national shelter

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Background Paper

Tax Settings Relating to Housing in Australia

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The material home represents the concrete expression of the habits of frugality and saving ... one of the best instincts in us is that which induces us to have one little piece of earth with a house and a garden which is ours; to which we can withdraw, in which we can be among friends, into which no stranger may come against our will.

Sir Robert Menzies, 'Forgotten People' speech, 1942

The land is the basic property of the Australian people. It is the people's land, and we will fight for the right of all Australian people to have access to it at fair prices.

Gough Whitlam, 'It's Time' speech, 1972[1]

Not taxing principal residences and lower taxes for investor owners

Since Robert Menzies declared it "one of our best instincts" Australia and Australians have declared a preference for homeownership as their tenure of choice and successive governments have rhetorically supported that aim, yet their actions in relation to tax settings and other policies have seen a decline in homeownership,[2] especially since the 1990s and a rise in the number of 'mum and dad' investors.

A principal reason for this situation is the tax treatment of housing, a detailed look at which shows the contradictions between rhetoric and action and the deliberate undermining of owner-occupation in favour of housing speculation.

National Shelter remains 'tenure neutral' in not preferring one form of tenure over another, preferring to focus on security, affordability, safety, wellbeing and accessibility as markers of an appropriate housing system. So, in relation to the tax treatment of housing, we need to contrast and compare the preference of the population for ownership and the relative supports and transfers provided to ownership and renting and in renting's case, whether the support or transfers go to lessors or lessees in determining whether our tax settings have a positive or negative effect on housing outcomes.

It is understandable, if not equitable, that housing owned and occupied is exempt from a capital gains tax (CGT) - many nations protect the principal residence from capital gains, although National Shelter proposes one could be introduced with appropriate thresholds, to protect the "little piece of earth", whilst having a CGT on properties over a deemed level to avoid expensive homes operating as tax havens for over consumption rather than reasonable properties in which a household lives.

However, at the Commonwealth Government level, it is unfathomable why Australia continues to offer such generous negative gearing on housing (and other assets) and a 50% discount on capital gains for investment properties.

Prominent economist Saul Eslake has commented, "Likewise, the long-standing availability of "negative gearing" for investors in property (and other assets) has done very little (at very large cost in terms of revenue foregone) to increasing the supply of rental housing, as opposed to doing a great deal to inflate the price of the existing stock of both rental and owner-occupied housing." [3]

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1 https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Former_Committees/hsaf/report/c02
2 https://www.ahuri.edu.au/research/news/trends-show-that-home-ownership-is-unlikely-to-increase-in-the-future
3 https://www.smh.com.au/business/the-economy/australias-tax-system-is-like-swiss-cheese-saul-eslake-20150922-gjs8lt.html

The Tax Institute has released a new report “The Case for Change” which in relation to negative gearing for property and capital gains discounts shows, "The interaction of the two measures has a much broader economic and social impact on the property market, for example, volatility and reduced homeownership." [4]

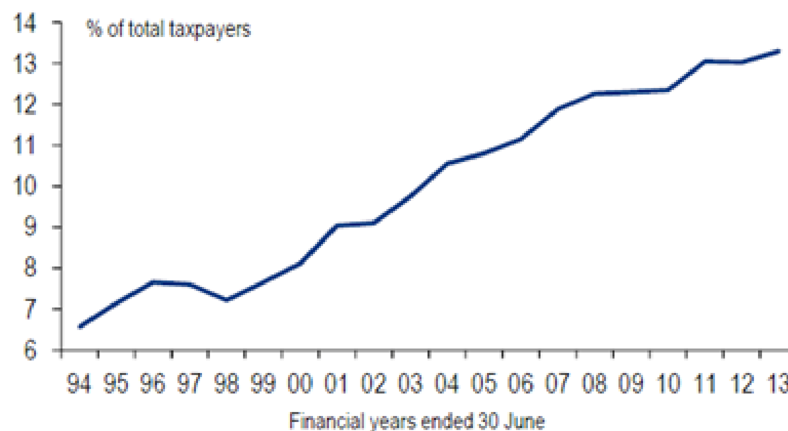
The Grattan Institute reports,"The two measures in combination allow investors to reduce and defer personal income tax, at an annual cost of $11.7 billion to the public purse. Other taxes, which often drag more on the economy than a capital gains tax does, must be higher as a result." [5]

Prior to 1999 and the Ralph Business Tax Review, CGT on investment property was calculated by the indexation method, “a method of applying indexation to the cost base to account for inflationary increases in the value of the asset." The Ralph review recommended, and the Howard government approved, a change in calculating the CGT on investment properties to be a 50% discount on the increase in value.[6]

The Australia Institute and the National Centre for Economic Modelling estimate that the 50 per cent CGT discount is costing the Federal Government around $4 billion per year, with almost three-quarters of the benefit going to the top 10 per cent of income earners.

Since the change in CGT in 1999, the proportion of investors competing for available properties has also risen dramatically having been a stable proportion of purchasers prior to the change.

PROPORTION OF TOTAL TAXPAYERS REPORTING NET RENTAL INCOME LOSSES



The CGT change was introduced in a high inflationary period and with the introduction of the Goods and Services Tax. If the same formula was applied today the discount would be approximately 11% rather than 50%, about which the Tax Institute indicates, “Clearly, such a discount rate (11%) would be politically unpalatable but the point of the comparison is that the current rate no longer reflects the policy it was originally designed to replace. Moreover, it is inconsistent with the tax treatment of other unearned income, such as rents and interest.”

4 https://tticdn.blob.core.windows.net/tti-files/dmfile/0688nat_project_reform_paper-case-for-change_v16_online.pdf?__hstc=29393440.024376248d802f82b23f080977e0b821.1626391046761.1626391046761.1626391046761.1&__hssc=29393440.11.1626391046761&__hsfp=2186660142&hsCtaTracking=b548fc60-f92d-47ad-b5e4-6dfa8847a4de%7Caa9ca599-9c4a-4981-b280-923857333371

5 http://grattan.edu.au/report/hot-property/

6 https://tticdn.blob.core.windows.net/tti-files/dmfile/0688nat_project_reform_paper-case-for-change_v16_online.pdf?__hstc=29393440.024376248d802f82b23f080977e0b821.1626391046761.1626391046761.1626391046761.1&__hssc=29393440.11.1626391046761&__hsfp=2186660142&hsCtaTracking=b548fc60-f92d-47ad-b5e4-6dfa8847a4de%7Caa9ca599-9c4a-4981-b280-923857333371

The Henry report proposed a solution to the problem by applying a general 40% discount to all investments which at least equalised the treatment of tax applied to different investment types.

There is a clear need to change the current tax settings on housing in relation to both CGT and negative gearing, the simplest start to this is to halve the capital gains tax for investments and work towards quarantining the deductibility of losses (negative gearing) to the income source rather than all income sources.

Shifting from individual owners to institutional ones

Nearly $12 billion per annum is forgone in revenue to investors to support the provision of rental housing. This also means that our rental housing ownership is an ‘amateur’ approach, in that it is largely individuals chasing a capital gain rather than any form of institutional investment making rational long-term investments for a cash flow business. This is partly due to the low yields of rental property investment but also because the tax benefits which accrue to individual investors do not accrue to institutional investors.

There are also very few unit trust investment vehicles in residential property in Australia, so individuals need to purchase an entire property rather than a share of a property portfolio. It adds to large household debt levels and limits the scale of investment that might be available through a trust vehicle which would allow investors to purchase units or shares in a portfolio.

The increase of build to rent developments, which in Australia are very limited, would benefit from an equalisation of tax treatments between institutional and individual investors. The Property Council of Australia has called for the same withholding tax rates applied to foreign investors in commercial property to be made available to residential property, as a means of unlocking scale investment.

Currently, the withholding tax on investment in commercial property is 15% while for residential it is 30%. In principle, it seems logical to equalise those rates between investment types, although National Shelter's position is that in looking at equalisation of withholding tax, the rate of it may need to be adjusted upwards from 15%.

State taxes: Stamp Duty & Land Tax

Stamp duties are taxes on the sale of items (property) payable by the buyer on purchase, widely regarded as anachronistic, archaic, no longer fit for purpose adding inflationary costs [7], inhibiting workforce mobility and the ‘right sizing’ of property for a household's makeup, e.g. older people requiring a smaller property in retirement or after raising families.

Stamp duties are a major source of revenue for State and Territory Governments in Australia and create major variations in revenues from year to year based on the value and rate of properties increasing in price and the turnover of properties in any given year. They create a boom-bust cycle for State and Territory revenues. The revenue cycles could be alleviated by shifting from stamp duties to broad-based land taxes which would provide a predictable and regular income stream to the same value as stamp duties, without the inflationary impact, being levied annually rather than as a one of cost at purchase.

Land taxes are considered to be more efficient and fairer means of applying tax to land’s unimproved value. The current application of land taxes has many exemptions which reduces its fairness and efficiency.

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7 https://tticdn.blob.core.windows.net/tti-files/dmfile/0688nat_project_reform_paper-case-for-change_v16_online.pdf?__hstc=29393440.024376248d802f82b23f080977e0b821.1626391046761.1626391046761.1626828971150.2&__hssc=29393440.2.1626828971150&__hsfp=2186660142&hsCtaTracking=b548fc60-f92d-47ad-b5e4-6dfa8847a4de%7Caa9ca599-9c4a-4981-b280-923857333371

The Australian Capital Territory has already legislated to move, over a twenty year process, from stamp duties to a broad-based land tax and other jurisdictions (New South Wales) have flagged an intention of making the switch.

The Tax Institute supports a move to a property tax, broadly a stamp duty for land tax swap, but with fewer exemptions and consideration of other factors.

"There are a number of key factors when considering reform in this area. One is establishing a comprehensive base with minimal exceptions. Another is determining the appropriate rate (or rates) at which the tax will be imposed (and the extent to which any thresholds will operate in tandem). Whether or not reform in this area should be revenue-neutral, and how the desired outcome can be achieved, whether in the short, medium or long term. Another important consideration is the potential overlap between a property tax and local government charges, such as council rates and levies. While the real risk here is different levels of government competing for the same base and potential double taxation, the opportunity is the streamlining of regimes which can lead to greater cohesion between different levels of government, thereby further enhancing efficiency. A reform package which takes into account these factors would lend itself to greater efficiency, stability and a fairer outcome for residents." [8]

Consideration might also be given to an optional system where purchasers have the option of paying an upfront one-off payment akin to a stamp duty although this would add complexity to the changeover.

National Shelter has considered these inputs and recommends that States follow the ACT down the 20-year process of swapping stamp duties for a broad-based land tax.

Superannuation

In recent years, as superannuation balances rise and rates of homeownership decline, there have been increasing calls to allow people to draw on their superannuation accounts to provide deposits for home ownership.

At the end of working lives, as more people retire owing money on mortgages, they are increasingly using superannuation to pay off outstanding mortgages at retirement.

It appears to be a logical change to allow people to draw on superannuation except it would exacerbate and amplify existing distorting effects in housing markets.

We have already shown how the use of first homeowner grants, negative gearing and capital gains tax discounts combine to increase demand-side pressure to inadequately supplied housing markets which adds inflationary pressure. Allowing access to superannuation would do exactly the same thing.

The net result of all these existing and proposed measures is to inflate prices by at least as much as is provided in grants, tax discounts and offsets.

8 Ibid