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Committee Secretary
Standing Committee on Economics
PO Box 6021
Parliament House
Canberra ACT 2600

By email: economics.reps@aph.gov.au

Dear Committee

Inquiry into Tax Deductibility

Thank you for the opportunity to comment on the Committee's review of the personal and company income tax system.

The Property Council is the peak body representing the interests of owners and investors in Australia's $670 billion property investment industry. The Property Council represents members across all four quadrants of property investment, debt, equity, public and private.

We understand from the Inquiry's terms of reference that the Committee's review is particularly focused on whether the base of these taxes can be broadened in order to fund reductions in marginal rates.

The Property Council supports the Government's push to reform Australia's federal and state taxes.

However, the property industry does not support any narrowing of interest deductibility for businesses and individuals.

The property industry is Australia's biggest industry contributing 11.5% to GDP, and employing 1.1 million Australians, more than mining and manufacturing combined. It helps underpin the retirement savings and economic prosperity of Australians, with one in every two Australians having a stake in commercial property through superannuation and managed funds.

Debt funding is critical to financing major property and infrastructure projects.

Interest deductibility is a normal cost of business that creates income by encouraging investment. It is a necessary part of Australia's mainstream tax system principles and has been in place for as long as we have had a federal income tax system, i.e. well over 100 years.

Limiting interest deductibility will make investments more expensive. It will make property projects harder to fund and act as an anchor holding back investment. This will exacerbate Australia's undersupply of housing and infrastructure.

Our tax system should be encouraging investment and activity to generate jobs and boost the economy. It is self-defeating to remove measures that drive investment and competitiveness in return for a decline in the corporate or personal tax rates.

The changes effectively reduce business prosperity – business may have a lower corporate tax rate but they will also make less investments and income.

For the property industry, the impact is worse still as trusts will not benefit from a lower corporate tax rate, and the loss in profit will effectively be shouldered by mum and dad superfund investors.

Interest deductibility is critical for property and infrastructure investment

The ability to gear and use debt for all asset classes is a crucial part of investing and fostering economic growth.

Loans allow investors to add to their own savings by borrowing from the savings of other individuals. This means that investors, whether they are businesses or individuals, can access funds to purchase investments they would otherwise not be able to afford using their savings alone.

This includes the homes we live in, the offices in which we work, and the shopping and recreational areas where we spend our leisure time.

Interest paid by investors on their investment loans is tax deductible, while any income from the investment is taxable. This is part of the normal operation of the Australian tax system which is generally designed to tax profits, rather than gross income.

Any wholesale removal of deductions for interest expense will make investments more expensive to fund, and jeopardise or hold back property and infrastructure projects.

We have set out below further details on the impact for businesses and individuals.

Impact for businesses – review of corporate income tax system

The Committee has been asked to examine the company income tax system, with particular reference to the deductibility of interest incurred by businesses in deriving their business income.

Australia depends on international capital to finance infrastructure and building projects because domestic investors are unable to fund all of Australia's property needs.

As such, it is critical that we have the right balance of taxes and regulatory frameworks to remain competitive.

Limiting or removing interest deductibility will blow out borrowing costs for property and infrastructure projects. Projects will become more expensive and harder to fund.

This will threaten the viability of developments, reduce Australia's ability to attract the capital needed to finance critical projects, and unfairly shift the tax burden to capital intensive sectors of the economy.

Australia already has robust integrity measures (known as thin capitalisation rules) in place to limit excessive interest deductions by businesses.

Removing deductions altogether will put Australia's tax system out of kilter with major competitor economies. Even the best domestic investment will find it harder to attract investors if the tax system is out of step with competitors. Investors have choice for their investment and will factor in risk from complexity and profitability to their decision.

Critically, property trusts are unable to use a corporate tax rate cut. This means mum and dad superannuation investors (as beneficiaries of Australia's property trusts) will unfairly shoulder the burden of any corporate tax cut.

Impact for individuals – review of personal income tax system

The Committee has been asked to examine the personal tax system as it applies to individual non-business income, with particular reference to the deductibility of expenditure of individuals in earning assessable income.

Currently, interest paid by individuals is deductible for all forms of investment, including property investments, share investments and business ventures. It is common for this financing method to be referred to as "negative gearing".

Negative gearing benefits a range of Australian households by providing all individuals with an opportunity to invest in property, and save for their retirement. 72.8% of investors own only one investment property, while an additional 18% own two properties.[1]

Critically, negative gearing keeps a lid on rental costs and house prices, acting as a surrogate rental concession. The Henry Tax Review noted that any changes to negative gearing could reduce residential property investment, which in a market facing supply constraints would place further "downward pressure" on the availability of affordable rental accommodation.

Any wholesale removal of negative gearing would significantly harm investment, diminish rental supply and ensure that in the short to medium term, rents and property prices will escalate, as investors seek to recover their higher costs.

Recommendation

The Property Council recommends that the Committee rejects any narrowing of interest deductibility for businesses and individuals.

With an economy in transition, anaemic productivity growth and long term fiscal pressures from demographic change, it is more urgent than ever that Australia adopts a tax system which facilitates growth and investment.

[1] ACIL Allen Consulting, Australian Housing Investment, 2015, based on ATO Taxation Statistics 2010-2011

Removing interest deductibility will discriminate against capital intensive projects, such as housing and infrastructure, and make them more expensive to fund. This will exacerbate Australia's undersupply of housing and infrastructure, and severely hamper our ability to generate jobs and boost the economy.

Instead, Government should focus on removing inefficient taxes that hold back economic growth and productivity.

Stamp duty on conveyancing is universally recognised as one of Australia's most inefficient and harmful taxes. It stops people and businesses making the best investment decisions for their needs which adversely affects labour mobility, housing affordability and economic activity.

We believe a fundamental objective of tax reform should be to grow the economy. This means reshaping Australia's tax mix to remove our most distorting tax, stamp duty on conveyancing.

The Property Council is available to discuss our submission with you further at your convenience.

Please contact me (on 0406 45 45 49) or Belinda Ngo (on 0400 356 140) to discuss the submission.

Yours sincerely,

Andrew Mihno
Executive Director, International & Capital Markets