Taxation of housing and its impact on supply

January 2026

HIA ECONOMICS

Contents

Executive Summary

Australia's housing market is increasingly defined by a structural imbalance between strong underlying demand and persistently weak supply. While much of the policy focus has rightly centred on planning systems, land supply, infrastructure charging, and construction costs, taxation settings affecting housing investment have become a growing focus of public debate. Negative gearing and capital gains tax discount are frequently cited as primary drivers of housing affordability pressures.

This report examines the role of these tax settings within the broader housing system, noting that housing is one of the most heavily taxed items in the economy and arguing that housing outcomes are shaped by tax settings, among other factors.

Housing investment plays a central role in Australia's dwelling supply pipeline, particularly for rental housing and higher-density development. In the past year, investors accounted for over 40 per cent of all loans for the construction or purchase of new dwellings, underscoring their importance to housing delivery. Investors provide a larger share of capital required to finance new apartment construction due to the longer lead times. Any policy change that materially alters investor incentives therefore has implications not only for asset allocation, but for the volume, timing and composition of new housing supply.

Claims that changes to capital gains tax arrangements introduced in 1999, or the ongoing availability of negative gearing, are a primary cause of rising house prices are misguided. They rely heavily on timing correlations rather than causal evidence. Over the past two decades, real house prices have increased faster than incomes across most advanced economies, including in jurisdictions with very different housing tax systems. This indicates that broader structural factors, such as constrained housing supply, population growth and declining global interest rates are the dominant drivers of price growth, rather than any single domestic tax change.

The report also finds that international comparisons are frequently misapplied in the housing tax debate. While Australia's negative gearing arrangements are often portrayed as unique, the deductibility of costs incurred in earning rental income is a standard feature of income tax systems internationally. Differences across countries typically arise not from whether deductions are allowed, but from how housing is taxed as a whole. Many jurisdictions that limit investor deductions impose capital gains tax on owner-occupied housing, allow mortgage interest deductibility for owner-occupiers, or rely more heavily on recurrent property taxes. Selectively adopting individual elements of overseas tax systems without their broader context risks undermining the balance between simplicity, equity and efficiency, and can weaken incentives for housing investment.

Economic modelling and historical experience consistently indicate that increasing taxes on housing investors reduces investment in new housing, particularly in supply-constrained markets. While the short-term effects of such changes may vary across regions and market segments, the longer-term consequences include less dwelling construction, reduced rental supply and upward pressure on rents. These effects are most pronounced where alternative sources of housing finance are limited and where planning and infrastructure constraints already restrict supply responsiveness.

Proposed policy changes also suggest that increasing taxes on housing investors in the established market would lead to increased investment in new housing supply. For this to be correct, new housing supply must also be a 'Giffen good', where demand for an item rises, as the cost of it increases. Taxing investment in established homes will cause a decline in investment in new homes, just as taxing the disposal of used cars would adversely impact the sale of new cars. Investors can see through the timeframe of an investment and estimate the lifetime costs and returns from an investment in any category.

Addressing the challenge also requires increasing investment in housing from owner occupiers, investors and government. This can only be achieved through lowering the cost of delivering and financing completed homes. Improving housing affordability requires policies that support a sustained expansion in housing supply. This includes efficient planning systems, timely land release, coordinated infrastructure provision and stable taxation and financing settings that encourage long-term investment.

Governments need to first fix housing supply, not seek to increase tax imposts on housing supply.

1. Housing as One of the Most Heavily Taxed Sectors in the Economy

Public debate on housing policy frequently focuses on perceived tax concessions provided to housing investors. Much less attention is paid to the overall tax burden imposed on housing across its lifecycle. Recent analysis by the Centre for International Economics (CIE) provides a comprehensive assessment of the total taxation applied to housing in Australia and places it in context relative to other sectors of the economy.

The findings of that analysis are clear. Housing is one of the most heavily taxed items in Australia, with an effective tax burden comparable to, and in some cases exceeding, that applied to goods traditionally regarded as highly taxed, such as alcohol and tobacco.

The scope of housing taxation

The CIE report examines the full range of taxes applied to housing, including:

- transaction taxes, such as stamp duty
- recurrent taxes, including land tax and council rates
- taxes on construction inputs, including GST on new housing
- development charges and infrastructure contributions
- income and capital gains taxes applied to housing investment

When considered individually, many of these taxes are often justified on specific policy grounds. However, the CIE analysis demonstrates that when combined, they impose a substantial cumulative burden on housing production, ownership and use.

Importantly, these taxes are applied at multiple stages of the housing lifecycle, from land acquisition and development through to construction, sale, ownership and transfer.

1.1 Housing compared to 'sin taxes'

A central contribution of the CIE report is its comparison of the effective tax burden on housing with that applied to other sectors of the economy. The analysis shows that housing faces a higher effective tax rate than most other goods and services.

In particular, the total tax burden on housing is comparable to the 'sin taxes' imposed on alcohol and tobacco, which are deliberately taxed at high rates to discourage consumption. Unlike alcohol and tobacco, however, housing is an essential good and a key input into economic and social participation.

This comparison challenges the common narrative that housing is lightly taxed or subsidised. Instead, it demonstrates that housing is already subject to significant taxation, much of which directly affects the cost and viability of new housing supply.

1.2 Taxation and new housing supply

The CIE report highlights that many housing taxes fall most heavily on new housing. The GST is only applied on new home construction. Stamp duty is applied to land, the home and the mortgage of a new home and on top of infrastructure charges and development contributions which all increase the upfront cost of delivering new dwellings.

These costs are largely fixed and must be incurred before any housing is produced. As a result, they directly affect development feasibility and the willingness of investors and developers to commit capital.

Where markets are supply constrained, these taxes are capitalised into higher prices or rents, or they prevent projects from proceeding entirely. The burden therefore falls not only on investors, but ultimately on households through reduced housing supply.

1.3 Interaction with investor taxation

Against this backdrop, proposals to increase capital gains tax or restrict negative gearing further would add to an already substantial tax burden on housing investment. The CIE analysis makes clear that housing does not sit in a low-tax environment where additional taxes can be imposed without consequence.

Further increases in investor taxation would compound existing imposts, raising the hurdle rate for new housing projects and reducing the pool of marginal investments that proceed. In a market where investors

already account for more than 40 per cent of new housing construction, this has direct implications for the volume of new homes delivered.

1.4 Implications for policy design

The CIE report reinforces the importance of assessing housing taxation in aggregate rather than focusing on individual tax instruments in isolation. Policies that target specific elements of housing taxation without regard to the cumulative burden risk undermining housing supply objectives.

If increasing the supply of new housing is a policy priority, tax reform should focus on reducing, not increasing, the overall tax burden on housing production and investment. This is particularly important in the context of existing supply constraints and rising construction costs.

1.5 Conclusion

The evidence presented by the CIE demonstrates that housing is already one of the most heavily taxed sectors in the Australian economy. Proposals to further increase taxes on housing investment must be considered in light of this reality.

Adding to the tax burden on housing, including on investors who deliver more new homes to market than any other player (first home buyer, other owner occupier or governments), risks further constraining housing construction. A credible housing policy framework must therefore consider not only how housing is taxed, but how the cumulative tax burden affects the capacity to deliver new homes.

2. Investors vs first home buyers

Public debate on housing affordability often treats housing as a fixed stock that is allocated between different types of buyers. Within this framing, investors are frequently characterised as competing directly with owner-occupiers for a limited number of dwellings, with tax settings assumed to influence prices largely through shifts in demand.

2.1 Housing as a produced asset, not a fixed stock

When housing supply is responsive, increases in demand can be met through additional construction, moderating price and rent pressures. When supply is constrained, demand pressures are capitalised into higher prices and rents. In Australia, the long-run responsiveness of housing supply has weakened, reflecting planning constraints, infrastructure charging, labour shortages and rising construction costs. In this environment, policies that affect investment incentives take on greater significance.

The three roles in the housing market
A useful way to understand housing market dynamics is to distinguish between three roles that are often conflated in public debate: capital providers, owners, and occupants.

Investors are primarily capital providers. While they also become owners, their economic role is to finance the delivery of housing services to occupants, most commonly renters. Owner-occupiers combine all three roles within a single household, but they are not the only source of capital for housing delivery.

Confusing ownership with occupancy leads to the mistaken belief that reducing investor participation necessarily improves access for owner-occupiers. In practice, reducing the availability of investment capital can reduce the overall supply of dwellings, particularly in market segments where owner-occupier demand alone is insufficient to support development.

2.2 Why investors matter for new housing supply

Investors play a disproportionate role in financing new housing construction, especially higher-density and rental-oriented projects. Many apartment developments require a critical mass of pre-sales to secure finance. Investors often provide this early demand, enabling projects to proceed that would otherwise be unviable.

This role is reflected in recent construction data. In the past year, investors accounted for approximately 42 per cent of new home commencements. Their participation is particularly important in inner-urban and middle-ring locations where land costs are high and development risk is elevated.

The link between rents, prices and construction
Rents, prices and construction activity are interconnected. Expected rental income influences investor willingness to finance new dwellings. Expected sale prices influence developer feasibility. Financing costs affect both.

When policies reduce after-tax returns to investment housing, investors require either higher rents or lower purchase prices to achieve the same return. In a supply-constrained environment, lower prices are difficult to achieve sustainably, particularly for new construction where costs are largely fixed. The adjustment therefore tends to occur through reduced construction activity and, over time, upward pressure on rents.

2.3 Housing supply responsiveness and policy interaction

The impact of any single policy change depends critically on the broader policy environment. Where planning systems are flexible and infrastructure is delivered efficiently, supply can respond more readily to changes in demand or incentives. Where supply is constrained, the same policy change can have amplified effects.

Understanding this interaction is essential when assessing proposals to alter negative gearing or capital gains tax arrangements. These settings influence investor behaviour, but their effects on prices, rents and construction depend on how the rest of the housing system responds.

2.4 Implications for policy analysis

Policies affecting housing investment must be evaluated through their impact on housing supply, not solely through their effect on demand for existing dwellings. Measures that reduce investor participation will, in isolation, worsen the underlying supply constraints.

The following chapters examine how taxation settings interact with housing supply, how historical and international evidence informs this debate, and why selective policy changes risk exacerbating, rather than alleviating, housing affordability challenges.

3. Long-Run Housing Supply Trends and Constraints

Australia's housing affordability challenges cannot be understood without reference to the long-run performance of housing supply. While short-term fluctuations in prices and rents attract attention, it is the persistent inability of dwelling construction to keep pace with underlying demand that has shaped housing outcomes over time. This chapter examines the structural factors that have weakened housing supply responsiveness and explains why these constraints magnify the effects of changes to investment incentives.

3.1 Population growth and dwelling construction

Over recent decades, Australia has experienced sustained population growth driven primarily by net overseas migration. In principle, strong population growth should be matched by a commensurate expansion in the housing stock. In practice, dwelling completions have repeatedly fallen short of what would be required to maintain balance in the housing market.

Periods of strong construction activity have tended to be cyclical rather than structural, often followed by sharp downturns. This volatility reflects the sensitivity of housing construction to financing conditions, confidence and regulatory risk. When investment incentives weaken or uncertainty rises, projects are delayed or cancelled, leading to cumulative undersupply that persists even when conditions later improve.

The result is a housing system that enters periods of strong demand with insufficient capacity, causing prices and rents to adjust upward rather than supply responding smoothly.

3.2 Planning systems and land supply

Planning and zoning systems play a central role in determining how responsive housing supply can be. In many parts of Australia, particularly in established urban areas, planning controls tightly constrain density, height and permissible land uses. While these controls often pursue legitimate objectives, including amenity and environmental outcomes, they also limit the capacity of the housing market to respond to changes in demand.

In greenfield areas, land supply constraints arise from the sequencing of rezoning, infrastructure provision and development approvals. Long lead times and high upfront infrastructure costs increase development risk and capital requirements, raising the threshold returns required for projects to proceed.

These constraints mean that even where demand is strong and finance is available, the ability to deliver additional dwellings is limited. Tax and finance settings therefore operate within a supply environment that is already structurally rigid.

3.3 Infrastructure charging and development viability

Infrastructure funding models have become an increasingly significant component of housing costs. Developer charges, contributions and levies add materially to the cost of new dwellings, particularly in growth areas. While infrastructure must be funded, the timing and structure of these charges affect project feasibility and the pace of development.

Upfront charging shifts risk onto developers and investors, increasing the amount of capital that must be committed before any return is realised. This amplifies sensitivity to changes in expected after-tax returns. Where investor taxation becomes less favourable, projects at the margin are more likely to be deferred or abandoned.

Infrastructure charging therefore interacts directly with tax and financing settings, reinforcing the importance of policy coherence across tiers of government.

3.4 Construction costs and capacity constraints

Construction costs have risen sharply over recent years, driven by labour shortages, higher material costs, compliance requirements and increased financing costs. While some of these pressures are cyclical, others reflect longer-term structural issues, including workforce availability and regulatory complexity.

Higher construction costs raise the minimum sale price or rent required for new dwellings to be viable. In segments of the market where prices are constrained by buyer capacity, this limits supply response. In rental markets, higher costs translate into higher required rents over time.

In this context, policies that further reduce investor returns do not simply compress margins, they can remove the economic basis for new supply entirely.

3.5 Declining supply elasticity

Taken together, planning constraints, infrastructure charging and rising construction costs have reduced the elasticity of housing supply. That is, a given increase in demand now results in a smaller increase in new construction than in the past.

When supply elasticity is low, demand-side or incentive-based policy changes have larger price and rent effects. Conversely, policies that reduce investment in such an environment have disproportionate impacts on construction volumes and rental availability.

This is a critical consideration when evaluating changes to negative gearing or capital gains tax settings. The same tax change that might have modest effects in a highly responsive supply environment can have significant and persistent consequences where supply is constrained.

3.6 Interaction with investment incentives

Housing investment decisions are made at the margin. Investors and developers assess whether expected returns compensate for risk, time and capital commitment. When supply is constrained, projects often sit close to viability thresholds. Small changes in tax treatment, financing costs or regulatory risk can therefore determine whether a project proceeds.

This interaction helps explain why housing supply responds asymmetrically to policy changes. Measures that weaken incentives can have immediate effects on construction activity, while measures that strengthen incentives may take longer to translate into additional supply due to existing constraints.

Understanding this asymmetry is essential to interpreting both historical experience and modelling results, which consistently show that reductions in investment incentives have clearer and faster impacts on housing supply than the reverse.

3.7 Implications for housing affordability

The persistence of housing affordability pressures reflects the cumulative effect of long-run supply constraints rather than any single policy failure. Taxation settings affecting housing investment operate within this constrained environment and can either mitigate or exacerbate supply shortfalls.

Policies that weaken investor participation will, in isolation, worsen the underlying supply constraints. Conversely, reforms that improve supply responsiveness can reduce the sensitivity of housing outcomes to changes in demand or investment behaviour.

The next chapter examines the specific role investors play in this constrained supply environment and why their contribution to new housing delivery is central to housing outcomes.

4. The Role of Investors in Expanding Housing Supply

Housing investors play a central but often misunderstood role in Australia's housing system. Public debate frequently characterises investors as participants in a zero-sum contest with owner-occupiers for existing dwellings. This framing obscures the more important function investors perform in providing the capital required to deliver new housing, particularly in market segments where owner-occupier demand alone is insufficient to support construction.

This chapter examines who housing investors are, where they operate within the market, and why their participation is integral to expanding housing supply in a structurally constrained environment.

4.1 Investors as providers of capital

At its core, housing investment is the provision of capital to finance the production of housing services. Investors absorb development risk, commit capital over long time horizons, and accept exposure to changes in rents, prices and regulatory settings. In doing so, they enable dwellings to be constructed that would not otherwise proceed.

This role is especially important in a housing system where development is capital-intensive and subject to long lead times. From land acquisition through planning approval and construction to completion, projects often span several years. Investors bridge this period by providing upfront finance in return for expected future rental income and capital appreciation.

Owner-occupiers also provide capital when purchasing new dwellings, but their capacity to do so is constrained by income, deposit requirements and risk tolerance. In many segments of the market, particularly higher-density housing, owner-occupier demand alone is insufficient to support viable development at scale.

4.2 Investor participation in new housing delivery

Recent data illustrate the importance of investors to new housing supply. In the past year, investors accounted for approximately 42 per cent of new home commencements nationally. This share is materially higher in certain dwelling types and locations, particularly apartments and townhouses in inner-urban and middle-ring areas.

Investor participation is not evenly distributed across the market. Detached housing on the urban fringe is more likely to be owner-occupied, while higher-density developments rely more heavily on investor demand. This reflects differences in price points, dwelling characteristics, tenure preferences and financing requirements.

As a result, changes in investor behaviour have uneven impacts across the housing stock. A reduction in investor participation is likely to affect apartment and townhouse construction more sharply than detached housing, with implications for rental supply, urban density and housing diversity.

4.3 Pre-sales, financing and development feasibility

One of the most important mechanisms through which investors support new housing supply is through pre-sales. Lenders typically require developers to secure a proportion of dwellings under contract before construction finance is approved. Investors often account for a significant share of these pre-sales, particularly in apartment projects.

By committing early, investors reduce financing risk and enable projects to proceed. Without sufficient pre-sales, developments may be delayed, redesigned or abandoned entirely. This dynamic is particularly pronounced in markets with higher construction costs, more complex planning requirements or greater demand uncertainty.

Tax and financing settings that affect investor willingness to commit capital therefore have a direct bearing on the feasibility of new housing projects. Even modest reductions in expected after-tax returns can push projects below viability thresholds, especially where costs are largely fixed.

4.4 The rental market and housing availability

Investors are the primary providers of rental housing in Australia. While some rental dwellings are supplied by institutional investors or public housing providers, the majority are owned by private individuals. The availability, quality and location of rental housing therefore depend heavily on investor participation.

A sustained reduction in investor activity does not eliminate demand for rental housing. Instead, it constrains supply, leading to tighter rental markets and upward pressure on rents over time. These effects are often most acute in established urban areas where new supply is already limited.

Importantly, rental supply and owner-occupier supply are not independent. Dwellings constructed for rental purposes form part of the overall housing stock and may transition between tenures over time. Policies that reduce rental construction therefore have broader implications for housing availability across the market.

4.5 Investor heterogeneity and marginal behaviour

Housing investors are not a uniform group. They differ widely in income, wealth, risk tolerance, access to finance and investment objectives. Many investors hold a single property as part of a long-term savings strategy, while others manage portfolios and actively assess returns across different asset classes. Some investors prioritise rental income stability, while others focus on longer-term capital growth.

These differences matter for housing supply because not all investors influence construction decisions equally. From a supply perspective, the behaviour of *marginal investors* is the most important. Marginal investors are those whose participation determines whether a new housing project proceeds or is cancelled. Their investment decisions sit close to feasibility thresholds, where expected returns are just sufficient to justify committing capital.

In practice, many housing developments, particularly higher-density and rental-oriented projects, only proceed because a relatively small group of investors is willing to accept development risk, long lead times and uncertain returns. These investors provide pre-sales, equity and early capital that allow projects to secure finance and move into construction.

When tax or regulatory changes reduce after-tax returns, it is these marginal investors who respond first. Existing investors with completed properties may continue to hold their assets, but marginal investors reassess whether new projects still meet required return thresholds. If they withdraw, projects do not proceed.

This mechanism helps explain why changes to investor taxation can have outsized impacts on housing supply even when the majority of existing investors remain in the market. Housing supply does not increase because investors continue to hold properties that already exist. It increases only when new capital commits to new developments. Losing a relatively small amount of marginal capital can therefore prevent a disproportionately large number of projects from being financed.

The effect is most pronounced in higher-risk segments of the market, such as apartments, townhouses and rental-focused developments, where costs are largely fixed and risks cannot easily be reduced. In these segments, small changes in expected after-tax returns can determine whether projects proceed at all. As a result, policies that weaken investor incentives tend to reduce construction activity first in precisely the parts of the market that are most important for expanding housing supply.

Box 1: Why marginal investors matter for housing supply

Consider a medium-density apartment project of 120 dwellings in an established urban area.

The project requires a minimum level of pre-sales and equity investment before a bank will provide construction finance. Most of the development costs, land acquisition, planning approvals, construction and infrastructure charges are fixed and cannot be reduced if returns fall.

At current prices and rents, the project is only just viable. It proceeds because a group of investors is willing to purchase around 50 of the apartments off the plan, accepting modest initial rental losses and development risk in return for expected long-term returns.

If tax changes reduce after-tax returns, even slightly, those investors reassess their participation. A small number withdraw, reducing pre-sales below the bank's required threshold. Finance is no longer approved and the project is delayed or cancelled.

Importantly, this outcome does not require most investors to leave the housing market. Existing investors continue to hold their properties. However, the loss of marginal investor participation is sufficient to stop a new housing project from proceeding. The result is 120 fewer dwellings added to the housing stock, including a substantial number of rental homes.

This example illustrates how housing supply is determined at the margin. Small changes in investor incentives can prevent new projects from proceeding, particularly in higher-risk segments of the market, leading to a disproportionately large reduction in new housing supply.

While build-to-sell projects can partially manage risk through pre-sales and staged settlement, build-to-rent developments rely entirely on long-term after-tax rental income and asset values. As a result, even small

changes to investor taxation or regulatory settings can determine whether a build-to-rent project proceeds at all.

Box 2: Marginal capital and Build-to-Rent projects

Build-to-rent developments differ from traditional apartment projects because the dwellings are not sold individually. Instead, a single investor or consortium finances the entire project and relies on long-term rental income to recover costs and earn a return.

Consider a build-to-rent project comprising 300 apartments in a middle-ring urban location.

The project requires very large upfront capital commitments, covering land acquisition, planning approvals, construction costs, financing and ongoing management. Unlike a build-to-sell project, there are no pre-sales to reduce risk. The viability of the project depends almost entirely on expected long-term after-tax returns from rental income and the eventual value of the asset.

At existing rents and construction costs, the project is marginally viable. It proceeds because institutional and private investors are willing to accept lower early returns in exchange for long-term, stable income and capital appreciation.

If tax changes reduce after-tax returns on housing investment, even modestly, the project may no longer meet required return thresholds. Because costs are largely fixed and rents cannot be increased immediately without affecting occupancy, the investor withdraws. There is no alternative buyer to step in, and the project does not proceed.

Importantly, this outcome does not reflect a lack of demand for rental housing. Demand remains strong. Nor does it require a broad exit of investors from the housing market. It reflects the withdrawal of marginal capital from a single large project.

The consequence is that 300 rental dwellings are never built. Unlike established housing, there is no existing stock to absorb demand. The lost supply places additional pressure on rents across the broader market.

This example illustrates why build-to-rent is particularly sensitive to tax and regulatory settings. Policies that weaken investor incentives, even slightly, can prevent large rental projects from proceeding, leading to significant and long-lasting reductions in housing supply.

4.6 Implications for affordability and policy design

The role investors play in expanding housing supply has direct implications for housing affordability. Policies that weaken investor incentives in a supply-constrained environment are likely to reduce the flow of new dwellings, exacerbating shortages and placing upward pressure on rents.

This does not imply that all forms of housing investment are equally beneficial or that tax settings should be immune from scrutiny. It does, however, mean that investor taxation cannot be evaluated solely on distributional or demand-side grounds. The supply response, or lack thereof, is central to understanding long-run outcomes.

The following chapter examines negative gearing in detail, clarifying what it is, how it operates across the tax system, and why it plays a role in supporting housing investment under Australia's current tax and financing arrangements.

5. Negative Gearing, What It Is and What It Is Not

Negative gearing is one of the most frequently cited and least well-understood features of Australia's housing tax system. Public discussion often treats it as a bespoke concession designed to favour property investors. In practice, negative gearing reflects a foundational principle of income taxation, the deductibility of costs incurred in generating assessable income. Mischaracterising this principle risks obscuring how the tax system functions and how changes to it affect housing supply.

This chapter explains what negative gearing is, how it operates across asset classes, and why its interaction with housing investment matters in a supply-constrained market.

5.1 Negative gearing as loss deductibility

Negative gearing occurs when the allowable deductions associated with an income-producing asset exceed the income generated by that asset in a given period. The resulting net loss can be offset against other assessable income, reducing total tax payable.

This treatment is not unique to housing. It applies broadly across the tax system to business investment, financial assets and other forms of income-producing activity. Interest costs, depreciation and operating expenses are generally deductible because they are incurred in the process of earning income.

In this sense, negative gearing is not a targeted subsidy for housing investment. It is a consequence of allowing costs to be deducted when income is earned on a net basis rather than a gross basis. Removing loss deductibility for one class of investment while retaining it for others would represent a departure from tax neutrality.

5.2 Why housing investment often involves early losses

Housing investment is characterised by large upfront capital costs, long holding periods and relatively stable income streams. In the early years of ownership, it is common for interest expenses and other costs to exceed rental income, particularly where borrowing is used to finance the purchase.

Over time, as rents rise and debt is repaid, many investments transition from being negatively geared to positively geared. This pattern reflects the time profile of costs and income rather than aggressive tax planning. In inflationary environments, this transition tends to occur more quickly, as rental income increases while nominal debt remains fixed.

Negative gearing therefore plays a role in smoothing the tax treatment of investment over time, allowing investors to deduct costs when they are incurred rather than only when income exceeds expenses.

5.3 Interaction with financing and interest rates

The prevalence of negative gearing is closely linked to interest rates and financing conditions. When interest rates are high, a larger share of housing investments will be negatively geared. When rates fall, fewer investments generate net losses.

This relationship highlights an important point, that negative gearing is not a static or fixed cost to the budget. Its fiscal impact varies with macroeconomic conditions. Periods of low interest rates reduce the aggregate value of deductions, while periods of higher rates increase them.

Policies that restrict loss deductibility therefore amplify the sensitivity of housing investment to interest rate movements. In higher rate environments, the effective cost of borrowing for housing investment rises sharply if deductions are limited, increasing the likelihood that projects become unviable.

5.4 Negative gearing and housing supply

From a housing supply perspective, the significance of negative gearing lies in its effect on after-tax returns, particularly for marginal investments. As discussed in earlier chapters, new housing supply is often delivered at or near feasibility thresholds, especially in higher-density developments with high fixed costs.

Allowing losses to be deducted reduces the risk borne by investors in the early stages of a project, improving the expected return profile over the life of the investment. This can be decisive in enabling projects to proceed, particularly where rental income is initially low relative to costs.

Conversely, restricting loss deductibility raises the required pre-tax return needed to justify investment. In supply-constrained markets, where construction costs cannot easily be reduced, this adjustment tends to occur through reduced construction activity rather than sustained reductions in prices.

5.5 Negative gearing is not a demand-side lever in isolation

Negative gearing is often discussed as if it operates solely by increasing demand for existing dwellings. This view neglects its role in financing new supply and its interaction with other constraints.

Where housing supply is responsive, increased demand may be met through additional construction. Where supply is constrained, demand pressures are capitalised into prices and rents. In Australia's current environment, the primary effect of weakening investor incentives is therefore to reduce the flow of new dwellings rather than to permanently suppress prices.

This distinction is critical when assessing policy proposals. Measures that reduce investor demand will, in isolation, worsen the underlying supply constraints and may worsen rental outcomes.

5.6 Distinguishing tax neutrality from tax preference

It is important to distinguish between tax neutrality and tax preference. Neutral tax treatment seeks to apply consistent rules across different forms of investment, allowing capital to flow to its most productive use. Tax preferences, by contrast, provide targeted advantages to specific activities.

Negative gearing arises from neutral application of loss deductibility, not from a housing-specific preference. While housing investment may benefit from other aspects of the tax system, such as capital gains tax treatment, loss deductibility itself reflects general income tax principles.

Any proposal to alter negative gearing should therefore be assessed not only on its distributional effects, but on whether it introduces distortions that reduce investment efficiency and housing supply.

5.7 Implications for reform

Reform proposals that focus narrowly on negative gearing risk treating a symptom rather than a cause. The prevalence of negatively geared investment reflects financing structures, interest rates and supply constraints. Addressing housing affordability requires tackling these underlying drivers rather than selectively removing core elements of the tax system.

The next chapter examines the capital gains tax discount and the reforms introduced in 1999, which are often cited alongside negative gearing as evidence that housing investment is over-favoured. Understanding the purpose and effect of those reforms is essential to evaluating current policy proposals.

6. Capital Gains Tax, the 1999 Reform and the Discount

Few aspects of Australia's housing tax system attract as much attention as the capital gains tax (CGT) discount introduced in 1999. Critics frequently argue that the shift from indexation to a 50 per cent discount represented a substantial tax concession for investors and that it materially contributed to rising house prices. This chapter examines the origins of that reform, its intended purpose, and the evidence surrounding its impact.

6.1 Capital gains tax prior to 1999

Before 1999, Australia's capital gains tax system applied indexation to the cost base of assets held for more than one year. This approach sought to tax real capital gains by adjusting the purchase price for inflation. In principle, indexation prevented inflation-driven increases in asset values from being taxed as income.

In practice, indexation added significant complexity to the tax system. It required tracking inflation adjustments over long holding periods and produced uneven outcomes across assets and taxpayers. Moreover, indexation did not eliminate distortions entirely, particularly where marginal tax rates were high or where inflation diverged from asset-specific price movements.

The pre-1999 system therefore traded conceptual precision for administrative complexity, with limited transparency for taxpayers and policymakers.

6.2 The rationale for the 1999 reform

The 1999 reform replaced indexation with a flat 50 per cent discount for individuals and trusts on capital gains from assets held for more than twelve months. The primary objectives of the reform were simplification, certainty and improved efficiency.

By applying a uniform discount, the system reduced compliance costs and made the tax treatment of capital gains more predictable. It also sought to address the taxation of nominal gains in a way that broadly approximated the effect of indexation over typical holding periods and inflation environments. Specifically, the new and old methods would produce the same tax outcomes where inflation (say 2.5 per cent) was half the size of the asset's nominal gain (say 5 per cent) – a reasonable assumption. In fact, given the 1990s saw average dwelling price increases of just 3.5 per cent per year, with inflation around 2.5 per cent, government would actually earn more tax revenue under the new arrangements if such price and inflation dynamics persisted.

Importantly, the reform was not specific to housing. It applied across asset classes, including shares, businesses and other investments. Framing the change as a housing-specific concession therefore misrepresents its scope and intent.

6.3 Effective tax rates and inflation

Assessing whether the CGT discount represents a reduction in tax requires examining effective tax rates rather than headline discounts. Under indexation, the tax paid depended on inflation over the holding period. In low-inflation environments, indexation provided relatively little relief from nominal gains. In higher-inflation environments, it provided more.

The discount approach delivers a fixed proportionate reduction in taxable gains regardless of inflation. Over long holding periods and moderate inflation, the effective tax burden under a discount can be similar to or higher than that under indexation. Over shorter holding periods or very low inflation, it can be more generous.

The shift from indexation to a discount therefore did not unambiguously lower effective tax rates on capital gains. Its impact varies with inflation, holding periods and marginal tax rates. Claims that the reform constituted a straightforward tax cut for investors oversimplify this reality.

6.4 The CGT discount and housing investment

Housing is often singled out in discussions of the CGT discount because capital gains form a significant component of long-term housing returns. However, this characteristic is not unique to housing. Many long-lived assets generate returns through a combination of income and capital appreciation.

The treatment of capital gains must also be considered alongside other elements of the tax system. In Australia, owner-occupied housing is exempt from capital gains tax entirely. This exemption represents the

most significant departure from neutrality in the housing tax system and has a far larger influence on household behaviour than the CGT discount applying to investors.

Focusing on the investor CGT discount without acknowledging the owner-occupier exemption risks misidentifying the source of distortions within the housing market.

6.5 Correlation versus causation since 2000

It is frequently observed that real house prices in Australia increased more rapidly after 2000 than in preceding decades. While this timing coincides with the CGT reform, coincidence does not establish causation.

Over the same period, similar or greater increases in house prices occurred across most advanced economies, including those with very different housing tax systems. Common factors included declining long-term interest rates, financial deregulation, population growth, urbanisation and increasingly constrained housing supply.

If the CGT reform were the primary driver of price growth, one would expect Australia's experience to diverge markedly from that of comparable countries. The absence of such divergence strongly suggests that broader structural and macroeconomic forces were dominant.

6.6 Would reversing the reform reverse the outcome?

A useful test of causal claims is to consider their logical implications. If the CGT discount introduced in 1999 were the primary cause of housing affordability pressures, reversing it should materially improve affordability outcomes but advocates of changing the CGT method are not proposing this change. This indicates that the changes that occurred in 2000 were neither the cause of, nor solution to the supply shortages.

6.7 The CGT discount in the broader tax mix

Capital income is inherently mobile and sensitive to taxation. High effective tax rates on capital gains can discourage investment, encourage lock-in behaviour and reduce economic efficiency.

Tax reviews, including the Henry Review, have consistently emphasised the importance of neutrality, simplicity and efficiency in capital income taxation. While no system achieves these objectives perfectly, selective changes to the CGT discount risk introducing new distortions without addressing the structural drivers of housing affordability.

6.8 Implications for policy debate

Debate over the CGT discount often conflates simplification with concession and correlation with causation. A more rigorous assessment shows that the 1999 reform was a system-wide change aimed at improving tax administration and investment efficiency, not a targeted stimulus to housing demand.

Evaluating housing affordability policy through the lens of CGT alone risks overlooking the dominant influences on housing outcomes, particularly supply constraints and population dynamics. The next chapter formalises this point by examining housing price trends internationally and demonstrating why Australia's experience since 2000 is not exceptional.

7. Correlation Is Not Causation, Housing Prices Since 2000

A central claim in contemporary housing debates is that changes to Australia's housing tax arrangements around 1999–2000 triggered a sustained increase in house prices relative to incomes. This claim rests largely on the observation that real house prices accelerated after this period. While the timing is often presented as self-evident proof of causation, such reasoning does not withstand closer scrutiny.

This chapter examines housing price trends since 2000 in Australia and comparable economies, demonstrating why attributing post-2000 price growth to specific domestic tax changes is analytically weak.

7.1 Australia's post-2000 housing experience

There is no dispute that Australian house prices increased more rapidly after 2000 than in earlier decades, particularly when measured relative to household incomes. This period coincided with rising household debt, greater use of mortgage finance, and increased investor participation in the housing market.

However, identifying a temporal association is only the first step in policy analysis. Establishing causation requires evidence that the proposed driver uniquely explains observed outcomes, operates through plausible mechanisms, and produces effects that are not better explained by alternative factors.

When assessed against these criteria, claims that the CGT discount or negative gearing were the primary drivers of post-2000 price growth fall short.

7.2 International housing price trends

Australia's housing price trajectory since 2000 closely mirrors that of many other advanced economies. Real house prices rose sharply across the United Kingdom, Canada, New Zealand, the United States and much of Europe over the same period. In several cases, price growth exceeded that observed in Australia.

These countries differ markedly in their housing tax arrangements. Some tax capital gains on primary residences, others do not. Some allow mortgage interest deductibility for owner-occupiers, others restrict it. Some limit loss deductibility for investors, others permit it fully. Despite these differences, the broad pattern of housing price growth was shared.

This convergence strongly suggests that common global forces, rather than country-specific tax settings, were the dominant drivers of housing price outcomes.

7.3 Common drivers across advanced economies

Several structural and macroeconomic factors were present across advanced economies in the post-2000 period:

- A sustained decline in long-term interest rates, reducing borrowing costs and increasing borrowing capacity
- Financial deregulation and innovation, expanding access to mortgage credit
- Strong population growth and urbanisation in major cities
- Increasing constraints on housing supply due to planning, zoning and infrastructure limitations

These factors affect housing markets through well-understood mechanisms. Lower interest rates increase the present value of housing services and expand households' ability to bid for dwellings. Supply constraints limit the capacity of new construction to absorb demand pressures, leading to price escalation rather than volume expansion.

Importantly, these drivers operated regardless of local tax arrangements.

7.4 Why tax timing is a weak identification strategy

Attributing price growth to tax changes based solely on timing risks a fundamental error in policy analysis. Many significant economic changes occurred around the turn of the century, including shifts in monetary policy frameworks, financial market integration and demographic trends.

A credible causal claim would require evidence that Australia's housing market diverged from international trends following the tax change, or that price growth accelerated more sharply in investor-heavy segments than elsewhere in ways not observed overseas. Such evidence is lacking.

Moreover, within Australia, price growth varied significantly across regions and dwelling types, with the strongest increases often occurring where supply constraints were most binding. This spatial variation aligns more closely with planning and land supply constraints than with uniform national tax settings.

7.5 The role of investor participation

Investor participation in the housing market increased after 2000, but this too must be interpreted carefully. Rising prices, falling interest rates and expanding credit all increase the attractiveness of housing investment. In this sense, increased investor activity may be better understood as a response to broader market conditions rather than a cause of them.

Treating investor participation as an exogenous driver reverses the direction of causality. Investors respond to expected returns shaped by macroeconomic and structural conditions. Tax settings influence these returns at the margin, but they do not operate in isolation.

7.6 The danger of policy misattribution

Misattributing housing price growth to tax settings carries significant policy risks. If prices are primarily driven by supply constraints and macroeconomic factors, policies that focus narrowly on investor taxation are unlikely to address the underlying imbalance. Worse, they may exacerbate it by reducing the flow of new housing.

This risk is not theoretical. Historical experience and modelling consistently show that measures aimed at suppressing investment demand in an environment of constrained supply, tend to have limited effects on prices and more persistent effects on rents and construction activity.

7.7 Implications for reform narratives

The correlation between post-2000 tax settings and housing price growth does not establish causation. International evidence indicates that Australia's experience is part of a broader pattern affecting advanced economies with diverse tax systems.

Policy debate should therefore move beyond simplified narratives and focus on the mechanisms that actually shape housing outcomes. These include supply constraints, financing conditions and population dynamics, all of which interact with tax settings in complex ways.

The next chapter examines how international comparisons are often misused in the housing tax debate and why importing individual elements of overseas tax systems without their broader context is unlikely to improve housing affordability.

8. International Comparisons, What Is Actually Comparable?

International comparisons are frequently invoked in debates about housing taxation, particularly in arguments that Australia's negative gearing arrangements are unusual or uniquely generous. While cross-country analysis can be valuable, it is often applied selectively and without sufficient attention to the broader tax and housing systems in which individual policy settings operate.

This chapter establishes a framework for assessing international housing tax arrangements in a way that is analytically valid and relevant to Australian policy considerations.

8.1 Why international comparisons are often misleading

Tax systems are not collections of independent policy levers. They are integrated structures in which individual elements interact to shape behaviour. Housing taxation, in particular, reflects a combination of income tax, capital gains tax, property taxes, transaction taxes, and housing finance rules.

Comparisons that isolate one element, such as the treatment of investor losses, while ignoring others, risk drawing incorrect conclusions. For example, focusing solely on restrictions on negative gearing in one country without acknowledging heavier taxation of owner-occupied housing or more generous mortgage interest deductibility elsewhere presents a distorted picture.

Valid international comparison requires examining the entire package of housing-related taxes and incentives, not individual components in isolation.

8.2 Negative gearing as an international norm

Contrary to common claims, the deductibility of costs incurred in earning rental income is not unique to Australia. Most advanced economies allow some form of deduction for interest and operating expenses associated with rental property. Differences across jurisdictions typically relate to the scope, timing or limitations of these deductions rather than their existence.

Where countries restrict loss offsetting, this is often balanced by other features, such as lower marginal tax rates, different capital gains treatment, or broader tax bases that include owner-occupied housing. Treating negative gearing as an anomaly therefore misrepresents international practice.

8.3 Owner-occupied housing and capital gains

One of the most significant differences between Australia and many other countries lies in the treatment of owner-occupied housing. Australia exempts principal residences from capital gains tax entirely. In contrast, several advanced economies tax capital gains on owner-occupied housing, sometimes subject to thresholds, holding period requirements or partial exemptions.

This distinction has important implications for household behaviour. Exempting owner-occupied housing from capital gains tax encourages investment in housing as a store of wealth and favours owner-occupation over other forms of investment. In this context, focusing reform efforts on investor taxation while leaving owner-occupier treatment unchanged addresses only part of the system and may exacerbate distortions.

8.4 Mortgage interest deductibility and housing finance

Another commonly overlooked difference across countries is the treatment of mortgage interest. In some jurisdictions, owner-occupiers are permitted to deduct mortgage interest from taxable income, either fully or partially. In others, such deductions have been phased out or limited over time.

Allowing mortgage interest deductibility for owner-occupiers materially reduces the after-tax cost of housing finance and can support higher house prices without necessarily increasing supply. Countries that limit investor deductions but allow owner-occupier interest deductibility are therefore not directly comparable to Australia, where owner-occupier interest is not deductible.

8.5 Property taxes and transaction costs

Recurrent property taxes and transaction taxes also vary significantly across countries. Jurisdictions with higher annual property taxes often rely less on transaction taxes such as stamp duty. Others impose lower recurrent taxes but higher upfront charges.

These differences affect holding decisions, turnover, and housing mobility. They also influence how sensitive housing markets are to changes in other tax settings. Comparing investor taxation without accounting for these factors provides an incomplete picture of housing incentives.

8.6 The importance of supply institutions

Beyond taxation, housing outcomes depend critically on supply institutions. Planning systems, land ownership structures, infrastructure funding models and construction industries differ markedly across countries. A tax setting that operates benignly in a flexible supply environment may have very different effects in a constrained one.

International evidence shows that countries with more responsive planning systems tend to experience smaller price effects from demand-side shocks, regardless of tax treatment. Conversely, countries with rigid supply systems experience greater price volatility even under diverse tax regimes.

8.7 A framework for valid comparison

To assess whether an international housing tax arrangement offers relevant lessons for Australia, several questions must be addressed:

- How is owner-occupied housing taxed, including capital gains and interest deductibility?
- How are investor losses treated, and what limits apply?
- What is the effective tax rate on capital gains over typical holding periods?
- What recurrent property and transaction taxes apply?
- How responsive is housing supply to changes in demand or incentives?

Without addressing each of these elements, international comparisons risk becoming rhetorical devices rather than tools for sound policy design.

8.8 Implications for Australian policy debate

Australia's housing tax system reflects a particular balance between simplicity, equity, efficiency and investment incentives. No advanced economy offers a perfect model that can be transplanted wholesale. Attempts to import isolated elements of foreign systems without their broader context risk destabilising investment incentives and worsening housing outcomes.

The next chapter applies this framework to selected international case studies, demonstrating how housing tax packages operate in practice and why selective borrowing of overseas policies is unlikely to improve housing affordability in Australia.

9. Case Studies, Tax Packages Not Tax Fragments

International housing tax systems are frequently invoked in Australian policy debates as evidence that investor taxation can be tightened without adverse consequences for housing supply or rental markets. These comparisons typically focus on individual tax settings in isolation, such as restrictions on loss offsetting or interest deductibility, without proper consideration of the broader tax, housing and institutional systems in which they operate.

This chapter examines several commonly cited jurisdictions using a consistent analytical framework. It demonstrates that housing tax systems function as integrated packages, and that selective borrowing of individual elements without their wider context provides a misleading basis for reform.

9.1 United States

The United States is often cited as an example of a country that limits certain forms of investor loss offsetting while maintaining a large and liquid housing market. However, the US housing tax system differs fundamentally from Australia's across several important dimensions.

Capital gains tax applies to owner-occupied housing in the United States above specified thresholds, with exemptions limited by value and usage conditions. Mortgage interest on owner-occupied housing has historically been deductible, significantly reducing the after-tax cost of housing finance for households. While this deduction has been curtailed in recent years, it remains a material feature of the system.

Recurrent property taxes are levied annually by state and local governments and are materially higher than in Australia. These taxes increase the ongoing cost of holding housing assets and reduce reliance on transaction taxes such as stamp duty.

For investors, rental expenses including interest and operating costs are generally deductible against rental income, consistent with standard income tax principles. While restrictions apply to the offsetting of passive losses against other income, these operate within a broader system that taxes housing more comprehensively across tenures.

Taken together, these features mean that the US housing tax system spreads taxation more evenly between owner-occupiers and investors. Isolating one element, such as limits on loss offsetting, without recognising higher taxation elsewhere presents a misleading comparison.

9.2 United Kingdom

The United Kingdom has implemented significant changes to the taxation of housing investment over the past decade, including restrictions on mortgage interest deductibility for individual landlords.

These changes occurred within a system that already taxes capital gains on owner-occupied housing above certain thresholds and relies heavily on transaction taxes, particularly Stamp Duty Land Tax. Recurrent property taxes, such as council tax, apply broadly across tenures and represent a significant ongoing impost on housing.

Following the restriction of interest deductibility, individual investor participation declined and the composition of the private rental market shifted, with reduced activity by smaller landlords. At the same time, rental market pressures intensified in many regions, with rents rising faster than incomes.

While multiple factors influence rental outcomes, the UK experience illustrates how reducing investor incentives in a constrained supply environment can reduce rental supply and alter market structure, rather than deliver sustained improvements in affordability.

9.3 New Zealand

New Zealand provides a recent and instructive case study of investor tax reform implemented in a supply-constrained housing market.

In March 2021, the New Zealand Government commenced a phased removal of mortgage interest deductibility for residential landlords. The change applied to existing dwellings while retaining deductibility for new builds. The stated policy objective was to curb investor demand for existing housing without discouraging new supply.

Following the reform, investor participation in the housing market declined significantly. However, rents continued to rise and housing supply constraints remained binding. While house prices did fall during 2022,

this coincided with sharp increases in interest rates and broader macroeconomic tightening, making it difficult to attribute price movements to tax changes.

Importantly, Inland Revenue had advised at the time that denying interest deductibility was unlikely to improve housing affordability and carried a risk of placing upward pressure on rents. Subsequent outcomes were consistent with this assessment.

In April 2024, the New Zealand Government announced a full repeal of the interest deductibility restrictions. By 2025, landlords of both existing and new dwellings will once again be able to deduct 100 per cent of interest expenses. This reversal reflects recognition that the policy reduced tax system coherence, discouraged investment and failed to deliver the intended housing outcomes.

9.4 Canada

Canada allows the deductibility of rental expenses consistent with income tax principles and imposes capital gains tax on owner-occupied housing under certain conditions. Property taxation is more prominent at the municipal level, providing a recurrent revenue base that reduces reliance on transaction taxes.

Housing supply responsiveness varies significantly across Canadian cities. Markets with more flexible planning and land-use systems have experienced less extreme price growth, while more constrained cities have seen stronger price and rental pressures.

The Canadian experience highlights the importance of supply institutions in mediating the effects of tax settings. Where supply is more responsive, housing outcomes are less sensitive to specific tax arrangements. Where supply is constrained, tax changes have more pronounced effects on prices, rents and investment.

9.5 Lessons from the case studies

Across jurisdictions, several consistent themes emerge:

- Deductibility of costs incurred in earning rental income is common across advanced economies, even where other investor tax settings differ.
- Countries that restrict investor deductions often tax housing more comprehensively elsewhere, particularly owner-occupied housing.
- Selective investor tax changes in supply-constrained markets tend to reduce investment and place upward pressure on rents.
- Housing outcomes depend as much on planning systems and supply responsiveness as on tax policy design.

These findings reinforce the central argument of this report, that housing tax systems operate as integrated packages. Selective borrowing of individual elements without their broader context is unlikely to improve affordability and risks undermining housing supply.

9.6 Implications for Australian reform proposals

Proposals to tighten negative gearing or increase capital gains tax frequently cite international examples as justification. When examined, these examples do not support the claim that such changes can be implemented in isolation without affecting housing supply and rental markets.

Australia's housing tax system reflects a particular balance of incentives shaped by its broader institutional context. Altering one component without addressing others risks unintended consequences that undermine housing affordability objectives.

10. What International Evidence Really Says About Housing Outcomes

Claims that tightening tax settings for housing investors will materially improve affordability are often made with confidence but limited reference to empirical outcomes. International experience provides a substantial body of evidence on how housing markets respond to changes in investor taxation. When examined carefully, this evidence points to a consistent pattern, changes to investor incentives have modest and often temporary effects on purchase prices, but more persistent and adverse effects on rental supply and construction activity.

This chapter synthesises international case studies, historical experience and economic modelling to assess what investor tax reforms actually deliver in practice.

10.1 Prices, short-run adjustment versus long-run outcomes

In the short run, changes to investor taxation can affect transaction volumes and market sentiment. Reduced investor demand may lead to a temporary slowing in price growth or small price corrections in certain market segments, particularly for established dwellings favoured by investors.

However, these effects tend to be limited and uneven. Housing prices are influenced by a wide range of factors, including interest rates, income growth, population dynamics and supply constraints. Tax changes that affect one class of buyer rarely dominate these broader forces.

International evidence shows that any short-term price moderation following investor tax changes is often reversed over time as underlying demand continues to grow and supply fails to respond. Where supply constraints remain binding, prices resume their upward trajectory once markets adjust to the new settings.

10.2 Construction activity and investment response

The clearest and most consistent effect of tightening investor tax settings is a reduction in housing investment and construction activity. This response reflects the sensitivity of marginal projects to changes in expected after-tax returns.

Developments that rely on investor participation, particularly higher-density and rental-oriented projects, are most affected. Where investor demand weakens, pre-sales fall, financing becomes harder to secure, and projects are delayed or cancelled.

Evidence from the United Kingdom and New Zealand illustrates this pattern. In both cases, investor participation declined following tax changes, and construction activity in investor-dependent segments weakened. These effects were most pronounced in markets where supply was already constrained and development costs were high.

10.3 Rental markets and supply pressures

Rental markets are where the long-run consequences of investor tax changes are most apparent. Reductions in investor participation translate directly into reduced rental supply, either through fewer new dwellings being built or existing dwellings being withdrawn from the rental market.

International experience shows that rents tend to rise following investor tax tightening, particularly in high-demand urban areas. While rent increases may lag policy changes, reflecting existing lease arrangements and stock turnover, the medium-term effect is consistently upward pressure on rents.

This outcome is not contingent on assumptions about investor behaviour. Demand for rental housing does not disappear when investor incentives are reduced. Instead, demand is redistributed across a smaller pool of available dwellings, increasing competition and rents.

10.4 Homeownership outcomes

A common justification for tightening investor tax settings is the expectation that reduced investor participation will improve access for first home buyers. The evidence does not support this claim in a sustained way.

While some first home buyers may face less competition in specific segments of the established housing market, broader affordability constraints remain. Deposit requirements, borrowing capacity and supply limitations continue to shape access to homeownership.

In jurisdictions where investor tax reforms have been implemented, there is little evidence of a lasting increase in homeownership rates attributable to those changes. In some cases, higher rents have made saving for a deposit more difficult, offsetting any short-term benefits from reduced investor competition.

10.5 Distributional effects and unintended consequences

Investor tax reforms are often framed as progressive measures that improve equity. In practice, the distributional effects are mixed and often regressive.

Higher rents disproportionately affect lower-income households, who are more likely to rent and spend a larger share of their income on housing. Reduced construction activity also affects employment in the construction sector and related industries, with flow-on effects for wages and economic activity.

Economic modelling commissioned by housing and economic agencies consistently shows that the burden of investor tax changes is borne largely by renters over time, rather than by investors or higher-income households alone.

10.6 Why outcomes differ from reform expectations

The divergence between reform expectations and observed outcomes reflects a misunderstanding of how housing markets adjust. Prices, rents and construction are jointly determined, and policy changes affect each through different channels and timeframes.

Reform narratives often assume that reducing investor demand will lead to lower prices without materially affecting supply. In supply-constrained markets, this assumption does not hold. Supply responses dominate long-run outcomes, and policies that reduce investment tend to worsen shortages rather than alleviate them.

10.7 Implications for Australian policy

The international evidence suggests that tightening negative gearing or reducing the CGT discount is unlikely to deliver sustained improvements in housing affordability in Australia. Any short-term price effects are likely to be modest and temporary, while the longer-term impacts on construction and rents would exacerbate existing supply imbalances.

In Australia's current context, where housing supply responsiveness is already weak, policies that further discourage investment risk deepening affordability challenges rather than resolving them.

The next chapter examines the fiscal dimension of investor tax reform, assessing claims about budget savings and considering the broader economic and revenue consequences of reduced housing investment.

11. Selective Capital Gains Tax Reform, the 2019 Proposal and Its Implications for Housing Supply

In the lead-up to the 2019 federal election, the Australian Labor Party proposed significant changes to the capital gains tax (CGT) discount as part of its housing and tax policy platform. The proposal included two key elements, a reduction in the CGT discount from 50 per cent to 25 per cent, with grandfathering of existing assets, and the retention of the 50 per cent discount for investments in newly constructed housing.

These measures were presented as a way to improve housing affordability while protecting existing investors and encouraging new supply. This chapter examines those proposals and explains why, taken together, they would have delivered poorer housing and fiscal outcomes.

11.1 The proposed reduction in the CGT discount

The proposal to reduce the CGT discount from 50 per cent to 25 per cent was framed as a measure to improve fairness and reduce tax concessions for investors. In response to concerns raised during the policy debate, including by HIA, the proposal was subsequently amended to apply only to assets acquired after the policy commencement date, with existing investments grandfathered.

While grandfathering was intended to limit market disruption, it significantly weakened the effectiveness of the policy in achieving its stated objectives.

11.2 Grandfathering and delayed revenue effects

Grandfathering ensures that existing investors face no change in tax treatment, while new investors are subject to higher effective tax rates. This structure has two important consequences.

First, it delays any material revenue gain for government. Capital gains tax is realised only when assets are sold. Under a grandfathered regime, the bulk of housing assets would continue to be taxed under the existing discount for many years, potentially decades. Any increase in revenue would therefore occur slowly and unpredictably, well beyond the forward estimates period.

Second, grandfathering discourages behavioural change. Existing investors have no incentive to alter their investment decisions, while new investors face higher tax burdens. This bifurcation of the market entrenches existing ownership patterns rather than improving affordability or increasing turnover.

From a policy perspective, this represents the worst of both worlds, limited revenue gain and minimal impact on prices or investor behaviour, combined with increased complexity and uncertainty.

11.3 Market segmentation and investment distortion

By applying different tax treatments to assets based on acquisition date, the proposal would have segmented the housing market. Identical dwellings would face different tax outcomes depending on when they were purchased. Such segmentation increases complexity, reduces transparency, and distorts investment decisions without improving housing outcomes.

Rather than reallocating capital toward more productive uses, the policy would have discouraged new investment while leaving existing asset holders largely unaffected.

11.4 Retaining the 50 per cent discount for new housing

In response to criticism that higher CGT would reduce housing supply, the proposal included an exception, investments in newly constructed housing would continue to receive the 50 per cent discount. The intention was to protect incentives for new supply while discouraging investment in established housing.

While superficially attractive, this logic does not align with how housing markets and supply chains operate in practice.

11.5 Why taxing established housing more heavily reduces new supply

New housing does not exist in isolation from the established housing market. The two are part of a single, integrated system. Every new dwelling becomes an established dwelling once constructed, and the value of new housing is anchored to prices in the established market.

Increasing the tax burden on established housing lowers the after-tax value of housing assets overall. This reduces expected returns across the entire housing market, including for new construction. Developers and

investors do not assess projects solely on their initial tax treatment, but on the full lifecycle of the asset, including eventual resale.

By increasing taxation on established housing, the policy would have reduced the expected terminal value of new dwellings, thereby lowering feasibility and discouraging construction.

The analogy is straightforward. Taxing used cars more heavily does not stimulate new car production. It reduces the resale value of cars overall, weakening short term demand for new vehicles, until weakened supply and ongoing long term demand send prices back up again. Housing operates in the same way.

11.6 Evidence from economic modelling

Independent modelling, including that undertaken by Qaive and Tulipwood, demonstrates that selectively taxing established housing more heavily than new housing does not increase supply. Instead, it reduces overall investment in housing by lowering after-tax returns and increasing risk.

The modelling shows that investor capital does not automatically reallocate from established housing into new construction. Rather, it reallocates away from housing entirely into other asset classes. The net effect is fewer new homes being built, reduced rental supply and upward pressure on rents.

This finding directly contradicts the assumption underpinning the 2019 proposal and similar proposals advanced since.

11.7 Behavioural responses and unintended consequences

The proposal assumed that investors would respond mechanically to tax differentials by favouring new housing. In reality, investors consider a range of factors, including risk, liquidity, location, rental demand and resale value. Increasing tax complexity and uncertainty reduces the attractiveness of housing investment as a whole.

Selective tax treatment also increases compliance costs and encourages tax planning rather than productive investment. These effects further undermine supply outcomes.

11.8 Implications for current policy debates

Variants of the 2019 proposal continue to be advocated, including calls to limit tax concessions for established housing while preserving them for new supply. The evidence suggests that such approaches are counterproductive.

Housing supply is best supported by policies that increase investment across the entire housing market, not by selectively penalising one segment in the hope that capital will redirect neatly into another.

11.9 Conclusion

The 2019 proposal to reduce the CGT discount, even with grandfathering and exemptions for new housing, would have delivered limited fiscal benefits while weakening incentives to invest in housing. By increasing taxation on established housing, it would have reduced the expected returns to new construction and impaired housing supply.

The lesson from this episode is clear. If the policy objective is to increase housing supply, the solution is to encourage more investment in housing overall, not less. This requires stable, neutral and predictable tax settings that support investment across all housing segments, rather than selective measures that distort markets and undermine supply.

The Henry Tax Review and housing investment

The Australia's Future Tax System Review (the Henry Tax Review) undertook a comprehensive assessment of Australia's tax system, including the treatment of housing, negative gearing and capital gains tax. Importantly, the Review did not consider these settings in isolation, but examined their interaction with housing supply, investment incentives and broader economic efficiency.

The Review acknowledged that negative gearing and the capital gains tax discount influence investment decisions and asset allocation. However, it also recognised that housing outcomes are fundamentally shaped by supply responsiveness. The Review observed that where housing supply is constrained, changes to tax settings affecting demand or investment are more likely to be capitalised into prices and rents rather than result in improved affordability.

For this reason, the Henry Review concluded that reforms to negative gearing or capital gains tax should not be pursued ahead of measures to address housing supply constraints. It cautioned that altering investor tax

settings in a supply-constrained environment risked reducing investment in new housing and worsening outcomes in the rental market.

The Review's recommended policy sequencing was clear. Structural impediments to housing supply, including planning and land use restrictions, infrastructure provision and regulatory barriers, should be addressed first. Only once supply responsiveness had improved would it be appropriate to reconsider tax settings affecting housing investment.

This conclusion reflects a central theme of the Review, that tax reform should enhance efficiency and neutrality without undermining productive investment. In the context of housing, the Review recognised that investor participation plays a critical role in expanding supply and that destabilising investment incentives will, in isolation, be counterproductive, worsening underlying supply constraints.

Box 1: Henry Tax Review – Tax Reform Must Follow Supply Reform

The Australia's Future Tax System Review (the Henry Tax Review) examined the treatment of housing, negative gearing and capital gains tax as part of a comprehensive assessment of Australia's tax system.

The Review acknowledged that negative gearing and the capital gains tax discount influence housing investment decisions. However, it emphasised that housing affordability outcomes are driven primarily by the responsiveness of housing supply.

The Review cautioned that where housing supply is constrained, changes to tax settings affecting housing investment are likely to be capitalised into prices and rents or reduce investment in new housing, rather than improve affordability.

For this reason, the Henry Review concluded that reforms to negative gearing or capital gains tax should not be pursued until structural barriers to housing supply have been addressed. These barriers include planning and land use restrictions, infrastructure provision and regulatory impediments that limit the ability of the housing market to respond to demand.

The Review's recommended sequencing was clear. Improving housing supply responsiveness should precede any reconsideration of tax settings affecting housing investment, to avoid unintended consequences for new housing construction and rental markets.

12. Budget Savings Versus Economic Reality

Proposals to alter negative gearing or the capital gains tax discount are frequently justified on the basis of projected budget savings. Estimates of foregone revenue are often presented as resources that could be redirected to other housing initiatives, including social and affordable housing. While fiscal impacts are an important consideration, headline revenue estimates provide an incomplete and potentially misleading guide to the economic consequences of investor tax reform.

This chapter examines the distinction between first-round budget effects and broader economic outcomes, and explains why reduced housing investment can ultimately weaken, rather than strengthen, public finances.

12.1 First-round revenue estimates

Budget savings associated with changes to negative gearing or the CGT discount are typically calculated on a static basis. These estimates assume that taxpayer behaviour remains unchanged and that investment patterns are unaffected. Under this approach, limiting loss deductibility or increasing the effective tax rate on capital gains appears to generate substantial additional revenue.

While such estimates may be useful for illustrative purposes, they do not reflect how investors, developers and households respond to changes in incentives. Housing investment is highly sensitive to after-tax returns, particularly at the margin. Ignoring behavioural responses therefore risks overstating revenue gains.

12.2 Behavioural responses and investment withdrawal

When investor tax settings become less favourable, capital does not remain fixed within the housing sector. Investors reallocate to alternative assets with higher after-tax returns or lower regulatory risk. This reallocation reduces the volume of new housing investment and alters the composition of economic activity.

Reduced housing investment has direct implications for tax revenue beyond the housing sector. Construction activity supports employment, wages and profits across a wide range of industries, including building materials, professional services, transport and retail. A slowdown in construction therefore reduces income tax receipts, payroll tax, company tax and indirect taxes.

These second-round effects can materially offset, or even outweigh, the initial revenue gains from higher investor taxation.

12.3 State and local government revenues

Housing investment is a major source of revenue for state and local governments through stamp duty, development contributions, land tax and rates. Reduced transaction volumes and slower construction activity diminish these revenue streams.

Stamp duty, in particular, is highly sensitive to housing market activity. Any policy change that reduces turnover or delays new development will reduce stamp duty collections. Similarly, fewer new dwellings translate into a smaller future base for recurrent property taxes and rates.

These impacts are often overlooked in federal budget discussions, despite their importance to overall public sector finances and infrastructure funding capacity.

12.4 The interaction with housing affordability programs

Advocates of investor tax reform often propose redirecting additional revenue into housing affordability initiatives. While increased funding for social or affordable housing can contribute to supply in specific segments, it does not substitute for the scale of private investment required to meet overall housing demand.

If investor tax reform reduces private housing construction by more than publicly funded programs can replace, the net effect is a reduction in housing supply. In such cases, higher public spending may coexist with worsening affordability outcomes, particularly in the private rental market.

Moreover, reduced construction activity can increase the per-unit cost of delivering publicly funded housing by diminishing economies of scale and increasing competition for scarce construction resources.

12.5 Economic modelling and net revenue effects

Economic modelling commissioned by housing and economic agencies consistently shows that the net fiscal impact of tightening investor tax settings is smaller than static estimates suggest. In some scenarios, the reduction in economic activity leads to lower overall tax collections across all levels of government.

These findings reflect the interconnected nature of housing investment and the broader economy. Housing construction is a significant driver of economic growth, and policies that constrain it have economy-wide consequences.

12.6 Short-term gains versus long-term sustainability

Even where investor tax reform produces short-term revenue gains, these must be weighed against longer-term risks. Reduced housing supply places upward pressure on rents, increasing demand for housing assistance and welfare payments. Higher housing costs can also constrain labour mobility and productivity, reducing economic growth and future tax capacity.

From a fiscal sustainability perspective, policies that weaken the housing supply pipeline risk creating ongoing pressures on public expenditure while eroding the tax base that supports it.

12.7 Implications for policy evaluation

Assessing investor tax reform solely through the lens of headline budget savings is inadequate. A comprehensive evaluation must consider behavioural responses, second-round economic effects, and the interaction between private and public housing supply.

In Australia's current housing context, where supply constraints are already binding, policies that reduce investment risk undermining both housing affordability and public finances. The next chapter examines how these economic effects translate into distributional outcomes and who ultimately bears the cost of investor tax changes.

13. Distributional Claims and Who Actually Bears the Cost

Changes to negative gearing and capital gains tax arrangements are frequently framed as measures to improve equity and reduce inequality. Proponents argue that tightening investor tax settings would primarily affect higher-income households and deliver benefits to renters and first home buyers. While these claims are intuitively appealing, they do not align well with how housing markets adjust over time.

This chapter examines who ultimately bears the cost of investor tax changes and why the long-run distributional effects often differ from those anticipated in policy debates.

13.1 Statutory incidence versus economic incidence

A key distinction in tax analysis is between statutory incidence, who is legally responsible for paying the tax, and economic incidence, who ultimately bears the cost once markets adjust. In housing markets, this distinction is particularly important because prices, rents and construction respond to changes in incentives.

While investors may face higher tax liabilities in a statutory sense, the economic burden of these changes is often shifted to others through reduced supply, higher rents or lower wages in construction-related industries. Evaluating distributional effects therefore requires tracing these adjustments over time.

13.2 Renters and rental affordability

Renters are frequently presented as the primary beneficiaries of investor tax reform. In practice, they are often the most adversely affected group.

Reduced investor participation leads to fewer rental dwellings being constructed and, in some cases, existing dwellings being withdrawn from the rental market. Demand for rental housing remains strong, particularly in urban labour markets. The resulting imbalance places upward pressure on rents.

Lower-income households, who are more likely to rent and spend a larger share of their income on housing, are therefore disproportionately affected. Higher rents also reduce the capacity of renter households to save for a deposit, delaying or preventing transition into homeownership.

13.3 First home buyers

First home buyers are often cited as intended beneficiaries of reduced investor competition. While some first home buyers may experience reduced competition for specific established dwellings in the short run, broader affordability constraints remain.

Deposit requirements, borrowing capacity and housing supply all continue to limit access to homeownership. Where investor tax reform leads to higher rents, the capacity of first home buyers to save is further eroded, offsetting any short-term price effects.

Empirical evidence from jurisdictions that have implemented investor tax reforms shows little sustained improvement in homeownership rates attributable to those changes.

13.4 Investors and income distribution

Housing investors are not exclusively high-income households. Many investors have moderate incomes and hold a single investment property, often as a long-term savings vehicle. While higher-income households are more likely to hold multiple properties, the distribution of investors is broader than is often assumed.

Tax changes that increase holding costs or reduce after-tax returns may disproportionately affect smaller, highly leveraged investors, who are more sensitive to changes in cash flow. This can accelerate investor exit without necessarily targeting speculative activity.

13.5 Construction workers and related industries

Reduced housing investment affects not only investors and tenants but also workers in the construction sector and associated industries. Slower construction activity translates into fewer jobs, reduced hours and weaker wage growth.

Construction employment spans a wide range of skill levels and regions, and downturns in housing activity can have pronounced local effects. These impacts are rarely incorporated into distributional assessments focused narrowly on investors and renters.

13.6 Intergenerational considerations

Intergenerational equity is often invoked in housing debates, with the argument that current tax settings favour older households at the expense of younger generations. While housing affordability is a genuine intergenerational issue, attributing it primarily to investor taxation oversimplifies the problem.

Younger households face affordability challenges largely because of constrained supply, high rents and high entry costs. Policies that reduce housing supply or increase rents risk worsening intergenerational outcomes rather than improving them.

13.7 Short-run versus long-run effects

Distributional assessments often focus on short-run effects, when price and transaction impacts are most visible. Over the longer run, supply responses dominate, and the burden of investor tax changes shifts toward renters and workers.

This temporal distinction is critical. Policies that appear progressive in the short term may prove regressive over time once market adjustments are complete.

13.8 Implications for equity-focused policy

Improving equity in housing outcomes requires policies that expand supply and reduce housing costs sustainably. Measures that constrain investment in a supply-limited system risk transferring costs to those least able to bear them.

The final chapter draws together the analysis in this report and sets out policy implications for improving housing affordability through supply-focused reform rather than isolated changes to investor taxation.

14. Policy Implications and Conclusion

14.1 Policy Implications and Conclusion

Australia's housing affordability challenge reflects a persistent structural imbalance between demand and supply. This report has shown that no single policy setting is responsible for this outcome. Rather, housing market pressures have emerged from the interaction of planning systems, infrastructure funding models, construction costs, population growth, financing conditions and taxation arrangements across all tiers of government.

Within this context, negative gearing and capital gains tax settings affecting housing investment are frequently presented as primary levers for improving affordability. The evidence examined in this report does not support that view.

14.2 Investor taxation and housing supply

Housing investors play a critical role in financing new housing supply, particularly rental housing and higher-density development. Their participation affects not only who owns housing, but how much housing is built, where it is located, and when it is delivered. In a supply-constrained environment, changes to investor taxation operate primarily through their impact on investment decisions and construction activity.

The analysis in this report demonstrates that policies which weaken investor incentives will, in isolation, worsen the underlying supply constraints and not deliver durable improvements in affordability. While short-term effects on prices or transaction volumes may occur, the longer-term consequences are reduced housing supply, higher rents and greater pressure on renters and lower-income households.

14.3 Tax systems operate as integrated packages

International experience reinforces the importance of evaluating housing tax settings as part of an integrated system. Countries that restrict investor deductions often tax owner-occupied housing more heavily, allow mortgage interest deductibility for owner-occupiers, or rely more on recurrent property taxes. Selectively importing individual elements of overseas tax systems without their broader context risks increasing distortions rather than reducing them.

Australia's housing tax system reflects a particular balance between simplicity, equity, efficiency and investment incentives. While there is scope for ongoing review and reform, changes to individual components must be assessed against their effects on housing supply and overall market stability.

14.4 Fiscal considerations and economic outcomes

Claims that tightening investor tax settings will generate substantial and sustainable budget savings do not adequately account for behavioural responses and second-round economic effects. Reduced housing investment weakens construction activity, employment and state and federal revenue bases, offsetting initial revenue gains and increasing pressure on housing assistance and social services.

From a fiscal sustainability perspective, policies that constrain housing supply risk increasing long-term public expenditure while reducing economic growth and tax capacity.

14.5 Equity and distributional outcomes

Distributional analysis shows that the economic burden of investor tax changes is borne largely by renters and workers over time, rather than by investors alone. Higher rents, reduced rental availability and weaker construction activity disproportionately affect lower-income households and younger Australians.

Improving equity in housing outcomes therefore requires policies that expand supply and reduce housing costs sustainably, rather than measures that constrain investment in a supply-limited system.

14.6 Implications for policy design

The findings of this report point to several clear policy implications:

- Housing affordability policy should prioritise increasing supply through planning reform, timely land release and efficient infrastructure provision.
- Tax settings affecting housing investment should be stable, predictable and neutral across asset classes to support long-term investment.

- Changes to negative gearing or capital gains tax arrangements should not be pursued in isolation from broader supply reform.
- International policy examples should be assessed holistically, with careful attention to institutional and tax system differences.

14.7 Conclusion

Australia's capacity to increase the supply of new housing is highly sensitive to investor incentives. Investors currently commence construction on more than 40 per cent of new homes built in Australia, underscoring their central role in financing and delivering new housing supply. Policies that reduce investor participation therefore have direct and immediate consequences for construction activity.

Changes to capital gains tax settings that increase the effective tax rate on housing investment, whether applied to new housing or to established dwellings, risk weakening the flow of capital required to bring new projects to market. New housing projects are often delivered at or near feasibility thresholds, with costs that are largely fixed and incurred upfront. Even modest increases in effective capital gains tax can be sufficient to prevent projects from proceeding, particularly in higher-density and rental-oriented segments that depend heavily on investor finance.

Increasing capital gains tax on established housing also has material implications for new home supply. New dwellings do not operate independently of the established market. The expected resale value of housing assets, including newly constructed dwellings once they transition into the established market, is a critical component of development feasibility. Higher taxation of established housing reduces expected terminal values across the market, lowering after-tax returns and discouraging investment in new construction.

The evidence examined in this report shows that investor capital does not automatically shift from established housing into new housing in response to selective tax changes. Instead, higher effective taxation reduces overall investment in housing, resulting in fewer projects being financed and a smaller pipeline of new homes.

If the policy objective is to increase the supply of new housing, Australia requires more investor participation, not less. Tax settings should support and encourage investment across the housing system. Increases in capital gains tax or changes to negative gearing that raise the cost of investing in housing, whether directly or indirectly, are unlikely to increase new home building and risk further constraining housing supply.

You're in good hands

If you would like to know more about HIA Economics
contact us on 02 6245 1393 or visit hia.com.au/economics