**BULAW3731 Income Tax Law &Practice Assignment**

**Semester 1, 2016**

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**Negative Gearing**

Negative gearing is a hot topic of conversation in Australia. It is the most talked about topic in the country as it is actually affecting the economy. It is defined as the excess of the expenses (depreciation, interest on loan, etc) over the incomes being earned from such property. TR 1995/33 states the clarity of definition on these two words as, when the investments are purchased, they may have several expenses attached to it such as depreciation which is written off over a period of time. If here is a loan attached to it then there will be interest paid on it. These expenses are allowed for deduction from the income which is earned from the property. The income which is earned from the property is less usually then the expenses. Therefore, it results into a loss, which is actually “negative gearing”. The main cause of it is the capital gain tax discounts. Due to the offset of the loss and the other benefits in the capital gain, negative gearing is taking place. Currently it is allowed in the taxation system to offset the property loss or the negative gearing with the other incomes.

**Capital gain tax on property**

Capital gain tax is a tax charged on the capital assets as specified in the Income Tax Assessment Act, 1997. Section 104 of the Act, provides the capital gain tax events which qualifies as the capital asset for taxation. As specified in the section 104 – 10 of the act, to make a capital gain or capital loss, an asset needs to get disposed. It means that an asset must be sold, or destroyed, or transferred or exchanged as rollovers, passing the title to someone else. It must be noted here that a capital gain is charged only when the asset is purchased after 20 September 1985. If purchased before it then it is not qualified for charging of the capital gain or allowance of set off of the capital loss with the other incomes of the individual.

As per section 108 – 5 of the act, a capital asset is called as a table right which is the property. It includes something which can be owned. It can be the furniture, plant, boats, land and the house property (other than residential) shares in companies, aero planes, etc. It also includes any kind which is not property such as goodwill, collectables (its losses can be set off with its gain only), and a personal asset. To make a capital gain or loss the asset must be owned by the individual. It must be acquired in order to dispose it.

Tax on investment property as capital asset.

To calculate tax on the property which is used as investment following points need to be noted:

1. The property should be purchased after 20 September 1985. Any property purchased before such date will be disregarded for the purpose of capital gain or capital loss.
2. It should not be a house property which is a residential property. Under the section 118 – B of the act, a capital gain on the property is disregarded when there is main residence clause. Reason being theat the property has not been used as the investment property and it was not used to produce any assessable income like rent or lease payments, etc.
3. Where the property is used part as the main residence and part as an investment property, there the capital gain is apportioned for such two periods on the capital gain calculated.

As per section 110 – 25 of the act, cost base is defined. The amount of sale prices if sold for more than the cost base, then there is capital gain and vice – versa. Cost base is the total of the cost price of the property, any other incidental costs on it, borrowing costs, costs incurred to improve or defend the property.

After the calculation of capital gain or capital loss, following of the given methods is applied to reduce only the capital gain. Section 114 mentions the indexation method, whereby the cost price and the other elements of the cost base updated as per the current market on the grounds of consumer price index. Thereafter the indexed cost base is subtracted from the sale price. The second method is defined in section 115, where by the capital gain for individual is reduced by 50 percent flat rate and 33.33 percent for the trusts. Companies cannot reduce by any rate. This method helps in reducing the capital gain completely at half rate. Indexation method is allowed on the expenses incurred before 20 September 1999. Discount method is only allowed when the asset is sold after 20 September 1999 and is held by the owner for 12 months or more. Capital loss if incurred it is allowed to set off with other capital gains.

**Negative Gearing with Capital gain tax has the following features**

1. The rent of the properties is very low. Due to the long term investment view the rent is kept low so as to keep the property on hold. This is because the long the property is kept on hold, the more the value of it will increase. It happens due to availability of the set off of the negative gearing with the other incomes of the individual including the capital gain. Also, the discount factor in the property is available to the properties which are hold for more than 12 months period which reduces the capital gain completely by half.
2. Supply of the properties are not more as the available houses are already used as residential property by the people of the country and people who are having the invested properties are not available for sale.. The investors are in the mood to earn more profits by selling the properties after a long time.
3. Offset of the losses from the property and reduction in the capital gain is available to all the properties for unlimited period of time for all the new and the continuous buyers.
4. The properties are built by the investors in bulk. They are the ones who put their money in such properties as their investments because of the future profits.
5. The revenue to the government is low because of the negative gearing and the capital gain tax concessions. When an expense is offset with other incomes, it reduces the tax simultaneously and with capital gain tax discounts, whatever gain is computed is reduced to half or the other percentage as specified thus reducing the tax. This tax is collected by the government which itself gets so low.
6. Housing affordability is a problem or a difficult task for the new buyers. Reason being the capital gain tax discounts and the negative gearing allows the investors to keep the properties on hold for a longer period of time which is beneficial for them. It on the other side increases the rate of the properties which makes it difficult for the buyers to buy them. Only the riches or the ones who can avail loans are buying the property.
7. The availability of the house is still an issue, as the properties are kept on hold and are not sold easily.
8. Most of the money of the country is invested in the house properties. It is not good for the economy on the grounds that people forget to put their money on other ventures which can be better for the economy.
9. The current system of housing affordability is good for those who are ready to move into the smaller properties as they will gain the tax discounts under the system and earn more profits. Instead for the new buyers and the people who are living in the small houses and looking for bigger homes are having difficulty in buying the new properties.

**The key points of the policy.**

As per the policy by the opposition the following points are stated in it.

1. Availability of negative gearing on the newly constructed homes only. – This means that currently the negative gearing is applicable to all the properties. The expenses are allowed to be deducted from the incomes of the property to all the buyers whenever it is sold whether by the first buyer or the consecutive buyers. This way it is estimated that around $32 billion will be saved. The reason for the saving is that currently negative gearing is allowed for set off with the other incomes of the individuals. When there will be restriction of it to only the newly constructed homes, then only the first buyers will be able to avail this benefit and the consecutive buyer will not be able to set off negative gearing with their incomes. This way their incomes will not reduce and there will be no saving of taxes by them and the government will increase its revenue.
2. The abolishment of negative gearing on the consecutive properties will create more new construction jobs. – The reason being for such statement means that when there will be no set off of negative gearing other than of the new buyers then investors or people will get involved in making more new home thus creating more jobs.
3. Reduction in capital gain discount option on the capital assets from 50 percent to 25 percent – This will also increase the government’s revenue. The increase in the taxable capital gain amount because of the decrease in the discount rate lead to more tax payable the individuals.
4. No change on the main residence exemption and personal superannuation. They will continue to be tax-free like before. The main residence will be exempted on the grounds like before only, which included it to be lived as the residence for the whole ownership period.

**Whether the proposed tax system is good?**

1. Abolishment of the negative gearing to the next buyers will leave them to buy the new properties. People will tend to buy the new properties rather than purchasing it from the earlier owners because of the tax evasion on the new ones.
2. Supply of the properties will increase thereafter. People will invest their money on new properties only in order to earn more, because of which more new ones will be constructed. It will create new and more jobs in the construction field.
3. Capital gain tax reduction from 50 percent to 25 percent will disregard the new investors in investing in the properties as the profit which they earlier used to make will get reduce and people will try to sell them on short periods.
4. Property rents will make some hike because of low income in later years. People will try to earn from rents in short periods.
5. People who will to sell their properties in order to get the new one for their needs will increase. Those who wish to grow their home because of large family need will buy the new properties. Instead the ones who want to sell their big homes and get into the small ones will reduce.
6. Resale of property will be affected as there will be no benefit attached to it in terms of set off of losses and capital gain reduction. There will be whole lot of construction to avail the negative gearing and it will increase the supply therefore. It may be good for the new buyers who wish to buy new properties but this way there will be a big lot of properties which may not get resell.
7. It is beneficial for the moms and dads as they are the one who can take the advantage of the new property, but for those who are looking for long term investment, their children will not be happy with this tax structure.

It is seen that negative gearing and the capital gain tax concession are highly insufficient for the economy as they both put negative impact on the economy. The rent may be less, but the revenues for the government is also very less which otherwise can help in building the economy. It also increases the price of the house and makes affordability of it an issue.

The tax system policy being proposed by the opposition is not completely a good tax system, but yes it will create a lot of advantages for the economy and the people. It will make the house prices lower done making it easier for the people to buy it. The revenues will be generated more because of more tax charged on the capital gain than before. The policy will create investment a bigger name for the investors in terms of defining it broadly. The investors will spread themselves more on the new investment opportunities thereafter in order to make profits and will put their money efficiently than before.

The rent which is an issue is not taken into consideration, as for those who cannot buy the new properties are relying on the rented properties. The abolishment of negative gearing will create a hike in the rent. The capital gain reduction will create a lot of revenue for the government which will be beneficial for the people only as it will be used for the development of the country. There will be no adjustment of the negative gearing on the resale of the property. Therefore, this will create a hub of properties allover and people will be not interested in buying the second hand properties. It will create a congested environment. However, this will be big step in the housing market if new tax system implies. The commercial properties and share market trading losses are still not affected from the proposed policy. These two also affect the economy at a large scale. The existing property holders will invest in new properties.

It is partially a good tax system with the scope of few more changes as per the needs of all the people affected by it and harming no one.

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