Australia's future tax system

Balancing our taxes to remove distortions in our housing system

Acknowledgements

This report was compiled by Adrian Pisarski, Chairperson of National Shelter based on a report by Craig Johnston at Shelter NSW subsequent inputs from a range of stakeholders and informed by a national roundtable on the tax treatment of housing conducted in May 2001.

The report was possible due to the financial support of the Department of Families and Housing Community Services and Indigenous Affairs, FaHCSIA.

Introduction

This paper forms an addendum to the discussion paper, "Issues from the Henry report on Australia's future tax system for housing policy", released by National Shelter in December 2010. Our discussion paper provided a point of entry for those wishing to consider the tax treatment of Australia's housing system.

This paper has utilised that discussion and created principles and responses to the Henry recommendations which we believe should be implemented to redress a fundamental imbalance in Australia's tax treatment of housing.

The current tax system inflates house prices and rents, reduces housing and employment mobility, inflates household and national debt, rewards speculative activity, reduces productive capacity in the economy and aggravates inequity.

Without addressing these fundamental structural problems, our governments at all levels, our community housing sector, our welfare service system and our homelessness response system will always be wading against the general current in trying to house those most in need.

Without reforming tax we will continue to experience market failure for our lowest income households, will continue to exclude those households from opportunity and undermine their capabilities. We will exacerbate existing inequality, especially inter-generational inequality and further reward those who have been able to gain a foothold in the housing market.

National Shelter supports the pattern of Australian housing and would like to see a future where there is greater levels of ownership and a more equitable range of choices for consumers whether purchasers, renters, in shared equity arrangements or if renting from private, community or government agencies.

National Shelter would also like to see the development of institutional investment in residential property and move away from sole reliance on smaller investors reliant on tax concessions.

We believe there is a great deal of merit in applying many of the Henry review recommendations in relation to tax and propose a range of principles and specific responses in this paper.

Principles

Changes to the tax system should be based on the following principles. The tax treatment of housing should:

1. Improve access to good quality housing for low income households
2. Reduce inflationary pressure and improve housing affordability
3. Remove distortions which favour building upper-price housing rather than lower-price housing.
4. Encourage stable rather than volatile revenue streams
5. Influence markets to create more affordable housing
6. Encourage housing security
7. Remove barriers to housing mobility

Henry's recommendations and responses by National Shelter

14. Provide a 40 per cent savings income discount to individuals for non-business related: (a) net interest income; (b) net residential rental income (including related interest expenses); (c) capital gains (and losses); and (d) interest expenses related to listed shares held by individuals as non-business investments …

15. When the 40 per cent savings income discount is introduced a smooth transition should be provided to minimise any disruption that may arise. The transition to a savings income discount for net residential rental income should only be adopted following reforms to the supply of housing (Part Two Section E4 Housing affordability) and reforms to housing assistance (Section F5 Housing assistance).

National Shelter response:

National Shelter supports this recommendation towards turning around a regressive trend in taxation treatment. This change could encourage improved investment distribution and help remove distortions which encourage speculation.

25. While no recommendation is made on the possible introduction of a tax on bequests, the Government should promote further study and community discussion of the options.

National Shelter response:

National Shelter supports further investigation and encourages consideration of taxing bequests.

51. Ideally, there would be no role for any stamp duties, including conveyancing stamp duties, in a modern Australian tax system. Recognising the revenue needs of the States, the removal of stamp duty should be achieved through a switch to more efficient taxes, such as those levied on broad consumption or land bases. Increasing land tax at the same time as reducing stamp duty has the additional benefit of some offsetting impacts on asset prices.

52. Given the efficiency benefits of a broad land tax, it should be levied on as broad a base as possible. In order to tax more valuable land at higher rates, consideration should be given to levying land tax using an increasing marginal rate schedule, with the lowest rate being zero, with thresholds determined by the per-square-meter value.

53. In the long run, the land tax base should be broadened to eventually include all land. If this occurs, low-value land, such as most agricultural land, would not face a land tax liability where its value per square metre is below the lowest rate threshold.

National Shelter response:

National Shelter supports a move by states from stamp duties to land tax as outlined in the Henry Review

69. COAG should place priority on a review of institutional arrangements (including administration) to ensure zoning and planning do not unnecessarily inhibit housing supply and housing affordability.

70. COAG should review infrastructure charges (sometimes called developer charges) to ensure they appropriately price infrastructure provided in housing developments. In particular, the review should establish practical means to ensure that these changes are set appropriately to reflect the avoidable costs of development, necessary steps to improve the transparency of charging and any consequential reductions in regulations.

National Shelter response:

National Shelter supports a review of institutional arrangements to ensure zoning and planning encourage housing supply, affordability and good access to services and opportunities.

88. The current income and asset tests for income support payments should be replaced with a comprehensive means test based on a combined measure of employment income, business income and deemed income on assets.

National Shelter response:

National Shelter supports this recommendation.

102. The maximum rate of Rent Assistance should be increased to assist renters to afford an adequate standard of dwelling. To ensure that Rent Assistance can be maintained at an adequate level over time, the rent maximum should be indexed by movements in national rents, which could be measured by an index of rents paid by income support recipients.

National Shelter response:

National Shelter has as policy that the maximum rate of rent assistance should be lifted by 30%

103. To better target an increase in the maximum rate, Rent Assistance should be part of the income support system, with eligibility based on rent paid and the income support means test, rather than on eligibility for another payment (for example, Family Assistance).

National Shelter response:

National Shelter supports this recommendation

104. Mechanisms should be developed to extend Rent Assistance equitably to public housing tenants along with removing income-linked rent setting in public housing.

105. A high-need housing payment should be paid to social housing providers for their tenants who have high or special housing needs or who may face discrimination in the private market. This payment should be funded by the Australian government. The Commonwealth and the States should retain the option of providing capital for social housing construction.

106. Income-linked rents should be phased out in social housing, with providers charging their tenants rents linked to the market rate, with existing rent-setting for current tenants phased out using grandfathering or other transitional arrangements. However, continued use of income-limited rents is appropriate in some circumstances, such as in remote Indigenous communities.

National Shelter response:

National Shelter recognizes the inequities between systems and tenants in different systems that lead to the recommendations in Henry's review.

However we propose an alternative means of resolving the issues raised. The solutions to these problems are in themselves complex and require a more detailed response than is allowed for here and will be the subject of further papers around the structure of a National Affordable Housing Agreement. However for the purposes of this paper they include but are not limited to:

- **Fund the operating costs of the public housing system on a per dwelling basis**
- **Create a growth fund of (min) $1.5b per annum in addition to the operating cost and distributed on a per capita basis to states**
- **Broaden the eligibility criteria for all affordable housing programs**
- **Begin a process of stock transfer up to 65% of total stock held by State Housing Authorities to the community housing sector, 50% of which with full title**
- **Allocate dwellings on a portfolio basis with minimum requirements for tenant and rent profiles (including a range of market based and income based rents) to ensure growth of the system's allocations to highest needs households**
- **Allow flexible operations by both SHAs and community providers to encourage innovative thinking for housing development and delivery, including mixed tenure developments, whilst meeting minimum requirements established by the NAHA**

120. States should allow local governments a substantial degree of autonomy to set the tax rate applicable to property within their municipality.

National Shelter response:

National Shelter supports this recommendation

121. Over time, State land tax and local government rates should be more integrated. This could involve: (a) moving to a joint billing arrangement so that taxpayers receive a single assessment, but are able to identify the separate State and local component; and (b) using the same valuation method to calculate the base for local government rates and land tax (with this method being consistent across the State).

National Shelter response:

National Shelter supports this recommendation.

Post Discussion paper activity

Since delivering the discussion paper to FaHCSIA National Shelter has also distributed the paper to a range of sources including all members, has posted the discussion paper on our websites and sought feedback from stakeholders and members.

After considering the range of feedback, we conducted a roundtable on the issues raised by the Henry report and the discussion paper to arrive at draft policy positions in relation to the tax treatment of housing and specifically in relation to the Henry Review's proposals.

The roundtable invited a range of experts to provide their views and asked them to attend with the goal of developing policy positions which could be proposed to National Shelter.

Roundtable

The Roundtable was held I Sydney on May 26 2011 and was attended by

- Nicola Ballenden - General Manager, Public Affairs and Development, Brother of St Lawrence
- Kate Colvin - Policy and Public Affairs Manager, Victorian Council of Social Services
- Carol Croce - Executive Director, Community Housing Federation of Australia
- Peter Davidson - Senior Policy Officer, Australian Council of Social Services
- Julian Disney - Convenor, TaxWatch
- Saul Eslake - Program Director, Grattan Institute
- Warren Gardner - Senior Policy Officer, NSW Council of Social Services
- Jason March - Chief Financial Officer, Brisbane Housing Company
- Chris Martin - Senior Policy Officer, NSW Tenants' Union
- Viv Milligan - Associate Professor, City Futures Research Centre, University NSW
- Adrian Pisarski - Chairperson, National Shelter
- Judy Yates - Honorary Associate, School of Economics, University of Sydney

The Roundtable considered the report in general, looked at the specific positions developed in the henry report, suggested there needed to be principles which were being followed and then examined the tax treatment of owner occupied and rental housing as specific items.

The Roundtable also looked at the National Rental Affordability Scheme and the tax treatment of housing under the auspices of community housing organisations.

Issues and concerns

A number of general and specific issues and concerns were raised through our process. Feedback following our discussion paper continues to focus on the generosity of capital gains tax exemptions for both owners and investors and the ability to claim offsets against any income source. The tax system encourages owners, bequest recipients and investors to invest in the highest value properties and to stay in high value property whether it is the most suitable housing or not.

It encourages renovation in periods of low market activity further adding to potential overinvestment. It locks household capital in housing which is a non-productive asset and reduces the availability of capital to other purposes

Tax and transfer system

- It is important to see tax and transfer system as a greater whole, as the Henry review does. Analysis must seek to understand the interaction between the two, and give due regard to where reforms to taxes may have a negative impact on the transfer system, particularly the level at which people lose their entitlements to housing assistance.

- The tax system currently distorts household choices in favour of higher priced housing and of those with high incomes. There is a need to create equality of investment opportunity at all price points in the market.

General principles for reform

> Tax reform principles are often based on equity, efficiency and simplicity, we can see where Henry has utilised efficiency and simplicity and believe there is an under-utilisation of equity as a principle.

> We understand that the review's author has drawn on Amartya Sen's capabilities approach which focuses on a person's actual ability to be or do something, rather than on non-interference. However the review might also have considered Sen's approach to structural inequality in the distribution of housing which may have led to including equity as a key issue for reform.

> An approach to tax reform could consist of broadening bases and reducing rates, to achieve the lowest rates required to accrue the revenue needed. However recent history has seen most changes result in a narrowing base of taxes and therefore higher rates. Governments are now increasingly dependent on a narrow range of taxes.

> Because Henry reforms are so deeply interconnected, the community sector must set very clear principles and then test all proposed reforms against them. Principles might include:

Tax changes must improve the situation of lower income households. Reforms should ensure that changes should improve the disposable incomes available to low income households after their housing costs are met.

1) Tax Treatments of housing must reduce inflationary pressure and improve housing affordability overall.
2) Tax adjustments should include a consideration of equity and act to redistribute housing towards lower income households.

> More specific goals arising from these principles include:
1) Removing distortions which favour higher-priced housing rather than lower-priced housing.
2) To influence markets to create more affordable housing, more options for lower income households and to take pressure off affordability more generally.

These two goals would create more housing for lower-income households. This is important because the current distribution sees low priced housing taken by people who can afford to pay more, leaving little for those who can't.

Federal and state nexus

> There is a need to keep in mind the relationship between federal and state taxes. It is important to look at the overall picture, which currently trends towards fiscal federalism with more and more contraction of state tax revenue.

> There is general support for states to move to a land tax base as a more stable, reliable and non-inflationary means of taxing land and housing. Greater benefits could also be delivered to non-profit providers through land tax exemptions on aggregated land holdings than are currently possible without negative impacts on states' budgets.

> There is general support for the notion that stamp duties, whilst not intrinsically regressive, are flawed as a basis for taxing housing at the state level. Stamp duties are levied on buyers rather than sellers and collect large revenues in upward parts of housing cycles and consequently low revenues in downward or flat parts of the housing cycle. They create cyclical issues for States as a source of revenue discourage household mobility of in relation to employment opportunities. If States adopted a move to land taxes then stamp duties could be removed or phased out.

> Historically, competition amongst states has prompted state taxes to move in the opposite direction of good tax reform, for example very low payroll tax rates and very narrow land tax base. States could take steps to remedy this situation but they would have to act together. If they agreed to jointly change the way taxes operate, no state would be 'penalised' by the Commonwealth Grants Commission. The commission only equalises changes when states act unilaterally.

- Another option regarding the Grants Commission is to attempt to redefine the basis of deciding whether states are really utilising their base. If it was possible to have a particular tax base (eg. land tax) considered as something a state should be doing, then states who moved towards the tax wouldn't lose their advantage.

- The states have a number of options for increasing their revenue base. It should not be assumed that the only avenue for increasing state tax revenue is increasing land tax. For example, while the constitution says states can't levy a Goods and Services Tax, there is nothing to say they can't tax just services. Tasmania and the Northern Territory both used to levy taxes on services like hotel rooms. Other service areas could be examined for their potential to be taxable by States which could help to broaden state tax bases.

- A great deal of discussion and debate has centred around the cost of land provision and charging for infrastructure and servicing for housing. National Shelter is unconvinced that land provision, or shortage, plays as central a role as portrayed by elements of the housing industry and media. National Shelter agrees that the cost of providing land should be kept at a minimum and that planning systems should encourage the provision of affordable land and housing. We also agree that there is a high burden on new home purchasers for the provision of infrastructure that could be more equitably shared across communities. We are unconvinced that an emphasis on new releases at the urban fringe assist with household living costs. The relationship between transport cost and housing cost need to be considered together with opportunities for employment, access to services and household and community wellbeing.

Public housing, commonwealth rent assistance and rent levels in affordable housing dwellings.

- The relationship between public housing, Commonwealth Rent Assistance (CRA), rent levels in the private sector and in affordable housing dwellings has a long history and complicated interactions.
- Funding for public, or wholly subsidized and constructed, housing has changed over time from a broader based, internally subsidized and self-sufficient program, to a residualised, highly subsidized, narrow welfare housing program.
- Since Commonwealth Rent Assistance was introduced it has become the dominant form of assistance provided by the Commonwealth. Since the introduction of a NAHA removing the previous cap on state transfers to the community sector outlays on CRA have the potential to blow budget estimates on CRA as it is capable of being used by tenants of community housing in stock transferred from SHA's whose tenants are not eligible.
- Reliance on CRA has meant a reduction in capital outlays for public housing over the period 1996-2008
- There is a broad perception that increases to CRA could result in higher rents in the private market, this is most likely in rental cycles with very tight vacancy rates, which have been the case in Australian markets for the past 3-5 years. This is noted by Henry and acknowledged as an outcome.
- There are specific differences between how the Commonwealth treats housing managed by state housing authorities as compared to community housing organisations. E.g. tenants of SHAs are not able to claim Commonwealth Rent Assistance while those housed by community organisations are, community housing organisations claim GST exemptions when constructing housing. Removing distortions between housing provided by SHAs and that transferred to or acquired by community organisations is desirable but may be achieved through means other than high needs housing payments and or moving to market rents.
- The profile of tenants currently housed by SHAs and community providers does not include a high proportion of households who are job ready and therefore the suggested work disincentive of income based rents is probably overstated. AHURI research conducted by Gavin Wood indicates that while there are disincentives to work in public housing and CRA, that there is also a noted improvement in

employment outcomes after tenants move into public housing and that for many public tenants work is not an option whilst they are parenting or recovering from health issues.

> There is a strong case for retaining direct investment in fully subsidized housing as well as considering other means of correcting current distortions.

Political nature of reform

> It is important to recognise the political economy on tax reform measures. Timing of the introduction of measures is crucial. For example measures are better introduced at specific phases in the housing cycle, not at times when there is a high risk of mass impact. Changes in house values could be attributed to the reform measures, be reversed and then become very difficult to re-introduce. A flat or slightly declining market could be the best time to introduce a capital gains tax on houses over a determined value as households would not feel an immediate impact.

> Another critical factor in the political equation is the need for offsetting measures. Creating packages of tax reforms is very important. Often you can achieve something of enormous value by doing something of little or possibly slightly negative value. However you need to create packages that 'work'. For example, in NSW an attempt to broaden the base of land tax for owner occupied housing by lowering stamp duty was met with interest from the Ministerial office. They had been looking into it themselves but they then found that the level of land tax required to compensate for loss of stamp duty revenue would be too high to be palatable.

> There could be an opportunity to marry the removal of concessions, like negative gearing and capital gains tax concessions for investors, with increases in public investment in subsidies for low cost housing (both through NRAS and capital injections).

Conclusion

The Henry review recognises the Australian housing market is distorted by current tax treatments of housing and proposes far reaching reforms. The review recognises housing as both an investment asset and as a service providing a consumption good.

Australia has treated owner-occupation as a consumption good, and private rental purchase and ownership as an investment good, for tax purposes. The way that owner-occupation and rental housing are taxed favors owner-occupation over rental.

Henry believes our tax settings are not the fundamental means to addressing the growing unaffordability of Australia's housing or to establish desirable housing prices, however he recognises they do influence patterns of investment, ownership and renting.

The thrust of this paper has been towards getting the tax contribution to our housing affordability, distribution, patterns of investment and consumer choices aligned with the notions of Sen's capability philosophy which underpins Henry's thinking, or in keeping Australia as a place where opportunities for individuals and households are as equitably distributed and equally supported as they possibly can be.