Is Negative Gearing an Investment Property a Drain on the the Australian Economy?

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Executive Summary

In the 2013 – 2014 year there were 1.2 million negatively geared individual taxpayers who reported a net rental loss of nearly $12 billion dollars. This is out of 2.0 million individual taxpayers who held investment properties and nearly 13 million individuals who lodged a tax return.

These large headline numbers result in many people having the view that the other 11.8 million Australians who lodge a tax return should not subsidise these 1.2 million negatively geared individual taxpayers.

However, this judgement is taken without understanding the full economic benefit provided to Australian society by these 1.2 million individual negatively geared property investors. The question was therefore asked,

“Is Negative Gearing an Investment Property a Drain on the Australian Economy?”

Mr Wayne Wanders, Chartered Accountant and author of the book “Avoid the Poverty Trap” set out to answer this question. Mr Wanders undertook modelling and analysis using the Australian Tax Office’s own data from the March 2016 release of the 2013-2014 Taxation Statistics.

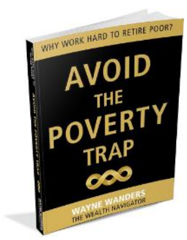
The first finding of this modelling and analysis is that these 1.2 million individual taxpayers are estimated to have received a federal tax subsidy from the rest of Australia to the tune of $2.6 billion dollars in the 2013 – 2014 year.

A substantial subsidy indeed leading to why many are wanting changes as to how negatively geared investment properties will be treated in individual tax returns.

But what Mr Wanders found was that these 1.2 million individual taxpayers through their negatively geared investment properties generated in the 2013 – 2014 year, at least $9.3 billion dollars of annual benefit to the Australian economy.

The benefits Mr Wanders was able to quantify were:

- More than $0.9 billion dollars paid indirectly to the Federal Government via collection of Goods and Services Tax or income tax paid by the businesses who supplied services to these 1.2 million individual taxpayers.
- In excess of $2.8 billion dollars paid directly to State and Local Government and Government Authorities.



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- Of at least $5.6 billion dollars paid directly to the small and medium business sector in Australia.

On top of this $9.3 billion dollars of economic benefit able to be quantified by Mr Wanders, there are other benefits which Mr Wanders was unable to find accurate data for. This includes:

- The value of capital improvements paid for by these 1.2 million individual taxpayers.
- The amount of stamp duty paid to State Governments by individual property investors.
- The amount of tax on capital gains paid to the Federal Government by individual property investors.

Once these are taken into consideration, it would be reasonable to assume that the economic benefit provided by these 1.2 million property investors exceeds $10 billion dollars per annum before taking into consideration the Federal Government subsidy.

So going back to the question,

“Is Negative Gearing an Investment Property a Drain on the Australian Economy?”

The answer is simple.

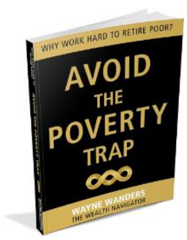
No.

So the next question on everyone’s mind is “Should we change federal income tax rules around negatively geared properties?”

Nothing stays the same forever. So these rules can be changed. But, and this is a big **BUT**, changing the rules to remove the federal governments “subsidy” without understanding the full flow on impact to the rest of the Australian economy is fraught with danger.

The Federal Government may save in one area, but given the extent of the economic benefit generated by these negatively geared property investors currently, the Federal Government may pay the price in other areas. This could be from higher support required at State and Local Government levels. Or from lower income tax and Goods and Services Tax collections from other sectors of the economy.

All of this needs to be properly understood before any changes in federal income tax rules around negatively geared properties are considered.



Introduction

Leading into the 2016 - 2017 budget and the 2016 Federal election, there has been a lot of debate about the impact, adverse or otherwise of mum and dad investors being able to negatively gear investment properties in Australia.

With the Australian Tax Office (ATO) releasing its 2013-2014 Taxation Statistics data in March 2016, this provided the most recent data available to analyse this debate with fact based analysis and not emotional statements.

So Mr Wayne Wanders, Chartered Accountant and author of the book "Avoid the Poverty Trap" extended the research done whilst writing his book to include the 2013-2014 Taxation Statistics data released by the ATO.

So What is Negative Gearing?

A lot of people talk about the term negative gearing, but Mr Wanders feel very few people understand exactly what it is.

It simply means that the revenue earned (in the case of investment property, rents) is less than the expenses incurred (in the case of investment property things like interest, insurance, rates, water, etc.).

So in plain English, you would say it was a loss. The person who has a negatively geared investment property has an annual loss. They are hoping this annual loss is more than compensated for by appreciation in value via capital gains.

To be consistent with the language used by the ATO, this report will also refer to negatively geared investment properties as those with a net rental loss.

Detailed Findings

In the 2013-2014 year there were 2,033,973 individual taxpayers who included an investment property in their income tax return.

1.2 million of these individual taxpayers claimed a net rental loss over $11 billion dollars. There were 0.8 million individual taxpayers who lodged a net rental profit of nearly $8.0 billion dollars.

In total, for the 2013-2014 year, these 2.0 million individual taxpayers with investment properties claimed a net rental loss of $3.8 billion dollars.

This is a substantial amount of money and would give rise to the view that this segment of the investment market enjoys considerable taxation subsidies from the rest of society.

As such you could see why there may be grounds for changes to how negatively geared investment properties are treated for income tax purposes.

So to see if the above statement is based on fact or emotion, a detailed review and analysis of the 2013 – 2014 Tax Statistics provided by the ATO was performed.

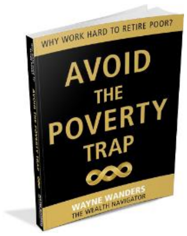
The starting point in the ATO 2013 – 2014 Tax statistics is the Individuals Table 18 - Rental property schedule items and net rent position. The data in this table is summarised in Table 1 below.

Table 1: Individual Investment Property Return Data 2013 – 2014

		2013-14 Loss	2013-14 Neutral/Profit	2013-14 All
Rental Property Schedules	no.	**1,755,469**	**1,168,031**	**2,923,500**
Individual Taxpayers	no.	**1,257,301**	**776,672**	**2,033,973**
Rent and Other Income	$	**19,468,115,264**	**18,517,665,036**	**37,985,780,300**
Deductions Claimed				
Bank Interest and Borrowing costs	$	17,983,514,143	3,375,268,031	21,358,782,174
Depreciation and other capital allowances	$	3,967,649,587	1,089,255,404	5,056,904,991
Council and Water Rates	$	2,467,473,816	1,817,389,905	4,284,863,721
Land Tax	$	364,946,188	444,270,546	809,216,734
Property Agent fees/commission (1)(2)	$	1,409,968,954	1,009,143,190	2,419,112,144
Repairs and maintenance (1)(2)	$	1,601,530,460	822,058,771	2,423,589,231
Body Corporate Fees (1)	$	1,240,734,166	766,372,167	2,007,106,333
Insurance (1)	$	807,105,584	550,729,580	1,357,835,164
Other expenses (1)(2)	$	1,397,019,097	694,268,546	2,091,287,643
Total Deductions	$	**31,239,941,995**	**10,568,756,140**	**41,808,698,135**
Net rental income	$	**-11,771,826,731**	**7,948,908,896**	**-3,822,917,835**
(1) Subject to GST	$	6,456,358,261	3,842,572,254	10,298,930,515
(2) Paid mainly to small business	$	4,408,518,511	2,525,470,507	6,933,989,018

Source: Australian Taxation Office 2013-2014 Tax Statistics

The average tax rate for all individuals in the 2013 - 2014 year was then applied to the losses reported in the above table. This is based in data in the 2013 – 2014 Tax Statistics which provides an average individual tax rate of 22.44%.



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From this an estimated tax benefit for those 1.2 million individual taxpayers with a net rental loss was determined. At the same time using the same basis, the estimated tax paid by those 0.8 million taxpayers with a net rental profit was also estimated. The results of these calculations are shown in Table 2 below.

Table 2: Estimated Tax impact on Individual Investment Property Returns 2013 - 2014

		2013-14 Loss	2013-14 Neutral/Profit	2013-14 All
Rental Property Schedules	no.	**1,755,469**	**1,168,031**	**2,923,500**
Individual Taxpayers	no.	**1,257,301**	**776,672**	**2,033,973**
Net rental income	$	**-11,771,826,731**	**7,948,908,896**	**-3,822,917,835**
Taxable Income all individuals	$			740,702,560,422
Tax payable all individuals	$			166,197,130,901
Average Individual Tax rate		**22.44%**	**22.44%**	**22.44%**
Estimated Federal Income tax (saved) paid based on average individual income tax rate	$	**-2,641,597,918**	**1,783,735,156**	**-857,862,762**

Source: Australian Taxation Office 2013-2014 Tax Statistics

From this analysis you can see that the 1.2 million individual taxpayers reporting a net rental loss of nearly $12 billion dollars obtained an estimated income tax saving of $2.6 billion dollars. This far outweighed the tax paid by the other 0.8 million individual taxpayers reporting net rental profit.

On the face of it, you could understand the view that the Australian taxpayers as a whole are subsidising 1.2 million negatively geared individual taxpayers reporting a net rental loss.

But this analysis is simplistic in its view in that it does not take into consideration what other payments these individual taxpayers made to fund all levels of government. The levels of government was defined to include the Federal Government, the State Government and State authorities, and Local Government and local authorities.

So, the next step in the analysis is to look at what direct payments these individual taxpayers made to all levels of government. Based on the ATO data, the summary of direct payments is shown in Table 3 over.

Table 3: Direct Payments by Individual Property investors to Federal, State and Local Government and Government Authorities

		2013-14 Loss	2013-14 Neutral/Profit	2013-14 All
Payments direct to other Government Bodies (excluding income tax)				
Capital Gains Tax (a)	$			
Stamp Duty (b)	$			
Council and Water Rates	$	2,467,473,816	1,817,389,905	4,284,863,721
Land Tax	$	364,946,188	444,270,546	809,216,734
Total direct payments to government bodies excluding income tax	$	**2,832,420,004**	**2,261,660,451**	**5,094,080,455**

Source: Australian Taxation Office 2013-2014 Tax Statistics
(a) & (b) Data unavailable

What this table shows is that direct payments to Federal, State and Local Government and Government Authorities by the 1.2 million individual taxpayers who reported a net rental loss was $2.8 billion dollars.

It is also important to note here that:

1. There is no data available to determine how much stamp duty was paid by individual property investors in the 2013 – 2014 year.
2. There is no data to determine how much capital gains tax was paid by individual property investors in the 2013 – 2014 year.

It would be fair to say that there would be significant payments made in respect of stamp duty and capital gains tax, which would increase the amounts paid directly to Federal, State and Local Government and Government Authorities well over and above those reported above.

The next level of analysis is to then look at what indirect payments these individual taxpayers made to these same levels of government.

One of the major payments is the Good and Services Tax (GST) paid on a large number of payments made by these individual taxpayers. It is important to note that these individual taxpayers pay GST but are unable to claim the GST back. Other indirect payments include income tax paid by the businesses that receive income from these individual taxpayers. The summary of the estimated in direct payments is shown in Table 4 over.

Table 4: Estimated Indirect Payments by Individual Property investors to Federal, State and Local Government and Government Authorities

		2013-14 Loss	2013-14 Neutral/Profit	2013-14 All
Indirect Payments to Government Bodies				
GST (c)	$	586,941,660	349,324,750	936,266,410
Income Tax from Small Business Suppliers (d)	$	264,511,111	151,528,230	416,039,341
Income Tax from Banks (e)	$	53,950,542	10,125,804	64,076,347
Total direct payments to government bodies excluding income tax	$	**905,403,313**	**510,978,785**	**1,416,382,098**

Source: Australian Taxation Office 2013-2014 Tax Statistics and analysis on the following assumptions.

(c) Equates to 1/11 of item (1) in Table 1

(d) Assumes 30% tax on 20% net margin of all small businesses at item (2) in Table 1

(e) Assumes 1% interest margin at 30% tax

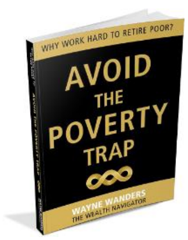
This table shows a further $0.9 billion dollars in estimated indirect payments to Federal, State and Local Government and Government Authorities was made by the 1.2 million individual taxpayers who reported a net rental loss.

So to summarise, the combined the impact on Federal, State and Local Government and Government Authorities by these 1.2 million individual taxpayers who reported a net rental loss is other direct and indirect payments of at least $3.7 billion dollars. This is set out in table 5 below.

Table 5: Total Contribution to Government Bodies including Income Tax but not any Capital Gains Tax or Stamp Duty

		2013-14 Loss	2013-14 Neutral/Profit	2013-14 All
Individual Taxpayers	no.	**1,257,301**	**776,672**	**2,033,973**
Direct and Indirect payments to				
Federal Government		**905,403,313**	**510,978,785**	**1,416,382,098**
State Government	$	**364,946,188**	**444,270,546**	**809,216,734**
Local Government	$	**2,467,473,816**	**1,817,389,905**	**4,284,863,721**
Total Direct and Indirect Payments to Government	$	**3,737,823,317**	**2,772,639,236**	**6,510,462,553**

Source: Australian Taxation Office 2013-2014 Tax Statistics and analysis by Mr Wayne Wanders



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So from the Federal Government's point of view, it "lost" income tax revenue of $2.6 billion dollars from those 1.2 million individual taxpayers who claimed a net rental loss. But these same 1.2 million taxpayers directly or indirectly resulted in the Federal Government collecting at least an extra $0.9 billion dollars from other sources. As stated previously this excludes any tax on capital gains on investment property held by individual taxpayers.

So, as the next table shows, the Federal Government in 2013 – 2014 was faced with a net "subsidy" of $1.7 billion dollars to those 1.2 million individual taxpayers who claimed a net rental loss. At the same time, these same 1.2 million taxpayers paid at least $2.8 billion dollars to State and Local Governments and their Authorities (excluding any stamp duty paid by individual property investors).

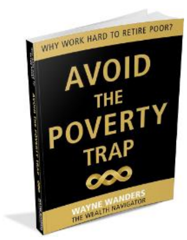
Table 6: Net Contribution to Government Bodies including Income Tax but not any Capital Gains Tax or Stamp Duty

		2013-14 Loss	2013-14 Neutral/Profit	2013-14 All
Individual Taxpayers	no.	1,257,301	776,672	2,033,973
Net Impact on Federal Government				
Direct tax impact	$	-2,641,597,918	1,783,735,156	-857,862,762
Indirect tax impact	$	905,403,313	510,978,785	1,416,382,098
Net impact on Federal Government	$	-1,736,194,605	2,294,713,941	558,519,336
Other Government Agencies				
State Government	$	364,946,188	444,270,546	809,216,734
Local Government	$	2,467,473,816	1,817,389,905	4,284,863,721
Total Payments to other Government Agencies	$	2,832,420,004	2,261,660,451	5,094,080,455
Net Impact on Government Agencies	$	1,096,225,399	4,556,374,392	5,652,599,791

Source: Australian Taxation Office 2013-2014 Tax Statistics and analysis by Mr Wayne Wanders

This means that at the government agency level alone, these 1.2 million individual taxpayers who claimed a net rental loss, made a net contribution of nearly $1.1 billion dollars.

Now let's look at the overall economic benefit that these 1.2 million individual taxpayers provide to the rest of the Australian economy.



Mum and dad individual property investors tend to deal with mainly small and medium businesses. These small and medium businesses include the property manager who manages these properties, the cleaner who cleans them at the change of tenant. The person who mows the lawns and keeps the gardens tidy. The trade's person who maintains and repairs the property. The pest controller.

It would be impossible to work out how many people are employed in these industries serving the investment property market. All we can do is look at the dollars involved. These are summarised in the table below.

Table 7: Payments made to Small and Medium Business by Individual Property investors

		2013-14 Loss	2013-14 Neutral/Profit	2013-14 All
Payments made to Small and Medium Businesses				
Property Agent fees/commission	$	1,409,968,954	1,009,143,190	2,419,112,144
Repairs and maintenance	$	1,601,530,460	822,058,771	2,423,589,231
Body Corporate Fees	$	1,240,734,166	766,372,167	2,007,106,333
Other expenses	$	1,397,019,097	694,268,546	2,091,287,643
Total Small and Medium Business Benefit	$	**5,649,252,677**	**3,291,842,674**	**8,941,095,351**

Source: Australian Taxation Office 2013-2014 Tax Statistics and analysis by Mr Wayne Wanders.

Note this does not include any money spent on capital improvements during the year either.

This table shows that not only do the 1.2 million individual taxpayers who report a net rental loss contribute nearly $1.1 billion dollars to the Federal, State and Local Government and Government Authorities, but they are responsible for at least $5.6 billion dollars of economic benefit to the small and medium business sector in Australia.

This is a combined economic benefit of over $6.7 billion dollars not including the positive impact on big business like the banks and insurance companies. The benefits are set out in the table over.

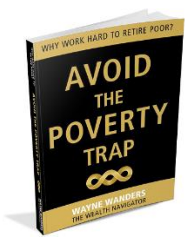


Table 8: Economic Benefit to Governments and Small and Medium Businesses Combined

		2013-14 Loss	2013-14 Neutral/Profit	2013-14 All
Rental Property Schedules	no.	1,755,469	1,168,031	2,923,500
Individual Taxpayers	no.	1,257,301	776,672	2,033,973
Impact on Federal Government Budget	$	-1,736,194,605	2,294,713,941	558,519,336
Impact on Other Areas				
Impact on State Government Budget	$	364,946,188	444,270,546	809,216,734
Impact on Local Government Budget	$	2,467,473,816	1,817,389,905	4,284,863,721
Impact On Small and Medium Businesses	$	5,649,252,677	3,291,842,674	8,941,095,351
Total Impact on Other Areas	$	8,481,672,681	5,553,503,125	14,035,175,806
Total Contribution not including Capital Tains Tax or Stamp Duty	$	6,745,478,076	7,848,217,066	14,593,695,142

Source: Australian Taxation Office 2013-2014 Tax Statistics and analysis by Mr Wayne Wanders

In terms of the economic benefit of all the 2.0 million mum and dad property investors out there, not only do they contribute over $5.6 billion dollars to the Federal, State and Local Government and Government Authorities, but they are responsible for at least $8.9 billion dollars of economic benefit to the small and medium business sector in Australia. This is a combined economic benefit of nearly $14.6 billion dollars not including the value of capital improvements, stamp duty, capital gains tax, and the positive impact on big business like the banks and insurance companies.

Now the scale of these dollars may make it a bit hard to comprehend. So let's average out these dollars by the numbers of individual taxpayers to get what the "average" individual taxpayer who owns investment property is contributing. This is set out in the table over.

Table 9: Economic Benefit by the "Average" Individual Taxpayer

		2013-14 Loss	2013-14 Neutral/Profit	2013-14 All
Individual Taxpayers	no.	**1,257,301**	**776,672**	**2,033,973**
Impact on Federal Government Budget	$	**-1,381**	**2,955**	**275**
Impact on Other Areas				
Impact on State Government Budget	$	**290**	**572**	**398**
Impact on Local Government Budget	$	**1,963**	**2,340**	**2,107**
Impact On Small and Medium Businesses	$	**4,493**	**4,238**	**4,396**
Total Impact on Other Areas	$	**6,746**	**7,150**	**6,900**
Total Contribution not including Capital Tains Tax or Stamp Duty	$	**5,365**	**10,105**	**7,175**

Source: Australian Taxation Office 2013-2014 Tax Statistics and analysis by Mr Wayne Wanders

So in simplistic terms, the cost to the Federal budget is $1,381 per person for those 1.2 million individual taxpayers who report a net rental loss. But the economic benefit per person is at least $6,746 with a net return of at least $5,365.

Or to make it even simpler, for every dollar of net Federal Government tax subsidy an individual taxpayer reporting a net rental loss receives, that individual taxpayer is responsible for contributing a minimum of five ($5) dollars to the Australian economy in that year alone.

As stated previously this is at the low end of the estimate as this does not include the:

- Value of capital improvements paid for by these 1.2 million individual taxpayers.
- The amount of stamp duty paid to State Governments by individual property investors.
- Any tax on capital gains paid to the Federal Government by individual property investors.
- Positive impact on big business like the banks and insurance companies.

Nor does this include any benefit to the Federal Government by any of these individual taxpayers later in life not qualifying for the pension because of the assets and income they have provided themselves.

Conclusion

If you just look at the impact on the Federal Budget of the 1.2 million individual taxpayers with a net rental loss, you would see that these 1.2 million individual taxpayers have received a federal tax subsidy from the rest of Australia to the tune of $2.6 billion dollars in the 2013 – 2014 year.

However what this fails to acknowledge is that these same 1.2 million individual taxpayers were responsible for payments in the 2013 – 2014 year:

- Of more than $0.9 billion dollars paid indirectly to the Federal Government.
- In excess of $2.8 billion dollars paid directly to State and Local Government and Government Authorities.
- Of at least $5.6 billion dollars paid directly to the small and medium business sector in Australia.

These payments total an amount of economic activity greater than $9.3 billion dollars and far outweigh the subsidy provided by the Federal Government.

So back to the original question, "Is negatively geared investment property a drain on the Australian Economy?"

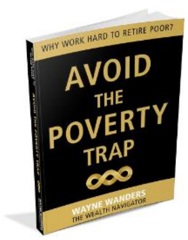
The answer is a resounding no.

So the next question on everyone's mind is "Should we change federal income tax rules around negatively geared properties?"

Nothing stays the same forever. So these rules can be changed. But, and this is a big **BUT**, changing the rules to remove the federal governments "subsidy" without understanding the full flow on impact to the rest of the Australian economy is fraught with danger.

The Federal Government may save in one area, but given the extent of the economic benefit generated by this sector currently, the Federal Government may pay the price in other areas. This could be from higher support required at State and Local Government levels. Or from lower income tax and Goods and Services Tax collections, from other sectors of the economy.

All of this needs to be properly considered before any changes in federal income tax rules around negatively geared properties are legislated.



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About the Author

Wayne Wanders, the Wealth Navigator, is committed to getting Australians off the treadmill of working hard all their life, just to retire poor. All so that hard working Australians can have the life they want, and more importantly, deserve.

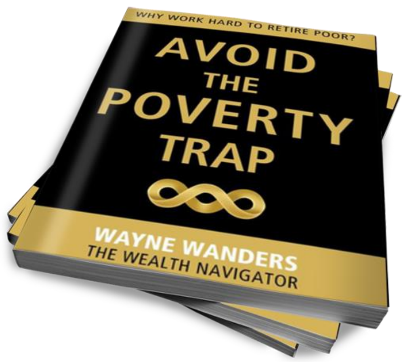
Whilst Wayne has been a chartered accountant for over 30 years, Wayne is not your normal accountant. His philosophy of "why think outside of the square when you can just make the square bigger", gives Wayne an open mind and the ability to dig deeper into challenges.

Some say Wayne's true talent is in seeing things that others do not. As Wayne makes the invisible, visible, you could call Wayne a forensic accountant.

It was this thinking that made Wayne realise that the retirement system in Australia is flawed. And that most Australians are on the treadmill to work hard and retire poor, heading straight for what Wayne calls the Poverty Trap.

So Wayne made it his mission to use his personal experience and knowledge to help hard working Australians avoid the Poverty Trap by:

- Raising awareness of the flaws in the current retirement system;
- Helping people accept responsibility for their own financial future;
- Helping people understand where they are financially today and where they want to be in the future;
- Showing people in plain English, actionable ways to get from where they are today to where they want to be in the future; and,
- Acting as their accountability partner, giving them guidance and motivation to achieve their goals.



All so that they can avoid the Poverty Trap.

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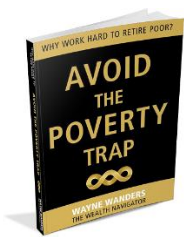

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