LAND AND HOUSING

[This Note summarises a number of problems and options for action which have been identified by tax experts, leading community sector organisations and other analysts as needing attention in the Henry report. TaxWatch itself does not express policy views.]

HOME PURCHASE

Some key problems

Housing is taxed more lightly in Australia than in almost every other developed country but this has backfired by stimulating excessive demand and inflating prices and rents. Our house prices relative to household income are now higher than in almost every other OECD country and, according to the IMF, over-priced by at least 40%. A major cause has been full exemption of all principal residences (ie, owner-occupied homes) from capital gains tax and land tax..

These exemptions are highly inequitable because they are of very much greater value for higher-earners than lower-earners, both overall and per dollar spent on home purchase. They greatly disadvantage young home purchasers, who often are also bearing the costs of parenting, but hugely benefit many established home owners. These problems are exacerbated by Australia's almost uniquely generous approach towards taxation of assets in general, due to the lack of a general tax on asset ownership and a gift and inheritance tax.

The exemptions also distort the use of housing and the patterns of urban development. For example, they tend to aggravate urban sprawl and thus lengthy travel times within cities. Together with the exemption of homes from the pension assets test, and the relatively high stamp duties on people wishing to sell and buy elsewhere, they encourage people to build or remain in housing which is larger than they need or is inappropriately located.

Tax exemptions and concessions for housing cost government revenue more than $20 billion each year. In addition, governments incur extra cost through inflation of the prices which they have to pay for public housing and of the size of grants to first home buyers. Yet even when some houses increase greatly in value due to planning changes or major public expenditure on a road or other key urban infrastructure, their owners' windfall gains remain largely tax-free. By contrast, the cost of buying in new suburbs may be increased by councils requiring developers to help meet basic infrastructure costs.

Options for Action

- ☐ Put an upper limit (eg, $1 million) on the value of a principal residence which is exempt from annual land tax, but allow payment to be partially deferred until the property is transferred by sale or death.
- ☐ If this limit is applied, also remove or reduce stamp duty on purchases of principal residences below a specified mid-level value, irrespective of whether they are first home purchases.
- ☐ Put an upper limit on the value of a principal residence which is exempt from the pension assets test, or the "deemed" income test, for the age pension.

- ☐ Introduce a "betterment tax" on increases in value arising from major planning or infrastructure initiatives by government, while also discontinuing or reducing developer levies.
- ☐ Apply the capital gains tax when property is transferred by bequest, rather than only by gift or sale.

RENTAL HOUSING

Some key problems

Excessive encouragement for ”negative gearing” by investors in residential property has caused serious harm. This includes unduly generous tax deductibility of investors' expenses, such as mortgage payments, and the general 50% discount on capital gains tax for property owned more than 12 months. The attractions of negative gearing are increased by capital gains being taxed only when property is sold, rather than as they accrue during ownership, yet the investor's expenses can be deducted on an annual basis.

Huge increases in negative gearing in recent times have greatly inflated house prices to the detriment of homebuyers and also of many investors who do not want to negatively gear. When inflation slowed and investors could no longer be sure of major capital gains, the shortage of rental accommodation became acute and rent levels surged. Other damage includes inflation of household debt levels and the diversion of investment resources into property speculation rather than genuinely productive activities.

The wide array of exemptions from land tax means that rates for non-exempt investors are higher than would otherwise be necessary to raise the same amount of revenue. Some landlords may be deterred from having substantial portfolios of low-rent dwellings by the fact that land tax rates per dollar usually increase as the value of the landlord's total rental property holdings increases, rather than being assessed separately for each property ("disaggregated”).

Options for Action

- ☐ Make interest payments and other investment expenses deductible only against income from investment rather than, for example, from salaries.
- ☐ Reduce or remove the 50% discount on capital gains for individuals, at least for assets held for less than five years (perhaps with a capped exemption for all gains, including housing, below an overall lifetime total).
- ☐ Provide disaggregation of land tax rates for low-rent dwellings (eg, those under the new National Rental Affordability Scheme).