

in past years (which have been especially strong for housing) if they sell earlier during the period of the phase-out.

Complementary changes should be made to the tax treatment of capital gains within superannuation
To ensure consistency in the tax treatment of capital gains, the CGT discount for superannuation funds should also be reduced, including a halving of the tax discount from one third to one sixth, which would increase the tax rate from 10% to around 12.5% (noting that the standard tax rate on superannuation fund income in the accumulation phase is 15%).

Further, action should be taken to prevent the avoidance of CGT on assets held in self-managed superannuation funds by disposing of them when the account is in pension phase (when the tax rate on investment income including capital gains is zero). To curb inflation in home prices and reduce investment risk, self-managed superannuation funds should no longer be permitted to borrow to invest.

Recommendations: Capital Gains Tax

Recommendation 1:
From 1 July 2025, the exemption of 50% of capital gains from CGT for investment in appreciating assets (including rental housing, shares and collectables) by individuals and trusts should be halved to 25% over five years, by 5% per year.

Budget impact: $1.2 billion in 2026-27, $2.8 billion in 2027-28, rising substantially in later years).[84]

Recommendation 2:
(i) The tax discount for capital gains of superannuation funds should be halved (from one third to one sixth of the 15% tax rate) so that they are taxed in accumulation accounts at around 12.5% rather than 10%.
(ii) Self-managed superannuation funds (SMSFs) should be prohibited from borrowing to invest in housing or other assets.
(iii) Measures should be introduced to prevent avoidance of CGT on assets in SMSFs by disposing of them when in pension phase (when the CGT rate on investment income is zero).

Budget impact: Not estimated.

Reforms to limit negative gearing

Purpose of reforms to negative gearing
As a general principle, investment expenses associated with passive investment in assets attracting CGT should be allowed, but quarantined so that they can only be offset against income from those investments (this is referred to as 'passive loss quarantining').[85] This

[84] Note on costings: These are derived from PBO (2024), op cit, Option 1. The main difference between those proposals and our own are that we propose to phase out the CGT discount over five years while they model grandfathering of existing assets. Further, we propose to reduce the discount for all assets attracting CGT whereas they model reducing it for rental housing only. We do not take account of any bring-forward in revenue from additional purchases and sales of homes in advance of the date of commencement of the policy (the PBO estimates that an additional $2.2 billion is raised in the year after commencement of the policy and that this 'washes out' over time).
[85] Passive investment is personal investment that is not the main business of the investor. Quarantining would not apply to active investment in business assets such as plant and equipment or the property from which a business is conducted.

ensures that deductions are appropriately matched with related income, given the concessional tax treatment of capital gains. This would:

- remove the inconsistency in both tax rates and timing between deductions (if allowed to offset other income such as wages) and the tax rates applied to income (e.g. capital gains vs wages),
- reduce a bias in the present system in favour of debt-financed over equity-financed investments,[86]
- reduce the incentive for highly leveraged investment that leads to market volatility, and higher house prices, and
- increase public revenue and improve equity in the tax system.

Income from which investment expenses can be deducted
Quarantining passive losses as described above is consistent with restrictions that already exist on the deductions of investment expenses from taxable income in other areas of tax law, including quarantining capital losses against capital gains, restricting trust losses within discretionary trusts, and quarantining some active business losses within businesses. Similar restrictions on deductions apply in many other countries, including the United States.

Similar rules apply to income tests for social security payments including pensions, allowances, Family Tax Benefits and Child Care Benefits, where annual investment expenses cannot be deducted from the total income considered in determining payment eligibility.[87]

There are a number of ways in which deductions could be restricted to income from investments yielding capital gains.

> (1) The most stringent approach is to quarantine passive losses to income from each particular asset (e.g. each property in an investment portfolio). This would be more complex to administer and comply with than the other options.
>
> (2) An intermediate approach would be to quarantine passive losses to income from each class of investments (such as rental housing or shares).
>
> (3) A less stringent approach would be to quarantine passive losses to the sum total of any type of investment asset subject to CGT (e.g. housing and shares) held by a taxpayer. This is similar to the 'dual income tax' model operating in Scandinavian countries.[88]

We recommend the second (intermediate) option, closer to the restrictions on negative gearing in the United States, in which passive losses are quarantined to the sum total of income from each asset class (for example, housing or shares). This would have a greater impact on borrowing to invest in rental property than option (3) above since wealthier investors in rental properties would not be able to offset losses from those investments against their other sources of investment income such as shares. For people with a portfolio of investments attracting CGT, it would be simpler to comply with than option (1) above. Deductions for expenses that exceed income from the investment would be carried forward to offset income from that source in later years (especially capital gains on sale of the asset).

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[86] If capital gains were taxed but investment losses were not deductible then higher-risk debt-financed investments would be less attractive.
[87] Department of Social Services (2025), *Guides to Social Policy Law: Social Security Guide*, available online, part 4.
[88] Dual income taxes, which operate in Sweden, Denmark and Holland, apply a different schedule of tax rates to labour and investment income. To limit tax avoidance opportunities (by claiming deductions for investment expenses against higher-taxed labour income) these systems quarantine investment losses so they can only be claimed against (lower-taxed) investment income.

Careful attention should be paid to any incentives arising from this reform for taxpayers to reduce tax through complex and unproductive ownership structures such as multiple discretionary trusts.

Other approaches to reform of negative gearing

Monetary limits on deductions

More complex proposals have been advanced to restrict deductions for investments yielding capital gains. Examples include:

- capping the annual value of losses that can be offset against other income;
- only allowing a proportion of losses to be deducted against other income.[89]

These options would be more complex and have less impact on incentives to borrow to speculate in housing and other assets, than the quarantining measures discussed above. The Henry review proposal to allow a proportion of deductions addresses the mismatch in tax rates between capital gains and other income but not the timing advantage due to the taxation of capital gains when an asset is sold.

Allowing negative gearing for one rental property investment only

Some reform proposals to 'partially' restrict negative gearing are motivated by other policy objectives. One such example is proposals to allow losses to be deducted against other income for the first investment property only.[90] This would sharply reduce the positive impacts of the proposed reforms on housing affordability, wealth equity, debt levels and public revenue since around half of all negatively geared rental properties are owned by investors with only one investment property.[91] A key consideration here is that our proposed transitional arrangements for both the CGT and negative gearing reforms (discussed above and below) already diminish the impact of the reform in the early years.

This proposal conflates two policy aims – improvement in affordability and security for tenants, and reductions in inequality among landlords (by supporting 'small' investors), yet does neither satisfactorily. It is not clear why circumstances of renters would be improved by increasing the share of rental properties owned by 'small' investors – indeed this may reduce the quality of their housing and security of tenure. The majority of rental housing investments are owned by the highest 10% of households ranked by wealth,[92] and the consequences of a worsening in financial circumstances is starkly different to that of renters: when met with cashflow issues, landlords can sell their investment property, while renters can face a risk of homelessness. A much simpler, principles-based approach is to restrict negative gearing regardless of the size of property holdings, as we recommend.

Allowing negative gearing for new builds

Another option is to allow negative gearing only for newly constructed dwellings, or more specifically new social and affordable dwellings, as a way to stimulate supply. This was proposed by the Labor Party when in Opposition.

This option should be considered to alleviate any reductions in rental housing supply in the transition to the reformed tax arrangements. However, there are more cost-effective ways to encourage investment in new rental properties including for government to invest directly in social and affordable housing or reintroduce a tax incentive along the lines of the NRAS scheme.

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89 Duncan et al (2018), op cit; Treasury (2010), op cit.
90 For example Duncan et al (2018) and the Australian Greens (2024) propose to limit negative gearing to one property.
91 ATO (2024), *Taxation statistics*, 2021-22.
92 Davidson P, Bradbury B, Wong M (2024), op cit, Figure 25.

In 2019 the PBO estimated that retaining negative gearing for new rental housing builds would only increase the share of negatively geared rental housing investments that are new builds by 8 percentage points from 22% to 30% in ten years after commencement of the Labor Party's housing tax reform (halving the CGT discount and removing negative gearing for assets purchased after commencement of the reform).[93]

Allowing negative gearing for social or environmental purposes

Another option is to limit negative gearing to socially or economically desirable investments, such as affordable or energy efficient rental housing. Again, it would be much simpler and more cost effective, to use a separate set of subsidies or tax incentives that are well targeted to achieve those objectives.[94] Negative gearing is a poorly targeted way to achieve them since it only benefits investors who have borrowed substantially, and the extent and duration of the tax subsidy depends on unrelated factors such as the level of official interest rates. Further, direct expenditures such as our proposed public investment in social and affordable housing are likely to be more cost effective than tax incentives, as they can be more precisely targeted and governments have lower borrowing costs than private investors.

Examples of more efficient incentives include an affordable housing tax incentive along the lines of the former NRAS scheme, Commonwealth Rent Assistance, and ACOSS proposals for direct public subsidies to improve the energy efficiency of low-income homes.[95]

Treatment of existing investments

An important consideration for the phasing in of restrictions on negative gearing is the potential impact on the availability of rental housing and rent levels, should investors sell their rental properties when the policy change is implemented. As discussed, this risk has been greatly exaggerated in the past, for example when negative gearing was limited during 1985-87.[96] Over time, as more tenants purchase their own homes (in response to declining home prices) this should offset the impact of the reform on rental vacancy rates, limiting this risk to the first few years of the transition to the new tax arrangements. Further, the proposed boost to public investment on social and affordable rental housing would be likely to offset any reductions in the overall supply of rental housing arising from the tax reforms.

Another consideration for reform of negative gearing is that negative gearing strategies generally rely on high levels of debt, since the largest ongoing expense for landlords is interest on borrowings to purchase the dwelling. If current investors using this strategy could no longer claim any tax deductions against their other income from the date of commencement of the tax reforms, it is likely that some would face cash flow problems. This increases the financial risks for them, and also the possibility that they exit the market suddenly once the reform is announced.

There are two main options we consider for managing the transition. One option is to 'grandfather' existing investments so that full tax deductions can still be claimed for existing investments. Grandfathering for negative gearing could be less problematic than for the CGT discount because investment properties generally become positively geared after around 5 years (as rents eventually exceed interest on borrowings and others costs), so there is in effect a natural sunsetting of negative gearing over time. [97] However, this could encourage investors to retain their existing rental properties for longer than they otherwise would, and may

[93] See Parliamentary Budget Office (2019), *Policy costing - Negative gearing and capital gains tax (CGT) reform, Australian Labor Party.* Available: https://tinyurl.com/5hus675f.
[94] OECD 2022, *Housing Taxation in OECD Countries*. Paris
[95] Rowley, S et al (2016), *Subsidised affordable rental housing: lessons from Australia and overseas: AHURI Final Report No. 267.* Available: https://tinyurl.com/5n8mwct5; ACOSS (2024), op cit.
[96] Badcock & Browett (2010), op cit.
[97] Daley J and Wood D (2016), op cit, p.38.

temporarily increase investment in the period immediately before introduction of the tax reform. This would significantly delay the home price reductions and public revenue benefits of the reform. In addition, such 'grandfathering' is inequitable, since the tax treatment of investments depends on their timing.

A better option would be to progressively phase out negative gearing for existing investments over five years from the date of implementation of the new tax regime, by progressively reducing the proportion of losses from negatively geared assets that can be claimed against other classes of income to zero over five years. This five-year phase out period is consistent with the fact that rental properties are typically no longer negatively geared after around five years, and with our recommendation to phase out the CGT discount over five years. As with the proposed changes to CGT, this gradual change would help avoid a sharp withdrawal of investors from markets, especially the rental housing market. Negative gearing would be disallowed for new investments from the date of implementation of the reform.

Speed and timing of reform to negative gearing

As with the proposed CGT changes the restriction of deductions to income from the same investment class would ideally be implemented as soon as practicable after announcement to prevent 'gaming' of the transition to take advantage of arbitrage opportunities. However, the change should be announced well before tax returns are due to give investors and their advisers sufficient time to adjust their accounts and deductions claims.

The restriction of deductions to income from the same investment class should be implemented all at once for any future investments (rather than being phased in), noting that most of these investments will be in existing homes.

Phasing in of CGT increases and grandfathering of negative gearing arrangements would together smooth the transition to a reformed tax treatment of housing which would still ultimately improve housing affordability by reducing increases in home prices over time. The proposed reforms and their transitional arrangements are therefore unlikely to have a large impact on reducing home prices *in the short-term*, but over time can still importantly reduce the growth in prices, especially during future housing booms.

Recommendations: Negative gearing

Recommendation 3:
Restrict deductions for personal passive investment expenses so they can only be offset against income from the same class of investments (e.g. rental housing or shares), including capital gains realised on sale:
(i) This should apply immediately to all investments of this type entered into after 1 July 2025.
(ii) In the case of negatively-geared investments entered into prior to that date, the proportion of losses from negatively geared assets that can be claimed against other classes of income would be progressively reduced to zero over five years.

Budget impact: $2.3 billion in 2026-27 ($3.4 billion in 2027-28, rising substantially in later years).[98]

[98] Note on costings: These are derived from PBO (2024), op cit, Option 1. The main difference between those proposals and our own are that we also remove negative gearing for assets other than rental property (e.g. shares) but this is unlikely to substantially impact the estimates as most negative gearing is for investment housing. We do not take account of any bring-forward in revenue from additional purchases and sales of homes in advance of the date of commencement of the policy (the PBO estimates that an additional $2.2 billion is raised in the year after commencement and that this 'washes out' over time).

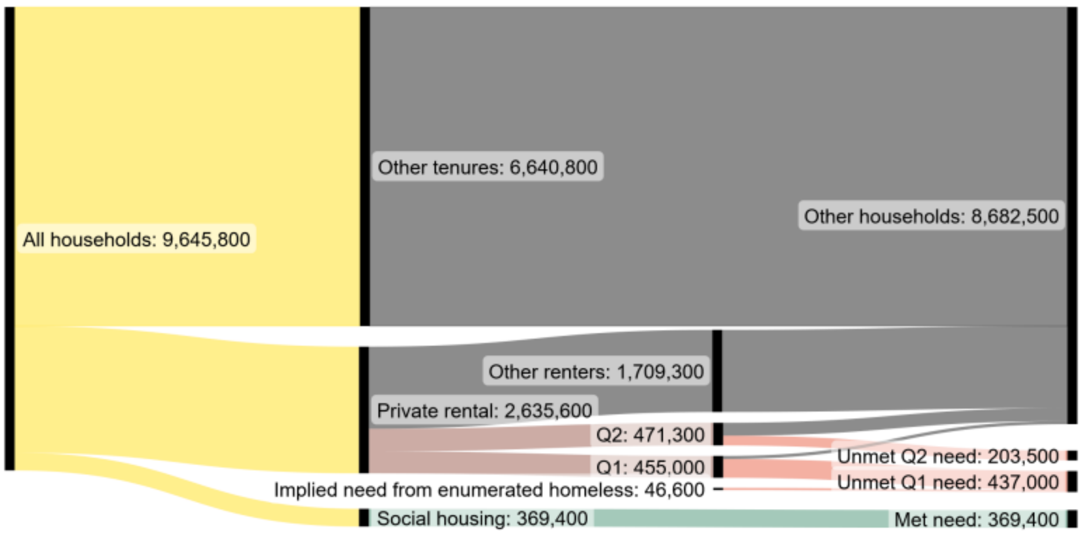
Invest the revenue raised in social and affordable housing

We propose that the revenue raised from reforms to the CGT discount and negative gearing be invested in social and affordable housing to help address unmet housing need.

Around 47,000 additional social and affordable homes are required annually to meet need, at an annual cost to all governments of at least $19 billion, for 20 years
There is significant unmet housing need in Australia. Over 640,000 Australian households have unmet housing need, comprising people in housing stress (who are spending over 30% of their income on rent and in the bottom 2 income quintiles) or experiencing homelessness, and this number is projected to grow to over 940,000 households with unmet housing need over 20 years.[99]

Of the 640,000 households with unmet housing need, just over two-thirds (437,000) are in lowest income quintile or homeless, and just under one-third (203,500) are in the second lowest income quintile but still in housing stress (Figure 24). These numbers are likely to be higher, as this analysis is based on 2021 census data, and since then housing unaffordability has worsened.

Figure 24: Households with unmet housing need based on 2021 census data

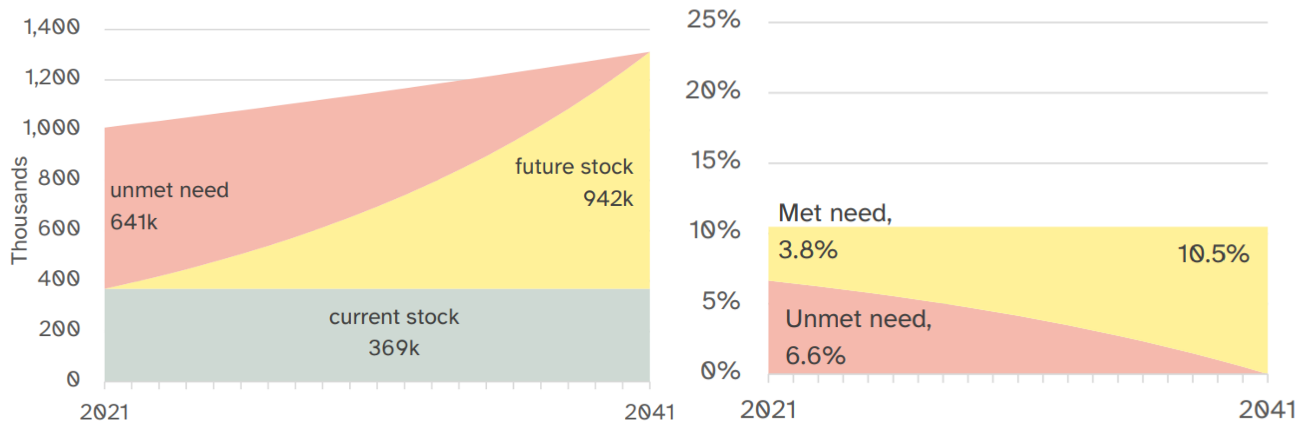


Source: Van den Nouwelant et al (2022) op cit p.10.

It is estimated that around 47,000 additional social and affordable dwellings are needed each year to meet this unmet housing need. Of these, based on current unmet need, it is estimated that at least around two-thirds (or 32,000 dwellings) should be social housing (capped as proportion of income), and up to one-third (or 15,000 dwellings) could be affordable rental housing (capped as a proportion of market rent). In total this is around 940,000 additional social and affordable dwellings needed over the next 20 years, which would equate to around 10.5% of all housing stock, up from the current 3.8% (Figure 25).[100]

[99] Van den Nouwelant et al (2022), op cit.
[100] Van den Nouwelant et al (2022), ibid.

Figure 25: Households with unmet housing need (thousands; %)



Source: Van den Nouwelant et al (2022) op cit. p.9.

A recent analysis has estimated the cost of building social and affordable housing to meet this unmet housing need, using a cashflow model that quantifies the costs (financing, development and operation) and revenues (government funding and rental income) of both building a unit of housing and renting this housing to a tenant with unmet housing need over 25 years.[101]

The estimated funding from all governments required to meet unmet housing need varies depending on the deliver model. The funding required from all governments to provide the average 47,000 additional dwellings needed annually to meet unmet housing need is in the range:

- from around $19 billion for a delivery model where government capital is provided up front, with an average cost per dwelling of around $400,000;
- to around $29 billion for a delivery model where government funding is paid each year for 25 years indexed annually to CPI at 3%, with an average cost per dwelling of around $600,000.[102]

The main additional expense of the latter delivery model is the cost of meeting interest payments on loans (based on low-cost Housing Australia finance at 4.75% interest rates) to cover the funding gap. Both assume not for profit delivery similar to that of Community Housing Providers.

If the cost of meeting unmet housing need was shared equally by the Commonwealth, and the States and Territories combined, the Commonwealth contribution to meet social and affordable housing need would be around $9 to $14 billion per year.

The proposed tax reforms could raise around $19 billion over four years, contributing a significant and growing portion of funding required to meet housing need
While there is greater uncertainty around long-term revenue projections, we estimate that our proposed reforms to the CGT discount and negative gearing would raise around *$18-19 billion over the forward estimates to June 2029* – comprising approximately $3-4 billion raised in the

[101] Troy and van den Nouwelant (2023), op cit. It uses a 3:1 ratio of social to affordable homes, sets rents at an average affordable rental payment (no more than 30% of income) for income quintiles Q1 and Q2 (which amounts to 49% of market rent), development costs based on industry constructions cost guides including taking a weighted national average of geographic construction cost loadings, and average operating costs based on estimates from Community Housing Providers.
[102] Other delivery models estimate the annual government subsidy cost for private investment and for-profit development models to meet unmet social and affordable housing need as ranging from $34 to $42 billion per year (van den Nouwelant R, Troy L & Soundararaj B (2022), ibid, p.18).

first 2 years, growing to $6 billion raised in year 3, and nearly $9 billion raised in year 4. The revenue gains are likely to continue to rise in the years following as asset values increase.

We estimate that this $19 billion in revenue raised could eventually fund the completion of *around 32,000 to 49,000 additional social and affordable dwellings* (higher within this range if funding is delivered by upfront government capital, and lower within this range if funding is delivered by yearly government payments). This is based on the average cost per dwelling estimates outlined above.

If the federal government were to cover half of the cost of additional social and affordable housing dwellings to meet need (around $9-14 billion per year for 20 years) alongside States and Territories, the cost would be nearly entirely covered by the annual revenue raised from our tax reforms by the fourth year of implementation or shortly after (estimated $9 billion raised in 2028-29, and rising in the years after). In the event that the revenue savings are insufficient for this purpose, the Commonwealth should use other revenue sources to close the gap.

We note that the completion of these dwellings would be delayed by around at least two years after announcement of new public investment due to the time taken for construction[103] and development approvals,[104] and perhaps longer due to other stages in development such as planning and any land acquisition. Accounting for an approximate two year delay, the $3-4 billion in revenue raised from our recommended tax reforms in the first two years, for example, would result in around 7,000 to 11,000 additional social and affordable dwellings completed by around the end of the forward estimates by June 2029 (but completion could take longer).

We also note that there may be limits to the capacity of housing markets and the construction industry to deliver social and affordable dwellings each year. For example, some suggest that Community Housing Providers (CHPs) may have capacity to deliver only around 20,000 to 25,000 social and affordable dwellings per year, and that certain policy settings are needed to allow this (such as long-term funding commitments and streamlined approval processes).[105] Alternatively or in addition, governments could engage with private developers on similar terms to CHPs (e.g. not-for-profit delivery and operation, low-cost finance) to boost the number of dwellings delivered by making use of broader market and industry capacity (which delivered around 170,000-180,000 dwellings per year over the last four years).[106] As such, to meet community housing need, there will likely need to be government investment to grow the

[103] We estimate the average time from development approval to completion for social and affordable dwellings is around 2 years. This is based on June 2024 ABS data on average completion times by dwelling type (around 28 months for units and 13 months for semi-detached dwellings), and AIHW data on the proportion of new social and affordable housing by dwelling type for 2023 (around 70% units and 30% semi-detached dwellings): ABS (2024), *Building Activity, Australia,* June 2024, Available: https://tinyurl.com/42yvak7f; AIHW (2024c), *Housing Assistance in Australia 2024*, Table DWELLINGS.9, Available: https://tinyurl.com/mknr5ary. However these are record-long completion times and may reduce in coming years. A government report suggested completion times were expected to shorten over the second half of 2024: National Housing Supply and Affordability Council (2024), *State of the Housing System*, p.67.
[104] Average approval times for development application decisions vary by state and territory. Absent reporting of national weighted averages, we note the latest figures available in 2024 federal budget papers note that the longest average approval times are in Victoria (around 20 weeks) followed by New South Wales (16 weeks). However, the estimates of social and affordable dwellings needed are disaggregated by geographical location, so the average approval times for the proposed investment of revenue would be less than this.
[105] See eg PowerHousing Australia (2024), *Housing for all: Leveraging community housing to address Australia's Crisis,* pp. 18, 21. Available: https://tinyurl.com/24xes42f; Van den Nouwelant et al (2022), op cit, p. 9; Urban Development Institute of Australia (2023), *Growing Affordable and Social Housing Supply,* p. 18. Available: https://tinyurl.com/mr238p8k.
[106] ABS (2024), *Building Activity, Australia,* 'Total Dwellings Completed'. Available: https://tinyurl.com/3vrt2hua .

capacity of CHPs, government, or government-engaged developers to deliver social and affordable dwellings (on terms similar to that of CHPs).

Recommendations: Investment in social and affordable housing
Recommendation 4: Increase Commonwealth government direct investment in social and affordable dwellings to meet existing and projected unmet need of around 47,000 additional dwellings per year over 20 years (940,000 dwellings in total), using savings from tax reforms (recommendations 1-3), combined with additional Commonwealth funding. Budget impact: -\$9 to \$14 billion on average per year, assuming the Commonwealth contribution is equal to that of the State and Territories combined – to be offset by the revenue raised from tax reform in earlier recommendations.

Impacts of the package of tax reforms and investment

Since the Labor Opposition proposed curbs to investor tax incentives in 2015, attempts have been made to model the impacts on home prices and ownership rates
Despite increased interest in investor tax incentives since the Labor Opposition proposed curbing them in the 2016 and 2019 federal elections, there are few rigorous independent, peer-reviewed studies that quantify the likely impact on housing markets, including on home prices, home ownership rates and rents.[107]

Daley and Wood (2016) estimate the impact of investor tax concessions on home prices, ownership rates and rents in a mechanical fashion.[108] They divide the capitalised value of the revenue foregone from the tax incentives by the overall value of residential property, and their impact on typical investment returns by the typical value of residential property. Tunny (2021) adopts a similar approach to estimate the impact of investor incentives.[109]

Cho et al (2023) develop a general equilibrium model of household decisions to buy or rent their homes across the life cycle and use it to estimate the impact of restrictions on negative gearing on home prices, home ownership, and rents.[110] Walters (2024) builds on this model to take account of changes in investor holding periods.[111]

Other studies suggest that the impact of reforms to negative gearing on home prices varies substantially among state housing markets.[112]

Other models of the Australian housing market do not explicitly estimate the impact of investor tax incentives.

Saunders and Tulip (2019) developed a model of Australia housing markets for the RBA based on 'user costs'.[113] The underlying logic of this model is that consumers of housing services

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[107] We do not discuss here reports commissioned by interests supporting or opposing the reforms.
[108] Daley J & Wood D (2016), op cit.
[109] Tunny, G (2018), *Untangling the debate over negative gearing*. Available: https://tinyurl.com/2nxcaek9.
[110] Cho et al (2017), *Negative gearing and welfare: A quantitative study for the Australian housing market.* Available: https://tinyurl.com/542wr5mf.
[111] Warlters, M (2024), 'The effect of negative gearing and capital gains tax reform on home ownership', *Australian Economics Papers,* vol. 63(3), pp.427-448; Warlters, M (2023), 'Stamp Duty Reform and Home Ownership,' *The Economic Record*, vol. 99(327), pp. 492-511.
[112] Carrington, Li & Larkin (2019), '*The Role of Tax and Subsidy Policy in Driving Australian House Prices',* Economic Record, Vol. 95, No. 309, pp. 227–247. They find that the largest impacts were likely to occur in Victoria, Queensland and South Australia.
[113] Saunders T & Tulip P (2019), op cit.

choose between renting and buying based on the costs and benefits of each option (including costs of finance and expected capital gains) and personal preferences (e.g. for housing security). They examine how income, interest rates, population and depreciation and other factors combine to influence construction activity, the housing stock, rents and housing prices. The model does not, however, take account of investor tax incentives. As Saunders and Tulip say:

> *'Our measure of the user cost is relevant to owner-occupiers. A more complicated measure for investors would be needed to assess the effect of tax changes. This is a task for future research.'*[114]

Abelson and Joyeaux (2023) use a long-run equilibrium model of house prices to estimate the impact of a range of factors including household incomes, consumer price inflation, interest rates and unemployment rates and housing supply on home prices.[115] As with Saunders and Tulip, they look beyond short-term fluctuations in home prices to identify the underlying drivers of long-term trends. However, they do not separately estimate the impact of changes to investor tax incentives.

Reform of housing tax concessions would reduce home prices and increase home ownership

The recent independent studies described above find that substantial reductions in the CGT discount and/or negative gearing would have modest impacts on home prices and ownership rates:

- lowering average home prices by 1-4%, and
- increasing the proportion of people owning or purchasing their homes by a larger amount (2-5%).[116]

These modest impacts reflect the fact that in any given year, the volume of new builds and transfers is a small proportion of the overall housing stock.

For this reason, they are similar in scale to the impact of government policies to boost housing supply such as the Commonwealth State and Territory governments' current target to build 1.2 million new homes over 5 years from mid-2024.[117] Given an existing average net increase of around 180,000 new dwellings per year, and supposing that the governments' efforts result in 25% more new dwellings (225,000) produced each year, Abelson and Joyeaux estimate that this extra 45,000 dwellings would increase housing stock by 0.4%, reducing average home prices of around 1% over two and a half years, or 4% over five years if the targets are consistently reached.[118]

The actual impacts of tax reform on home prices and ownership is likely to be towards the higher end of the above range of estimates, as these do not appear to take into account the disproportionate impact of rental housing investment on home prices (as discussed previously) or the dynamics of housing price bubbles. When prices are rising strongly, investment and tax advisors encourage investment in rental housing at scale, promoting the (claimed) tax advantages. This draws in a wider range of investors, including less sophisticated ones. As Bloxham described:

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[114] Saunders & Tulip P (2019), ibid., p. 24.
[115] Abelson P & Joyeaux R (2023), *Housing prices and rents in Australia 1980-2023: Facts, explanations and outcomes.* TTPI - Working Paper 14/2023.
[116] Cho et al (2017), op cit; Warlters, M (2024), op cit; Daley J & Wood D (2016), op cit; Tunny, G (2018), op cit.
[117] Treasury (2024), *Delivering the National Housing Accord*. Available: https://tinyurl.com/2a228cu7.
[118] Abelson P & Joyeaux R (2023), op cit, p.27.

> *'It was 'not uncommon … for promoters … to suggest that due to the operation of the tax system, investors could purchase an investment property worth $400,000 or $500,000 for as little as $50 per week.'*[119]

The impact on home prices (and crowding out of prospective homeowners) is likely to be greater at these times. Since prices rarely fall substantially, these effects are largely built into future prices.

Further, the existing models do not generally account for the different impacts of government policies on different segments of housing markets. Any downward pressure on rents due to the tax concessions is more likely to occur at the higher end of the rental market where capital gains are greater. First home buyers are more likely to come from the low-to-middle end of the rental market and to buy at the low end of the home purchase market. As Wood, Stewart and Ong have said:

> *'The asymmetric tax treatment of rents and capital gains push rents up relative to property values in the low value segments of the rental market, making rental housing more expensive in precisely those segments where lower income households typically seek housing.'*[120]

The impact of removing these tax concessions on supply of housing and on rents is less straightforward

The proposed reductions in CGT and negative gearing concessions would significantly alter the composition of housing. One study estimates they would lift the share of owner-occupied homes by around 5% in Sydney.[121] However, considered on their own (ignoring any direct expenditures or new investment incentives linked to these tax changes) they are likely to have modest impact on the overall number of homes available for rental or owner-occupation. This is because when investors dispose of a dwelling it is generally transferred to an owner occupier or another investor.

The impact of this shift in the composition of housing on rental vacancy rates and rents would mainly depend on two factors that push in different directions: lower investment in rental housing, and lower demand for rental housing as more people can afford to buy. Whether the longer-term impact on overall housing supply is positive or negative depends on the detailed design of the reform. Our proposed transitional arrangements would mitigate any risk of large-scale rapid withdrawal of investors from the housing market in the early stages of the reform (a risk that should not be exaggerated as explained earlier).[122]

As discussed, one option to maintain the supply of rental housing until demand for it is sufficiently reduced (as more renters transition into home ownership) would be to restrict negative gearing arrangements to newly built homes. While this is one of the better alternative reform options, as explained earlier we prefer more direct government investment in building homes using the revenue raised from reforms because this is likely to provide a greater boost to the supply of housing, and can be more precisely targeted to where there is housing need.

The combined operation of our recommended package of tax reforms and investment would likely boost overall rental housing supply, especially for people on lower incomes, since it involves investing the revenue raised into social and affordable housing. As outlined earlier, we estimate our proposed tax reforms could raise around $19 billion over the forward estimates,

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[119] Bloxham et al (2010), op cit, p. 18).
[120] Wood, Stewart & Ong (2009), *Housing Taxation and Transfers*. Research Study for the Review of Australia's Future Tax System. Canberra.
[121] Warlters, M (2024), op cit.
[122] See section A3 of this paper 'Impacts on rental affordability and homelessness'.

which could fund the completion of around 32,000 to 49,000 social and affordable dwellings, though these may take some years to complete (not all delivered during the forward estimates).

This additional supply in social and affordable dwellings is likely to exceed any loss of dwellings for rent that may arise from the tax reforms since the existing tax incentives for investors are a less efficient way to support the building of more homes, especially since around 81% of property investor loans are for existing dwellings, and growth in private sector dwelling construction is currently relatively weak. Additional supply of social and affordable housing would reduce rents.

Like the proposed tax reforms, boosting supply of social and affordable dwellings would also improve housing affordability and security of tenure, along with other important benefits, especially for people on low incomes. Social and affordable housing is more affordable than private rental (as it sets rents as a proportion of income and at a discount to market rates),and generally provides greater security of tenure than private rental.[123] Living in social and affordable housing can have positive impacts on financial security, access to services, participation in education in training, and health and wellbeing, especially for those with more complex needs.[124] There is also evidence that social and affordable housing has broader societal and economic benefits, including reduced expenditure on health, domestic violence, justice and homelessness.[125]

While the proposed tax reforms are likely to increase the home ownership rate, the impact of the proposed investment in social and affordable housing on home ownership is less clear. Additional supply of low-cost rental housing may have effects on home ownership in both directions: it may reduce home ownership by lowering demand for owner-occupied housing (as people can achieve more secure and affordable rent), but it may also increase home ownership because of lower home prices resulting from the lower demand for owner-occupied housing. The effects in both directions are likely to be modest given most people seeking home ownership would likely not make use of additional supply of social and affordable dwellings targeted at people on lower incomes (though indirect effects may still 'filter up' through the market). Several strong incentives for home ownership – including housing security, financial benefits, and other social preferences – may remain largely unaffected.

In any case an increase in home ownership is not necessarily a desirable outcome in its own right. The key social objective is to ensure that people can obtain secure, quality affordable housing. The proposed reforms would assist people to achieve this through social housing and the rental market as well as home ownership.

Investing the revenue raised from tax reforms would significantly increase federal government expenditure and dwellings committed in social and affordable housing
We estimate that the revenue raised from our proposed tax reforms and invested in social and affordable housing would *within 2-3 years match and surpass existing Commonwealth annual expenditure on social and affordable housing*. Annual Commonwealth expenditure on social and affordable housing has been around $1.8 to $2 billion per year from 2017-18 to 2023-24, other

[123] See eg AIHW (2024d), *National Social Housing Survey 2023.* Available: https://tinyurl.com/y79jsm44.
[124] See eg Valentine K et al (2024), 'The role of housing providers in supporting clients with complex needs' AHURI Report No. 428. Available: https://tinyurl.com/5n7cjeeb; AIHW (2024e), op cit.
[125] See eg Nygaard, C & Salari M, *Maximising Investment in Social and Affordable housing in Australia*. Report produced for PowerHousing Australia and Community Housing Industry Association. Available: https://tinyurl.com/3ape23uy.

than a brief spike to around $4 billion in 2022-23.[126] This compares to the $3-4 billion that we estimate would be raised within two years after the reforms are implemented and invested in social and affordable housing, rising to $9 billion in the fourth year after implementation.

The 32,000 to 49,000 social and affordable dwellings that could be funded by revenue raised by our recommended tax reforms approaches the magnitude of existing federal commitments estimated to build 55,000 social and affordable dwellings by 2029 if delivered on time.[127] Thus our recommended package would increase such dwelling output from federal commitments by around 1.5 to nearly 2 times, though likely over a longer timeframe since not all will be completed by 2029 (depending on factors affecting the development process including approval and construction times).

Other measures are needed to improve affordability and equity

Phasing out the tax breaks and investing the revenue raised in social and affordable housing are essential steps to improving housing affordability and equity, however they are not the only solutions. While not the focus of the paper, these other measures include:

- Planning and building reforms together with investment in related public infrastructure to increase housing supply.
- Replacing stamp duty with a broad-based land tax: Progressively broaden State and Territory land taxes to owner-occupied housing while removing stamp duties for housing, with deferred payment arrangements for people with low incomes. See ACOSS (2016), *The case for tax reform: stamp duties and land tax*. Available: https://tinyurl.com/296u75h3
- Strengthening rental rights and standards, including protections against excessive rent increases, and protections against no cause evictions including at the end of fixed-term leases. See National Shelter & National Association of Renters' Organisations (2024), *The rental report: A performance report on the progress of A Better Deal for Renters.* Available: https://tinyurl.com/54upsr7f
- Accelerating home energy upgrades by boosting investment in energy efficiency, electrification and solar upgrades for low-income housing, to cut emissions, reduce energy bills, improve health, and create jobs. See ACOSS (2024), *Funding and financing energy performance and climate-resilient retrofits for low-income housing*. Available: https://tinyurl.com/yxy2dwpx
- Increasing income support to parity with pensions (at least $82 on current rates), increase the Commonwealth Rent Assistance maximum threshold by 60% (resulting in a 110% increase in the payment), and ensuring ongoing indexation to wages, prices and actual rents. See ACOSS (2024a), *Raise the Rate survey 2024 "I wouldn't wish this life on anyone".* Available: https://tinyurl.com/merrrmn2
- Tightening APRA restrictions on loans to property investors to limit speculative property investment.
- Administrative changes to restrict tax deductions in respect of rental housing to homes currently rented on a long-term lease (rather than only 'available for rent') so that deductions cannot be claimed for holiday homes or short-term tourist accommodation.[128]

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[126] See Productivity Commission (2025), *Report on Government Services – Housing*. These numbers exclude funding of disbursements from the Housing Australia Future Fund (HAFF), expected to be a minimum of $500 million per year to social and affordable housing from 1 July 2024. Even with these disbursements considered, our proposed investment in social and affordable housing would still likely match and surpass existing and recent levels of Commonwealth expenditure on the same.
[127] Australian Government (2024), *Budget Paper 1, Statement 4: Meeting Australia's Housing Challenge*, pp. 133-134.
[128] ACOSS (2025), *Budget Priorities Statement*. Available: https://tinyurl.com/4e5bu24j.