Negative gearing changes will affect us all, mostly for the better

Don't have a negatively geared investment property? You're in good company. Despite all the talk about negatively geared nurses and property baron police officers, 90 per cent of taxpayers do not use negative gearing. But federal Labor's policy will still affect you through changes in the housing market and the budget. Here's what you should know.

Labor's negative gearing policy will prevent investors from writing off the losses from their property investments against the tax they pay on their wages. This will affect investors buying properties where the rent isn't enough to cover the costs of operating the property including any interest payments on the investment loan. Doesn't sound like a good investment? Exactly right: negatively gearing a property only makes sense as an investment strategy if you expect that the house will rise significantly in value so you'll make a decent capital gain when you sell.

The negatively geared investor gets a good deal on tax – they write off their losses in full as they occur but they are only taxed on 50 per cent of their gains when they sell. Labor's policy makes the tax deal a little less sweet – losses can only be written off against other investment income, including the proceeds from the property when it is sold. And investors will pay tax on 75 per cent of their gains, at their marginal tax rate.

Future property speculators are unlikely to be popping the champagne corks for Labor's plan. But other Australians should know that there are a lot of potential upsides from winding back these concessions.

Limiting negative gearing and reducing the capital gains tax discount will substantially boost the budget bottom line. The independent Parliamentary Budget Office estimates Labor's policy will raise about $32.1 billion over a decade. Ultimately the winners from the change are the 89 per cent of nurses, 87 per cent of teachers and all the other hard-working taxpayers who don't negatively gear. Winding back tax concessions that do not have a strong economic justification means the government can reduce other taxes, provide more services or improve the budget bottom line.

Labor's plan will reduce house prices, a little. By reducing investor tax breaks, it will reduce investor demand for existing houses. Assuming the value of the $6.6 trillion property market falls by the entire value of the future stream of tax benefits, there would be price falls in the range of 1-to-2 per cent. Any reduction in competition from investors is a win for first home buyers. Existing home-owners may be less pleased, especially in light of recent price falls in Sydney and Melbourne. But if they bought their house more than a couple of years ago, chances are they are still comfortably ahead.

And renters need not fear Labor's policy. Fewer investors does mean fewer rental properties, but those properties don't disappear – home buyers move in, and so there are also fewer renters. Negative gearing would affect rents only if it reduced new housing supply. Any effects will be small: around 90 per cent of investment lending is for existing housing, and Labor's policy leaves in place negative gearing tax write offs for new builds.

All Australians will benefit from greater stability in the housing market from the proposed change. The existing tax breaks magnify volatility. Negative gearing is most attractive as a tax minimisation strategy when asset prices are rising strongly. So in boom times it feeds investor demand for housing. The opposite is true when prices are stable or falling. The Reserve Bank, the Productivity Commission and the Murray financial system inquiry have all raised concerns about the effects of the current tax arrangements on financial stability.

And for those worried about equity? Negative gearing and capital gains are both skewed towards the better off. Almost 70 per cent of capital gains accrue to those with taxable incomes of more than $130,000 putting them in the top ten per cent of income earners. For negative gearing, 38 per cent of the tax benefits flow to this group. But people who negatively gear have lower taxable incomes *because* they are negatively gearing. If we look at people's taxable incomes before rental deductions, the top 10 per cent of income earners receive almost 50 per cent of the tax benefit from negative gearing. So, you shouldn't be surprised to learn that the share of anesthetists negatively gearing is almost triple that for nurses, and the average tax benefits they receive are around 11 times higher.

Josh Frydenberg says aspirational voters should fear Labor's proposed changes to negative gearing and the capital gains tax. But for those of us who aspire to a better budget bottom line, a more stable housing market and better opportunities for first home-buyers, the policies have plenty to find favor.

Danielle Wood is the Budget Policy and Institutional Reform Program Director at the Grattan Institute