Fixing tax, fixing housing: what reforms will improve housing affordability

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Introduction
Overview of presentation

- How is housing taxed in Australia?
- Key differences and similarities with other countries
- What are the key issues?
- Why are they so important - yet difficult to address?
- Policy Reform – is there any ‘low hanging fruit’?
- Replace stamp duties by a uniform land tax
- Better align investor tax concessions to social goals
### The taxation of housing

**GST**

<table>
<thead>
<tr>
<th>Owner occupied housing</th>
<th>Private rental housing</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Goods and Services Tax</strong></td>
<td></td>
</tr>
<tr>
<td>On sale of new houses and renovations to existing property</td>
<td>The lease of property is not subject to GST, but is ‘input taxed’</td>
</tr>
</tbody>
</table>
## The taxation of housing

### Income tax

<table>
<thead>
<tr>
<th></th>
<th>Owner occupied housing</th>
<th>Private rental housing</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Income tax</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Rental income</strong></td>
<td>Imputed rental income exempt (except 1915 – 1923)</td>
<td>Rental income included in assessable income</td>
</tr>
<tr>
<td><strong>Deductions (tax allowances)</strong></td>
<td>No allowances</td>
<td>Allowances for mortgage interest, repairs, land tax…etc. And can be ‘negatively geared’</td>
</tr>
<tr>
<td><strong>Capital gains</strong></td>
<td>Capital gains exempt</td>
<td>50% of realised capital gains added to assessable income and taxed according to the ‘top slice’ method</td>
</tr>
</tbody>
</table>
## The taxation of housing

### State and local government

<table>
<thead>
<tr>
<th></th>
<th>Owner occupied housing</th>
<th>Private rental housing</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Annual land tax</strong></td>
<td>Land tax exempt</td>
<td>The cumulative value of land taxed according to a progressive rate structure</td>
</tr>
<tr>
<td><strong>Stamp duty</strong></td>
<td>Purchasers pay duty on purchase price according to a progressive rate scale; some concessions to first home buyers</td>
<td>Investors pay duty on purchase price according to a progressive rate scale</td>
</tr>
<tr>
<td><strong>Local government rates</strong></td>
<td>Typically paid on unimproved capital value at a flat rate per dollar; some concessions to pensioners</td>
<td>Typically paid on unimproved capital value at a flat rate per dollar</td>
</tr>
</tbody>
</table>
The issues
Federal tax arrangements – home owners

- Empirical studies confirm that owner occupied housing is favourably treated by the taxation system in comparison to other assets.
- This ‘uneven playing field’ promotes ownership and the accumulation of savings in housing wealth.
- With inelastic housing supply tax concessions capitalised into house prices.
- Home ownership becomes less accessible.
- First home buyers becoming more indebted with consequent rise in investment and repayment risks.
- The tax concessions largely flow to high income, older home owners.
## Mean tax subsidy
by age and gross income quintile

<table>
<thead>
<tr>
<th>Age (years)</th>
<th>Gross income (Y) quintile ($’000)</th>
<th>All</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Y&lt;22</td>
<td>22&lt;Y&lt;39</td>
</tr>
<tr>
<td>25-34</td>
<td>473.3</td>
<td>1282.3</td>
</tr>
<tr>
<td>35-49</td>
<td>976.5</td>
<td>2347.3</td>
</tr>
<tr>
<td>50-65</td>
<td>2349.0</td>
<td>3451.2</td>
</tr>
<tr>
<td>&gt;65</td>
<td>2523.5</td>
<td>4889.0</td>
</tr>
<tr>
<td>All</td>
<td>2308.9</td>
<td>3798.6</td>
</tr>
</tbody>
</table>

Dollar value ($)
The issues
Federal tax arrangements – investors

- Critics point to ‘negative gearing’ as a tax shelter that imposes an unfairly high tax burden on other taxpayers
- But the discount on capital gains also offers important tax advantages relative to other sources of income (e.g. interest on bank deposits)
- The discount is most valuable to high tax bracket investors
- The discount and negative gearing means that high bracket investors can supply rental housing at a lower economic cost
- But low bracket investors still manage to survive though they need higher rental yields
- This disadvantages the more affordable segments of the market
The issues
Federal tax arrangements – the status quo

- There are benefits claimed on behalf of housing tax preferences
- Social benefits from a home ownership society supported by tax concessions (e.g. neighbourhood effects; sense of security)
- In Australia home ownership plays an important welfare role supporting living standards on old age
- After-housing cost poverty rates among seniors low by international standards, and is a pay-off from tax concessions promoting home ownership
- Negative gearing increases the supply of affordable rental housing
The issues
State government tax arrangements – stamp duty

- There is no strong efficiency rationale.
- The duty does not achieve an obvious redistribution goal.
- Stamp duties can impede access to home ownership.
- Those who move more frequently pay relatively high amounts of duty during their lifetimes – ‘tax on mobility’.
- It deters the transfer of property from lower value uses to higher value uses. It therefore impedes the efficient allocation of land and buildings between competing uses.
- But an important (if volatile) source of tax revenue for state governments.
The issues
State government tax arrangements – land tax

- Land tax is not uniformly applied and is therefore distortionary with negative impacts on productivity
- Land tax applies to the *cumulative* unimproved value of land:
  - Single property owners typically have a small or more often zero tax liability, while multiple property owners have relatively high tax burdens.
  - Important barrier to the attraction of private finance (superannuation funds, for instance).
A reform package that has attracted considerable support involves:

- Stamp duties on conveyance abolished and replaced by a broad based land tax that is paid by all landowners and levied by applying a flat rate structure to $m^2$ unimproved capital values above a threshold.
- The administration and collection of land taxes and rates merged

The number of taxes is reduced by one as there is already a land tax.
Possible future policy directions
Stamp duty and land taxes (2)

- If no land is exempt taxes will be capitalised into lower land values.
- Landowners cannot ‘escape’ the tax by changing land use.
- Those uses currently subject to land tax will expand (industrial, commercial, private rental housing).
- Development of vacant unused land accelerated
- Evidence suggests that land tax burden higher in communities where pressures on land use acute and household incomes higher
The geography of land taxes
Simulation modelling - Melbourne

<table>
<thead>
<tr>
<th>Distance to CBD (10km intervals)</th>
<th>Revenue</th>
<th>Proposed land tax</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Sum $ (millions)</td>
<td>% of Aggregate revenue</td>
</tr>
<tr>
<td>0km &lt; 10km</td>
<td>590</td>
<td>46%</td>
</tr>
<tr>
<td>10km &lt; 20km</td>
<td>488</td>
<td>38%</td>
</tr>
<tr>
<td>20km &lt; 30km</td>
<td>130</td>
<td>10%</td>
</tr>
<tr>
<td>30km &lt; 40km</td>
<td>29</td>
<td>2%</td>
</tr>
<tr>
<td>40km &lt; 50km</td>
<td>25</td>
<td>2%</td>
</tr>
<tr>
<td>50km &lt; 60km</td>
<td>10</td>
<td>1%</td>
</tr>
<tr>
<td>60km &lt; 70km</td>
<td>17</td>
<td>1%</td>
</tr>
<tr>
<td>&gt;70km</td>
<td>2</td>
<td>0.2%</td>
</tr>
<tr>
<td>Total</td>
<td>1,290</td>
<td>0.4%</td>
</tr>
</tbody>
</table>
Investor tax concessions

- Strong sentiment favouring their retention in political circles
- Fears that their removal would result in a contraction in supply
- But are these fears exaggerated?
- Equity investors are an important source of rental housing
- The ‘Buy to Let’ Boom in the UK has helped increase private rental housing to 18% of all households (2010)
- The private rental sector in USA has maintained a tenure share in excess of 20%
- In UK tax relief is being reduced and in the USA negative gearing is not permitted
Investor tax concessions
Possible reforms

- The Henry Review advocated a Savings Income Discount
- Other options include targeting concessions such as negative gearing on new supply
- Or as a condition for entering into secure leasing private-public partnerships
- These reforms seek to align tax concessions with housing affordability goals
Concluding remarks

- There is a new concern starting to influence debates around the fiscal treatment of housing
- Following the GFC there is a growing interest in measures that strengthen the resilience of housing markets
- Limitations on measures that promote indebtedness and are procyclical
- Instead introducing tax reforms that encourage flexible supply responses, efficient use of the housing stock and prudent borrowing