TAX FORUM 4-5 October 2011

STATEMENT OF REFORM PRIORITIES

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STATEMENT OF PRIORITIES

Tax Reform and Australia's Housing Shortage

Current Situation

Australia has a critical, structural housing shortage and a crisis of housing affordability. Tax reform is a powerful means to address these problems.

The HIA's most recent estimate forecasts a shortage of over 500,000 dwellings Australia-wide by 2020. The ANZ recently estimated the current underlying shortage as 54,000 dwellings. The Grattan Institute reports a cumulative undersupply of 105,000 apartments in Melbourne and Sydney.

Far from being just an economic problem, the housing shortage speaks to the kind of society we want, our sense of fairness and our sensitivity to the plight of Australians.

Despite brief respites in the climb of property prices (due more to fear of global economic circumstances than any change in the Australian property market or need), the cost of building new dwellings including unproductive taxes and other statutory charges, ensures that housing continues to be unaffordable. Many young people and families now believe that home ownership is beyond them. Those that over-reach, face cost of living pressures that leave them even more exposed to domestic and international economic uncertainties.

Governments, Federal and State, have not been ignoring this situation. Measures such as the First Home Owner's Grants (FHOGs) on existing residential, GST exemptions for existing residential and recent stamp duty reductions have been designed to help Australians own their own homes. However, these measures have not alleviated the problem.

Current measures do not address supply

Policy has not achieved its aims as it has not addressed supply as its main focus. It is only by increasing supply of new residential, driven by the private sector, that lack of affordability of both home ownership and private rental can be improved or resolved. Appropriate tax settings can reduce the cost of new dwellings and increase the numbers being built.

Conversely, measures that put more money in the hands of buyers to acquire existing residential have only pushed prices up - a reality that the FHOGs on existing property have demonstrated. These incentives have increased demand without addressing supply or price. FHOG statistics in respect of 2010/2011 indicate that a majority of grants were in fact claimed by people acquiring existing residential.

In Victoria alone (figures readily available) in respect of the year 2010/2011, almost two out of every three FHOGs (total in excess of $118Million) were granted on existing residential, providing little or no economic benefit and not creating a single new dwelling. These grants should be used to increase supply - by increasing or expanding FHOGs on new residential only. On the basis of redirecting $118Million FHOGs as above to residential construction, this alone could have created approximately $340Million in economic activity with the attendant benefits and the creation of many new homes.

An increase in construction would boost economic activity – for every $1Million increase in construction output, there is an increase in output elsewhere in the economy of $2.9Million.

The majority of States provide benefits to first home purchasers of existing homes.

Existing residential vs. new residential – taxes do not reflect the difference

The supply of existing residential housing remains constant (increases competition) and new residential housing is, by definition, always an increase in supply.

Given that encouraging construction of new residential dwellings is the only way to increase housing supply, one would expect that taxation would treat new residential dwellings favourably, i.e. make the tax burden for a new dwelling (and therefore the cost) cheaper than an existing dwelling. The reverse is the case.

The distinction between existing residential and new residential dwellings is a fundamental factor that must be considered by governments. The lack of such a distinction in a number of subsidies and taxes has been a major contributor to undesirable levels of residential dwelling price escalation and increasing gap between supply and demand, and the worsening affordability of housing.

Using an example of a dwelling worth $500,000 (median price of Australian capital cities ranges from $400,000 plus to $600,000 plus), the combination of GST and stamp duty make the tax burden in the vicinity of $35,000 to $50,000 greater for a new dwelling than an existing one.

Given the desire of governments to increase supply and make housing more affordable, this is a counter-productive outcome. Current tax policy does not encourage new construction, it actually encourages competition within the existing residential market.

State Governments have faced intense pressure to lower stamp duty without making a distinction between new and old in an attempt to make housing more affordable. Hopes that this will help to solve the housing shortage or improve affordability are unrealistic.

Stamp duty relief on existing residential will not increase supply

When the full effect of various proposed stamp duty reductions and the expiration of the boost to the FHOG on new dwellings (2012) are felt, the tax burden for a new dwelling as compared to an existing one will be even more pronounced. This will result in even more people competing for existing dwellings and an even more limited supply. This has been acknowledged recently in New South Wales which has abolished stamp duty exemptions on existing residential (eligible first homes) as of 1st January 2012.

Tax on the production of new housing should be streamlined

The production of new land, house and land packages and apartments is tantamount to a manufacturing process. However the process is treated differently from other manufacturing processes. In the vast majority of the manufacturing sector, there are no imposts during the process of production and the taxing point is usually at the point of sale. However, new housing suffers from a multiple set of taxing points and the consequential tax on tax. These imposts greatly increase the end cost. In large residential projects which may span four or five years there are multiple points of stamp duty, on acquisition by the developer, on subdivision and resale to builders and/or end user, land tax during the subdivision and construction periods and GST being payable on the end sale value.

Over time with the cascading effect of taxes on taxes and charges, these imposts now form a major component of the end price of residential land.

Convergence of the Goods and Services Tax and State Taxes

This paper is not a submission on GST, which is outside the scope of this Tax Forum. However, GST is necessarily referred to, as it is essential to recognise that some of the recommendations and propositions likely to be made in this Forum to change of other taxes, especially other indirect taxes like stamp duty and land tax, could significantly deepen the currently existing undesirable distortions caused by the current GST regime as it applies to new residential properties.

An analysis of the convergence of the GST and other taxes is necessary if we are to bring down prices and start to meaningfully address both the housing shortage and related housing affordability crisis.

New residential construction contributes to economic activity almost $40Billion inclusive of $3.7Billion GST. The value of non-residential construction works and engineering works is approximately $121Billion, which effectively yields no GST revenue.

Inbound Investment

Inbound investment in respect of the construction and purchase of new residential dwellings is a very important source of finance. Given the significant economic activity and job creation in the residential sector, policies encouraging inbound investment should be maintained and encouraged.

Revenue neutral

The extension and/or increasing of the Federal Government's FHOGs on new residential only would be funded only by the elimination/redirecting of the existing FHOGs on existing residential.

We also expect that any decline in tax revenue on the sale of new dwellings due to streamlining of the tax system would be countered by revenue generated from taxes on a greater stock of properties, increased economic activity in the construction and consumer products industry and collection of future capital gains tax on increased housing stock. The construction industry has a capacity to greatly enhance collection as there are over 350,000 people employed in the sector and there are substantial benefits from the knock-on effect. A substantial portion of the cost mix in construction is labour and the income tax collections on increased activities alone will be significant.

The Future

The National Housing Supply Council (NHSC) has given us the data to illustrate the importance of tax reform in relation to housing. If we take the NHSC Household projections (medium growth scenario) and project these through to 2050 it suggests Australia would need to provide some 6.8Million additional dwellings to meet these household numbers. This must be put into context - in 2010 there were about 8.5Million dwellings in Australia.

As the concern here is tax reform we believe the biggest initiatives are around eliminating stamp duty tax exemptions or reduction on existing residential (encourages turnover not new supply), GST relief for new residential housing (this would have direct supply incentives) and restructuring to eliminate or delay the numerous taxing points in the supply of new housing for both private owner occupation and private rental.

We cannot afford a system that encourages churning of existing stock without real economic activity. This is simply inflationary. We must have a system that encourages new affordable urban development.

Australian Government

A tax plan for our future
Stronger • Fairer • Simpler

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Australia's tax system needs to reflect the seriousness and immensity of the task of fundamentally improving housing supply and affordability - a mission that requires new residential construction to be treated markedly differently in a future tax system than it is today.

Conclusions

In December 1999 the weighted median established dwelling price in capital cities was approximately $200,000. Within a decade this had increased to $480,000 and in 2011 it is in excess of $500,000. At the same time, the average full-time earnings in 2000 were approximately $40,000 p.a. and by 2011 were $68,000 p.a. This clearly demonstrates the affordability crisis that currently exists and the enormity of the task ahead.

The paradox is that as housing shortage of new residential grows, prices will grow which increases the embedded taxes which in turn lessens affordability. This seemingly inevitable cycle must be broken by appropriate tax settings introduced urgently to encourage new supply.

Areas to be considered

1. The Federal Government should extend the FHOGs and the State Government's First Home Owner's Boost and/or incentives <u>on new residential only</u>.

2. Governments should eliminate demand-side grants on existing residential.

3. State Governments should not reduce stamp duty or provide an incentive on existing residential dwellings.

4. The tax system should be streamlined to avoid multiple taxing points in the creation of new land, houses and apartments.

5. Analysis of the effect of GST on supply of new residential.

6. Federal Government stimulus by providing accelerated depreciation on new residential to encourage increased supply of private rental stock.

LIST OF ATTACHMENTS