

Budget 2026-27: CGT change to divert private capital to CRE



June 2026

The changes to capital gains taxation and negative gearing announced in the Australian Budget 2026-27 are now law. This is broadly expected to have positive implications for the commercial property sector.

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- ▶ In the 2026-27 Budget, the Federal Government announced changes to the calculation of tax on capital gains that are now law.
- ▶ Assets with capital growth rates below 4.5% – such as commercial property – will typically pay less tax under inflation indexation.
- ▶ These changes will see private investors divert capital away from residential and towards commercial property.

70-80%

Proportion of time since 2000 when commercial property investors would pay less tax under inflation indexation, assuming 10-year hold

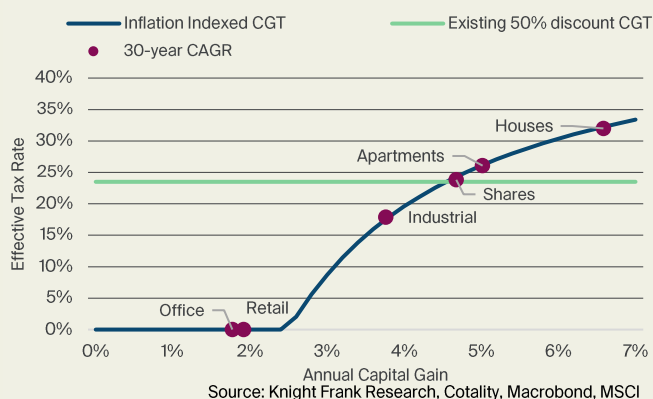
COMMERCIAL PROPERTY SET TO BENEFIT FROM INFLATION INDEXATION OF CAPITAL GAINS

Historic performance reveals that commercial property (CRE) is likely to be taxed more lightly under the new inflation indexed capital gains tax (CGT) than under the existing 50% discount – while the opposite is true for residential property. CRE returns are typically driven to a much greater extent by income returns rather than capital growth, and the new method for calculating CGT liability favours this type of investment over other investments offering lower income but the potential for higher capital growth.

Assuming inflation of 2.5% p.a. — the midpoint of the RBA’s target band — the new CGT system produces an equivalent tax rate at a capital growth rate of ~4.5% p.a. Below this, inflation indexation is the more favourable treatment; above it, the 50% discount produces a lower effective tax rate. Using the 30-year compound annual growth rate (CAGR) for each asset class as a guide, the effective tax rate on capital gains under the new system is lower for the traditional commercial sectors given that average capital growth has been below 4.5%. The opposite is true for residential assets given that their 30-year CAGR exceeds 4.5% p.a., resulting in a higher effective tax rate under the new indexation method.

Effective tax rate for old and new systems

Effective tax rate given annual capital gain (30 year CAGR) and CPI



ANALYSIS OF HISTORIC PERFORMANCE SHOWS NEW SYSTEM LOWERS TAX IN MOST PERIODS

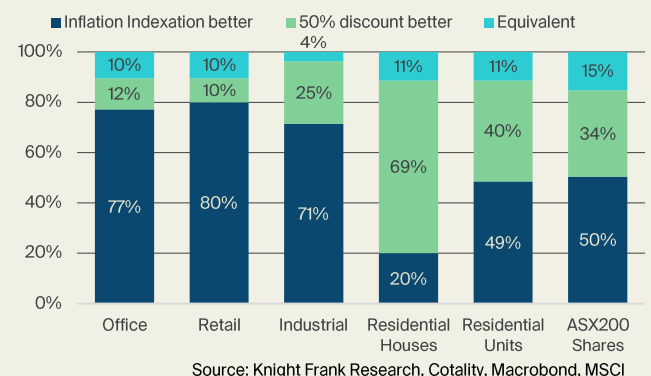
Looking beyond historic averages, we have also analysed how the CGT changes would have affected returns over different investment periods, recognising that rates of growth have fluctuated over time. Assuming a 10-year holding period — we simulate after-tax capital returns under both the existing 50% discount and CPI indexation of the cost base on a rolling quarterly basis from 2000 to Q1 2026.

This aggregated analysis of different investment periods concludes that CRE would have been better off under inflation indexation 70-80% of the time, worse off around 10-25% of the time, and equivalent 4-10% of the time (reflecting periods involving a capital loss).

This contrasts with established homes, where after-tax returns have mostly been stronger under the existing 50% discount. For houses, capital returns have been treated more favourably under the existing regime 69% of the time, while indexation would have better only 20% of the time. The holding period does impact these results as the 50% discount favours shorter holds during periods of strong growth, but the fundamental point remains that CRE is well-placed under the new CGT laws.

Inflation indexation typically results in less CGT for commercial property compared to 50% discount

Best (lowest) tax system by asset class since 2000, 10-year hold (%)



The structure of returns matters

COMMERCIAL PROPERTY MORE RELIANT ON INCOME

Total investment returns across all the major asset classes have been relatively similar over the past 30 years, averaging from 8–11%. However, in considering the impact of the tax change, the important question is not how much return each asset has generated, but how it has been split between income and capital growth.

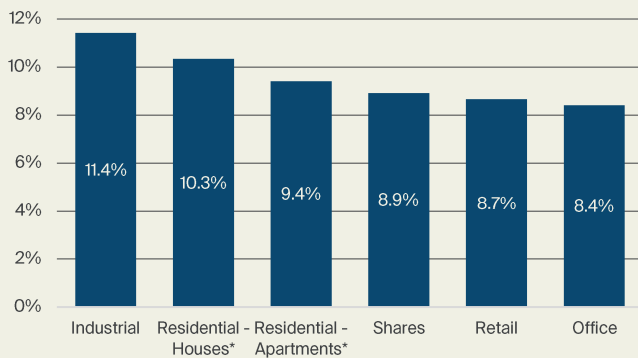
CRE is typically viewed by investors as a more income-focused asset (with yields averaging ~5.5% in the past decade). Capital growth, while welcome, has historically been the smaller part of the investment thesis and underwriting process. Across the three traditional commercial property sectors, around 70-80% of total returns have typically been derived from income.

Investors in established homes tend to have a different approach, typically buying houses on lower yields (3–4% in most capital cities) and focusing on the potential for growth in property values which has historically done most of the heavy lifting for investment returns. In residential houses and units, around 60–70% of total returns have been derived from capital growth.

Although total returns have been similar across asset classes, this difference in return composition translates into a material difference in after-tax outcomes under the policy.

Total returns similar among assets

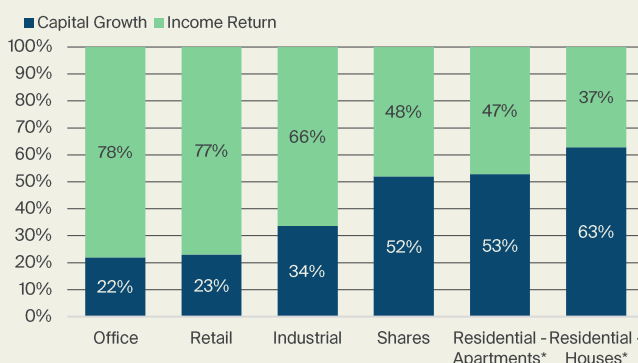
Total annual return by asset class, 30-year CAGR (% p.a.)



Source: Knight Frank Research
Note: *Income uses 20-year CAGR due to data availability.

Split of returns by asset type

Share of total returns by return type, 30-year CAGR (% p.a.)



Source: Knight Frank Research, Cotality, Macrobond, MSCI
Note: *Income uses 20-year average rental yield.

INCOME FOCUSED ASSETS WIN UNDER NEW SYSTEM

Under the old 50% discount, the composition of returns didn't matter much for tax purposes as the effective tax rate on capital gains remained the same regardless of the capital growth rate.

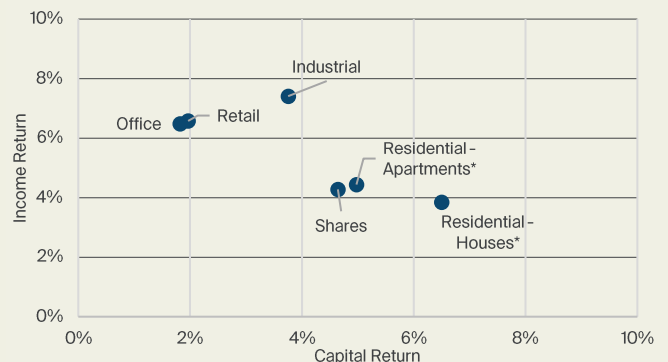
Under inflation indexation, return composition matters. Indexation taxes only real capital gains — growth in value above inflation. For commercial property, where capital growth has historically run at or only modestly above inflation over the long run, the real gain subject to tax is often small — lowering the CGT liability and the effective tax rate on capital gains.

Income returns are not directly affected by the CGT change. For CRE assets already generating the majority of their return through rent, the reform touches only a small portion of total investment gains — and the higher the income share, the more limited the CGT exposure.

On the other hand, in residential markets, returns have largely been driven by capital growth well above the inflation rate, and as a result the shift is more consequential. The real gains have typically been larger, increasing the CGT liability and the effective tax rate on capital gains.

Commercial property more reliant on income

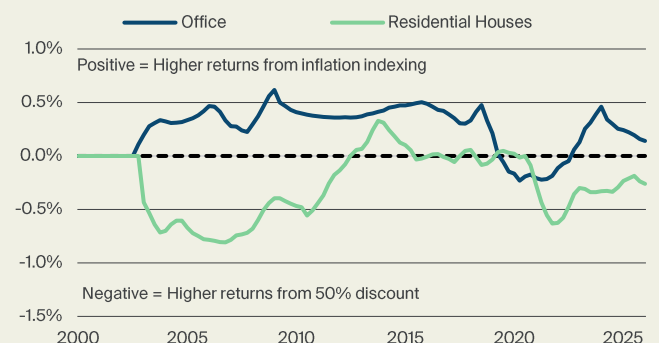
Average pre-tax average capital and income return by asset class, 30-year CAGR (% p.a.)



Source: Knight Frank Research, Cotality, MSCI, Macrobond
Note: *Income uses 20-year average rental yield.

Office returns higher with inflation indexation

Difference in post-tax annual capital gain between inflation indexed taxation and a 50% discount, 10-year hold (% p.a.)



Source: Knight Frank Research, Cotality, Macrobond, MSCI

Implications and outlook

PRIVATE CAPITAL WILL DIVERT TO COMMERCIAL ASSETS

The tax changes will encourage more private investors to invest in commercial property because of its yield advantage over residential stock.

As we have shown, CRE returns are typically driven to a much greater extent by income returns rather than capital growth, and the new method for calculating CGT liability favours this type of investment over other investments offering lower income but the potential for higher capital growth.

In addition to the yield advantage, commercial investments are also still eligible for negative gearing, although this tends to be less commonly used given typically lower gearing levels compared to residential investments.

CHANGE WILL BOLSTER DEMAND FOR SYNDICATES AND REITS AS WELL AS SINGLE ASSETS

The shift in incentives will translate into demand for standalone investments, including smaller assets that are a natural alternative for investors who have previously focussed on established homes. This includes strata office and industrial units, medical centres and service stations.

However, buyers new to the sector will still need to bridge a knowledge gap as they navigate commercial lease structures, local market supply dynamics, tenant management and a higher upfront capital outlay compared to residential investments.

These issues will see some investors gravitate to professionally managed structures with less upfront capital required including REITs, unlisted property trusts and syndicates.

“Many private investors have significant holdings of assets acquired prior to 1985, and the changes in the Budget include the prospect of those assets being subject to CGT for the first time. This will prompt a reappraisal of investment strategies, and we expect some owners to take the opportunity to divest, while others opt to inject additional capital to set a higher cost base moving forward and recommit to manage these investments more actively in the future.”

James Aroney
Partner, Institutional Sales



CGT ON PRE-1985 ASSETS WILL PROMPT A RETHINK

As part of the Budget changes, the government will also start to tax assets held since before 1985 that were previously exempt from CGT. This includes the long-standing holdings of many private investors with assets in the urban fringes of Sydney and Melbourne.

The change will prompt some investors to reconsider their strategy, leading to either divestment or a more active approach to refurbish and update older assets.

REVIEW OF SUPER FUND PERFORMANCE TEST WILL SUPPORT HOUSING INVESTMENT

Separate to the CGT changes, the Budget also flagged a review of the performance test applying to superannuation funds. The implementation of the existing performance test has arguably had the unintended consequence of reducing some funds appetite to invest in emerging asset classes including build-to-rent, because of their uncertain return profile in the early years of what are inherently long-term investments.

The review is intended to make it easier for funds to invest in riskier assets including those requiring development and without well-established performance benchmarks. This has the potential to attract more super fund capital to housing development across a range of asset types, including the growing BTR sector, social & affordable housing and land lease communities.

“Whatever their views on the Budget, investors will need to respond to the changes and reassess their strategy as a result. One potential consequence is greater allocation to non-residential asset classes, given that the new system is well aligned to these sectors and their inherent return characteristics.”

Many high-net-worth families were already reviewing their portfolios in light of changing market conditions, but now they are hurriedly reviewing not only their portfolios, but also how they are held and structured. Don't underestimate how this legislation is challenging the well-considered and often complex wealth management planning of many individuals and their families.”

Ari Petrovs
Partner, Head of Private Office Australia



What are the changes?

CAPITAL GAINS TAX (CGT)

From 1 July 2027, existing 50% discount on capital gains for assets held for 12 months will be abolished for individuals, partnerships, and trusts. Companies are unaffected by the change as they never qualified for the discount.

Capital gains tax will transition to an inflation indexation system from 1 July 2027 for assets held for 12 months. This system works by increasing the original purchase price of the asset by CPI. Tax is then only paid on the nominal gain that exceeds the inflation-adjusted cost base.

A 30% minimum tax will apply on real capital gains. This significantly reduces the benefit of the investment strategy of delaying the sale of assets until low-income years to reduce capital gains taxation.

All pre-CGT assets (acquired before 20 September 1985) — which were previously exempt from CGT will become taxable. Any capital appreciation post 1 July 2027 will be subject to the new CGT regime, but capital gains prior to this date will remain untaxed. The asset value on 1 July 2027, may be decided through a valuation or a ATO specified apportionment formula based on a growth rate over the asset's holding period.

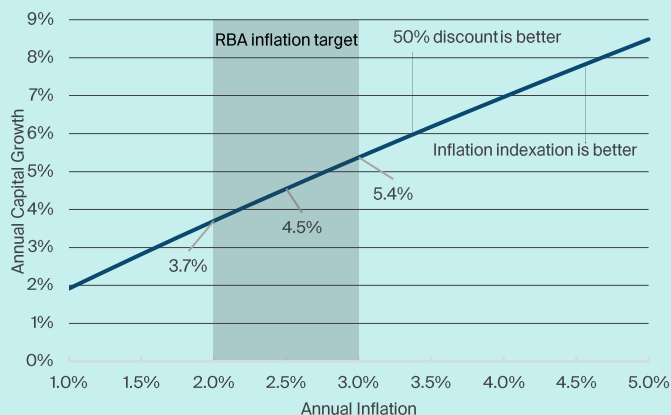
NEW CGT BETTER IN LOW GROWTH, HIGH INFLATION SCENARIO

Under inflation indexation, only real (inflation-adjusted) capital gains are subject to tax, whereas the existing 50% discount applies to the full nominal gain. The relative benefit of indexation therefore increases as inflation rises and capital growth moderates.

The 'double' principle is a simple rule-of-thumb to estimate which system would be better for your asset. That is, if annual capital growth on your asset more than double the inflation rate, then less tax is paid under the 50% discount calculation.

Scenarios under which the tax systems are equal

Rates of annual capital growth and CPI inflation where indexation is equivalent to 50% discount, 10-year holding period (%)



Source: Knight Frank Research

NEGATIVE GEARING

From 1 July 2027, negative gearing has been removed for investors who purchased established residential property after 12 May 2026, removing the option to deduct these losses against their salary or business income. Negative gearing remains available to properties purchased before 12 May 2026. Negative gearing remains available for investors who purchase eligible new residential property. However, these investors can only deduct losses against other income from residential property, including capital gains.

Negative gearing is also still available for commercial property and other asset classes. Commercial investors retain the right to offset net rental losses against their primary professional salaries or general business income.

DISCRETIONARY TRUSTS

From 1 July 2028, trustees of discretionary trusts will be subject to a mandatory 30% minimum tax on the trust's taxable income. Individual non-corporate beneficiaries will receive non-refundable credits for the 30% tax already paid by the trustee. This effectively means that many investors may shift from trusts to a *Corporations Act* entity (Pty Ltd companies). Recent announcement suggest that all testamentary trusts used to manage the income paid to beneficiaries of a deceased estate may be exempt from the proposed 30 per cent minimum tax rate.

This impacts commercial property as discretionary trusts have been the primary structure for holding commercial property for many private investors. So this change may have substantial impacts on the holding structure of private commercial assets.

INSTANT ASSET WRITE-OFF

The Government will permanently legislate the \$20,000 instant asset write-off, effective from 1 July 2026. This allows businesses (with <\$10m aggregate annual turnover) to immediately deduct the full cost of eligible depreciating assets costing less than \$20,000. This increases the incentive for commercial retail and office tenants to invest in equipment and their spaces.

DEPRECIATION

Commercial properties continue to be able to claim significant non-cash deductions each year for depreciation. This includes Division 43 (Capital Works) to write-off depreciation of the building structure and Division 40 (Plant and Equipment) which deducts the assets within a building. These provisions improve after-tax cash flow, relative to the residential sector where residential investors are restricted from Division 40.

HAVE THESE CHANGES BEEN LEGISLATED?

On 25 June 2026, the Government passed the legislation on changes to capital gains taxation and negative gearing passed through both houses of parliament and is set to become law. The proposed changes to discretionary trusts are in a separate bill and are yet to begin the parliamentary process.

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