TREASURY LAWS AMENDMENT (TAX REFORM NO. 3) BILL 2026:
NEGATIVE GEARING (TRANCHE 2)

EXPOSURE DRAFT EXPLANATORY MEMORANDUM

Table of Contents

Glossary

This Explanatory Memorandum uses the following abbreviations and acronyms.

Abbreviation	***Definition***
AEST	Australian Eastern Standard Time
Bill	Treasury Laws Amendment (Tax Reform No. 3) Bill 2026
CGT	Capital Gains Tax
ITAA 1997	*Income Tax Assessment Act 1997*
Tax Reform No.1 Act	*Treasury Laws Amendment (Tax Reform No.1) Act 2026*

Chapter 1: Negative Gearing (tranche 2)

Table of Contents:

Outline of chapter

1.1 The amendments ensure where an individual acquires an ownership interest in:

- a residential dwelling that was eligible to be negatively geared by the previous owner due to the dwelling being acquired before 7.30pm (AEST) on 12 May 2026, the 2026-27 Budget Night; or
- a new residential dwelling that was eligible to be negatively geared by the previous owner and who was eligible to choose between applying the 50 per cent CGT discount or cost base indexation and the minimum tax on capital gains;

then the individual can keep this treatment in certain circumstances.

1.2 This will ensure an individual can keep this treatment for an ownership interest in a residential dwelling acquired from their spouse when the spouse dies; an additional ownership interest in a residential dwelling acquired from a deceased co-owner as a surviving joint tenant or as a beneficiary of the deceased individuals' estate; or an ownership interest in a residential dwelling acquired from a spouse, company or trustee following a relationship breakdown. References to spouse in this Explanatory Memorandum should be taken to include former spouse when used in the context of a relationship breakdown.

Context of amendments

1.3 The tax law provides that, as a general rule, residential dwellings held or used as residential accommodation acquired after 7.30pm (AEST) on 12 May 2026 are subject to the requirement to quarantine losses. From 1 July 2027, for residential dwellings that do not meet an exception to the general rule, owners cannot deduct net rental losses from assessable income (such as salary and wages), a practice commonly referred to as negative gearing. Eligible owners of dwellings that accrue capital gains prior to 1 July 2027 retain access to the 50 per cent discount, while capital gains which accrue from 1 July 2027 are subject to the new cost base indexation and 30 per cent minimum tax.

1.4 The exceptions to the general rule include where the residential dwelling was acquired before 7.30pm (AEST) on 12 May 2026 (for negative gearing only), and where the residential dwelling is a new residential dwelling for an entity.

1.5 Where relevant, Tax Reform No.1 Act relies on existing arrangements in the ITAA 1997. Subsection 109-5(1) provides that, generally, a CGT asset, which includes a residential dwelling, is acquired by an entity when an entity becomes the asset's owner. Unless otherwise stated, all references to legislation are to the ITAA 1997. Subsection 109-5(2) then sets out a number of specific rules for particular situations. These situations include where an entity voluntarily disposes of a CGT asset to another entity, in which case, the entity acquires the asset either when the disposal contract is entered into, or, if there is no contract, when the other entity ceases to be the owner of the asset (item 1 of the table in section 109-5(1)).

1.6 Consistent with the Government's commitments, the amendments in this Bill address the interactions of the amendments in the Tax Reform No. 1 Act and the rules for acquisitions as they apply to joint tenancy and tenants-in-common arrangements, which are common forms of owning residential property, acquisitions flowing from the finalisation of financial matters between former spouses following a relationship breakdown, and acquisitions via inheritance by a surviving spouse.

Inheritance from a spouse or co-owner

1.7 A joint tenancy is where the tenants own the entire property jointly, with no specified share in the property, while tenants-in-common is where each owner holds a distinct share in the property. Crucially, joint tenancy includes a right of survivorship, so that in the event of death of one party, ownership of the property automatically flows to the other party.

1.8 In a joint tenancy arrangement, each joint tenant has a right to the whole property but does not have a right to an individual share of the property. On the death of a joint tenant, the deceased joint tenant's interest in the property reverts to the surviving joint tenant(s). Where there were only two joint tenants (e.g. a couple holding a residential dwelling as joint tenants), the surviving joint tenant becomes the sole owner of the property (known as survivorship). In contrast to the other main way of holding property, as tenants-in-common, ownership interests in a joint tenancy arrangement always pass onto the surviving owner(s). Therefore, where there is a change to a joint tenancy arrangement (e.g. death of a joint tenant), the remaining joint tenants automatically assume that ownership share.

1.9 However, the property law rules in relation to a joint tenancy arrangement do not apply under the tax legislation for the purposes of determining when a CGT asset is acquired. Section 108-7 provides that individuals who own a CGT asset as joint tenants are treated as if they each owned a separate CGT asset with an equal interest in the asset and as if each of them held that interest as a tenant-in-common. This means that where a joint tenant dies, the remaining joint tenant(s) will be treated as having acquired that ownership share. Section 128-50 provides that the time the remaining joint tenant(s) acquired the deceased's share is deemed to have occurred when the deceased died.

1.10 In the absence of these amendments, for those in joint tenancy arrangements who purchased a residential dwelling (or dwellings) prior to 7.30pm (AEST) on 12 May 2026, where a joint tenant dies after 7.30pm (AEST) on 12 May 2026, the surviving tenant(s) would automatically be deemed to have acquired a new ownership interest in the dwelling but that ownership interest would not be exempt from the loss quarantining or CGT indexation and minimum tax obligations.

1.11 This situation also applies in a tenants-in-common arrangement where one of the tenants leaves their share to another individual in their will.

1.12 This would also apply to the acquisition of an ownership interest in a new residential dwelling where the certificate of occupancy for the new residential dwelling was first issued more than two years ago. Where the certificate of occupancy for the new residential dwelling was first issued within two years, the ownership interest would still be an ownership interest in a new residential dwelling, regardless of these amendments (see the separate exposure draft on new residential dwellings).

Relationship breakdown

1.13 These issues also apply where a spouse acquires an ownership interest in a residential dwelling as a consequence of the resolution of a relationship breakdown. An ownership interest in a residential dwelling can be acquired by a spouse in a relationship breakdown by:

- consent orders made by the Family Court, which formalise an agreement between former partners;

- an enforceable binding financial agreement, which is a contract between former partners that is enforceable in court; or
- court orders made at the end of litigation.

Main residence first used to produce assessable income

1.14 Similar issues also arise for a dwelling that is a main residence acquired before 7.30pm (AEST) on 12 May 2026 or a new residential dwelling where the residence is first used to produce assessable income. Where a main residence is used to produce assessable income, the main residence is taken to be acquired under subsection 118-192(2) at the dwelling's market value at the time just before it is first used to produce assessable income. This is a rule in the existing tax law to disregard any capital gains until such time that a dwelling that has been solely a main residence is used to produce assessable income and ensures that taxpayers do not have to keep cost base records of a dwelling. This interaction is addressed by this Bill to ensure loss quarantining and CGT indexation and minimum tax obligations do not apply as a result of these existing provisions.

Summary of new law

1.15 Schedule X to the Bill amends the ITAA 1997 for individuals that acquire an ownership interest in a residential dwelling in the following circumstances:

- An individual acquires an ownership in a residential dwelling from their spouse when their spouse dies and their spouse's interest was exempt from loss quarantining in subsection 26-155(1).
- An individual (the surviving individual) with an existing ownership interest in a residential dwelling acquires an additional ownership interest in the residential dwelling from a deceased individual, who is not the surviving individual's spouse, as a surviving joint tenant or as a beneficiary of the deceased individual's estate where the deceased individual's ownership interest was exempt from the loss quarantining in subsection 26-155(1).
- An individual acquires an ownership interest in a residential dwelling from a spouse following a relationship breakdown where the spouse's interest was exempt from loss quarantining in subsection 26-155(1).

1.16 In those circumstances, the individual acquiring an ownership interest in the residential dwelling can retain the tax treatment applying to their spouse or the deceased and continue to negatively gear the residential dwelling and for new residential dwellings, have eligibility to choose between applying the 50 per cent CGT discount or cost base indexation and the minimum tax on capital gains when the ownership interest is disposed of.

1.17 Schedule X to the Bill also amends the ITAA 1997 to disregard the acquisition time that would otherwise arise in subsection 118-192(2) where a main residence is acquired before 7.30pm (AEST) on 12 May 2026, or is a new residential dwelling to the owner. This maintains the exemption from the loss quarantining rule in section 26-155 where the main residence is used to produce assessable income from residential accommodation.

Detailed explanation of new law

1.18 The amendments insert a note which informs of further exceptions to the requirement to quarantine amounts from a residential dwelling used or held as residential accommodation (the general rule). These further exceptions are set out in sections 26-156, 26-157 and 26-158, which are discussed below. ***[Schedule X, item 1, Note 1 to subsection 26-155(2) of the ITAA 1997]***

1.19 Sections 26-156, 26-157 and 26-158 utilise defined terms which cross-reference to the Dictionary definitions starting at subsection 995-1(1) of the ITAA 1997. These terms are:

- ‘Spouse’, which takes its meaning from section 995-1 of the ITAA 1997 which provides that an individual is a spouse through registered marriage or de facto relationship.
- ‘Ownership interest’ which, in relation to land or a dwelling, has the meaning given by section 118-130 of the ITAA 1997.
- ‘Acquire’, which is defined under sections 109-5 and 109-10 of the ITAA 1997. These provisions set out a number of specific rules for when a CGT asset is acquired. Generally, a residential dwelling, which is a CGT asset, is acquired by an entity when an entity becomes the asset’s owner. This will typically be at the time when the entity entered into the binding contract to purchase the residential dwelling or when the entity entered into a contract to purchase the vacant land upon which the residential dwelling was later constructed.
- ‘Passes’, which takes its meaning from section 128-20 of the ITAA 1997, which establishes when a CGT asset passes to a beneficiary.

Acquisition by surviving spouse

1.20 Section 26-156 provides a further exception to the general rule where an ownership interest (or a part of it) in a residential dwelling that was held by a deceased individual (the deceased) is acquired by their spouse (the surviving spouse).

1.21 Subsection 26-156(1) sets out the circumstances that must exist for the exception to apply. Those circumstances are that:

- the surviving spouse and the deceased were spouses;
- the deceased held an ownership interest in a residential dwelling;
- the surviving spouse acquires the deceased's ownership interest (or a part of it) in the residential dwelling either as the surviving joint tenant or because the interest was passed to them as a beneficiary in the estate of the deceased.

1.22 Where the surviving spouse acquires the deceased's ownership interest (or a part of it) as the surviving joint tenant, they will have had an existing ownership interest in the residential dwelling because in a joint tenancy arrangement, on the death of a joint tenant, the deceased joint tenant's interest in the property ceases and the ownership of the property remains with the remaining joint tenant(s).

1.23 Where the surviving spouse acquires the deceased's ownership interest as a beneficiary in the estate of the deceased, they do not need to have had an existing ownership interest in the residential dwelling. The deceased will have held the residential dwelling either as a sole owner or tenant-in-common with a third party. In either case, the deceased can determine how their ownership interest is transferred upon their death.
[Schedule X, item 4, subsection 26-156(1) of the ITAA 1997]

1.24 Where subsection 26-156(1) is satisfied, subsections 26-156(2) and (3) set out requirements for the surviving spouse to be able to rely on the exception to the general rule to quarantine amounts from a residential dwelling used or held as residential accommodation. Accordingly:

- Subsection 26-156(2) is satisfied where the residential dwelling was acquired by the deceased before 7.30pm (AEST) on 12 May 2026.
- Subsection 26-156(3) is satisfied where the residential dwelling was a new residential dwelling for the deceased.

1.25 The surviving spouse only needs to satisfy the relevant requirement for the exception to apply. For example, if they have acquired an ownership interest in a residential dwelling that was a new residential dwelling for the deceased, the surviving spouse only needs to satisfy the requirements in subsection 26-156(3).
[Schedule X, item 4, subsections 26-156(2) and (3) of the ITAA 1997]

1.26 Subsection 26-156(4) provides that the acquisition timing rules set out in subsection 128-15(2) and 128-50(2) do not apply for the purposes of determining the time of the acquisition in subsections 26-156(2) and (3). These timing rules would have provided that the surviving spouse acquired the ownership interest in the residential dwelling on the day that the deceased died. This would have meant that the surviving spouse would not be exempt from the general rule requirement to quarantine amounts from a residential dwelling used or held as residential accommodation. In other words, the surviving spouse would not be able to negatively gear the ownership interest in the

residential dwelling. However, because these timing rules are switched off by subsection 26-156(4), the surviving spouse can negatively gear the ownership interest in the residential dwelling they acquire because subsection 26-156(2) treats them as having acquired the ownership interest at the same time as the deceased, while subsection 26-156(3) treats the residential dwelling as a new residential dwelling for the surviving spouse.
[Schedule X, item 4, subsection 26-156(4) of the ITAA 1997]

Acquisition by a surviving co-owner

1.27 Section 26-157 provides a further exception to the general rule where a deceased individual’s ownership interest (or part thereof) in a residential dwelling is acquired by a co-owner of the residential dwelling.

1.28 Subsection 26-157(1) sets out the circumstances that must exist for the section to apply. Those circumstances are that:

- two or more individuals hold an ownership interest in a residential dwelling as joint tenants or tenants-in-common;
- the individuals are not spouses;
- one of the individuals dies (the deceased);
- the surviving individual(s) (the survivor) acquires the deceased’s ownership interest (or part of it) in the residential dwelling either as the surviving joint tenant(s) or because the ownership interest was passed to them as a beneficiary in the estate of the deceased.

1.29 A key distinction between section 26-157 and sections 26-156 and 26-158 is that section 26-157 requires the survivor to have a pre-existing ownership interest in the same residential dwelling that the deceased had an ownership interest in. The survivor and the deceased will need to have held their interests as joint tenants or tenants-in-common.
[Schedule X, item 4, subsection 26-157(1) of the ITAA 1997]

1.30 If the circumstances in subsection 26-157(1) are met, subsections 26-157(2) and 26-157(3) set out further requirements that must be met for the survivor to be exempt from the general rule. These are as follows:

- Subsection 26-157(2) requires that the survivor and the deceased needed to have acquired their ownership interests in the residential dwelling before 7.30pm (AEST) on 12 May 2026. If that is the case, the ownership interest that the survivor acquires from the deceased is taken to have been acquired at the same time as the deceased acquired that ownership interest.
- Subsection 26-157(3) requires that the survivor and deceased’s ownership interests were in a residential dwelling that was a new residential dwelling for them. If that is the case, then the ownership interest that the survivor acquires

from the deceased is deemed to be an ownership interest a new residential dwelling.

1.31 The survivor only needs to satisfy the relevant requirement for the exception to apply. For example, if they have acquired an ownership interest in a residential dwelling that was a new residential dwelling for the deceased, the survivor only needs to satisfy the requirements in subsection 26-157(3).
[Schedule X, item 4, subsections 26-157(2) and (3) of the ITAA 1997]

1.32 The amendments ensure that subsection 128-15(2) and 128-50(2) apply to prevent:

- subsection 26-157(2) deeming the survivor's acquisition to have occurred at the same time as the deceased acquisition; and
- subsection 26-157(3) deeming the residential dwelling to be a new residential dwelling for the survivor.
[Schedule X, item 4, subsection 26-157(4) of the ITAA 1997]

Acquisition by an individual from their spouse

1.33 Section 26-158 provides an exception to the general rule where an ownership interest in a residential dwelling is acquired by an individual from their spouse as part of the settlement of a relationship breakdown.

1.34 Subsection 26-158(1) sets out the circumstances that must exist for the section to apply. Those circumstances are that:

- the transferor was the spouse of the transferee, or a company or trustee;
- the transferor transfers an ownership interest in a residential dwelling to the transferee; and
- the transfer occurs because of an order, agreement or award of a kind mentioned in paragraphs 126-5(1)(a) to (f) of the ITAA 1997.

1.35 Broadly, paragraphs 126-5(1)(a) to (f) cover courts orders and court approved agreements.
[Schedule X, item 4, subsection 26-158(1) of the ITAA 1997]

1.36 If the circumstances in subsection 26-158(1) are met, subsections 26-158(2) and (3) set out further requirements that must be met for the transferee to be exempt from the general rule. These are that:

- Subsection 26-158(2) requires that the transferor acquired their ownership interest in the residential dwelling before 7.30pm (AEST) on 12 May 2026. If that is the case, then the transferee is taken to have acquired the transferred ownership interest at that time.
- Subsection 26-158(3) requires that the residential dwelling was a new residential dwelling for the transferor. If that is the case, then the ownership

interest in the residential dwelling that is acquired by the transferee is taken to be a new residential dwelling.

1.37 The transferee spouse only needs to satisfy the relevant requirement for the exception to apply. For example, if they have acquired an ownership interest in a residential dwelling that was a new residential dwelling for the transferor spouse, the transferee spouse only needs to satisfy the requirements in subsection 26-158(3).
[Schedule X, item 4, subsections 26-158(2) and (3) of the ITAA 1997]

Application of extended new residential dwelling exception for capital gains purposes

1.38 The amendments ensure that where an individual acquires an ownership interest in a residential dwelling that is taken to be a new residential dwelling for them as a consequence of subsections 26-156(3), 26-157(3) or 26-158(3) then, for CGT purposes, the dwelling is also taken to be a new residential dwelling in relation to the ownership interest acquired.
[Schedule X, item 4, subsection 26-159 of the ITAA 1997]

1.39 Section 26-159 ensures that the individual receiving the ownership interest from the deceased or spouse (as applicable) retains access to the CGT discount (under section 115-102) or the cost base indexation (under sections 114-30 and 115-102), the deemed sale and re-acquisition rule (under sections 112-115 and 112-165) and the 30 per cent minimum tax (under section 119-5) does not apply when the new residential dwelling is disposed of.
[Schedule X, item 4, section 26-159 of the ITAA 1997]

Main residence first used to produce assessable income

1.40 The amendments ensure that the loss quarantining rule in section 26-155 does not apply to an individual that uses their main residence to produce assessable income if:

- they acquired their main residence before 7.30pm (AEST) on 12 May 2026; or
- their main residence was a new residential dwelling under subsection 26-160(3).

1.41 In these instances, the effect of subsection 118-192(2) which deems the acquisition time of the main residence to be the time it is first used to produce assessable income is disregarded. This means when determining whether the general loss quarantining rules applies, the individual can rely on the time when they originally acquired their ownership interest in the residential dwelling or new residential dwelling.
[Schedule X, item 3, subsections 26-155(3AA) and 26-155(3AB) of the ITAA 1997]

Consequential amendments

1.42 As Note 1 is additional to an existing note below subsection 26-155(2), item 2 of Schedule X to the Bill amends the existing note to read 'Note 2'. ***[Schedule X, items 1 and 2, notes to subsection 26-155(2) of the ITAA 1997]***

Commencement, application, and transitional provisions

1.43 Schedule X to the Bill commences on the first 1 January, 1 April, 1 July or 1 October to occur after the day the Bill receives Royal Assent.

Future amendments

1.44 Further matters that are being considered for later amendments to the tax law concerning the loss quarantining provisions include:

- adjusted taxable income;
- ensuring the loss quarantining provisions apply correctly to general law partnerships and companies, including commercial restructures or scenarios where there is no substantial change in ultimate economic ownership; and
- excluded entities – listed investment companies.