



# TAX FORUM

4-5 October 2011

## STATEMENT OF REFORM PRIORITIES

### PARTICIPANT NAME AND POSITION

A/Prof Judy Yates

### ORGANISATION

University of Sydney<sup>1</sup> and National Housing Supply Council.

### STATEMENT OF PRIORITIES

Around two or three pages, please. Please address both of these issues:

1. What are your priority reform directions for the tax and transfer system?  
see following pages
2. How are your proposals financed over the short and longer term?  
see following pages

### LIST OF ATTACHMENTS

Yates, J. (2010a) "Tax Expenditures and Housing" in Stewart, M. (ed) *Housing and Tax Policy*, Australian Tax Research Foundation, Conference Series No. 26, 39-91

Yates, J. (2010b) "Housing and Tax: The Triumph of Politics Over Economics", in Evans, C., Krever, R. and Mellor, P. (eds) *Australia's Future Tax System: The Prospects After Henry*, Sydney: Thomson Reuters, pp233-265



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#### 1. What are your priority reform directions for the tax and transfer system?

1. Reduce the tax favoured status of owner-occupied housing. In particular, reduce concessions under the current income tax system through exemption from capital gains taxes, under the current land tax system through exemption from land taxes and under the transfer system through favourable treatment under the assets test.

Imposition of a capital gains tax to owner-occupied housing might be politically viable if, in the first instance, it applied only to gains over a defined threshold (which could be set quite high in the first instance but allowed to erode over time with inflation). Deferral until death provides a softener for asset rich income poor households (but should not be needed if tax applies only to realised gains above a high limit). Taxing only excess gains, means there is no need to simultaneously allow interest deductibility. An alternative is to tax only gains in excess of the average capital gain in housing across the country as a means of reducing spatial inequalities (again, interest deductibility would not be needed). Consideration of these options at a time when dwelling prices are flat would also reduce political pressures.

Extension of land tax to include owner-occupied housing provides an option for overcoming the political and administrative difficulties of taxing capital gains. A land tax on unimproved capital value is a tax on (unearned) economic rent and, as such is efficient. Land value assessments already exist (or can be readily obtained) as a means of defining the rate base in the various States. A land tax (which operates on an individual property base rather than on cumulative ownership and which forms part of the State rather than local tax base) could act as a supplement to rates. Broadening the land tax base (and applying it on an individual property basis rather than on cumulative holdings) would also allow a reduction in the current high marginal tax rates that act as a disincentive for large scale investment in affordable rental housing. One advantage over a CGT on realisation is that land tax would be an annual and provide predictable tax revenue.

2. Reduce deductibility of interest costs (along lines proposed in Henry Review). Quarantine losses associated with any income producing activity (such as rental investment) so that they can only apply against that particular activity.

3. Replace infrastructure charges on new development with broad based rates across all properties.

4. Despite their weaknesses, do not reduce stamp duties, at present the only significant tax on housing, until some of the above taxes are in place.

5. Provide a distributional analysis (and justification) for all proposals under consideration, particularly for proposals to tax capital income at a different rate from labour income.



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These priority reform directions focus specifically on policies that might improve housing affordability for lower income households in Australia. They are intended to address some of the distributional inequities and inefficiencies that exist in relation to housing in the current tax system.

Housing affordability in Australia has declined significantly over the past few decades. Many of the reasons for this are outside the scope of the tax system but there are tax drivers on both the demand and supply side that contribute to reduced housing affordability. In a highly urbanised economy such as Australia, with close to 40 per cent of households living in 2 cities, textbook analyses that assume infinitely elastic supply of housing (and land) are inappropriate. Regardless of what improvements are made at the fringe, without a total restructure of our settlement patterns, well-located urban land will always be in short supply. Therefore, any policy that adds to demand pressures will add to pressures on price. Policies designed to improve supply responsiveness will help to reduce price volatility and are to be encouraged. However, they will not, and cannot, remove the fundamental constraint imposed by fixed land supply in central urban locations.

More details can be found in the attached:

Yates (2010a) shows that tax expenditures for owner-occupation under the current tax system are inequitably and perversely distributed. They disproportionately benefit high income households with high net worth in owner-occupied housing and do nothing to assist first home buyers at a time when they need assistance most. They benefit home owners, not home ownership. Tax concessions for landlords are similarly inequitably distributed.

Yates (2010b) examines the implications of the Henry Review proposals that affect housing.



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### 2. How are your proposals financed over the short and longer term?

Cut the first home owners grant, or at least impose an income constraint on eligibility and limit availability to new dwellings below a modest price level (both of which might vary by location)

However, most of the proposals outlined above will raise revenue and so can be used to extend initiatives to increase the supply of affordable housing and reduced affordability problems for the most disadvantaged.

Use funds raised from proposed tax initiatives to:

#### (1) increase supply of social rental housing

- through direct government funding such as the Social Housing Initiative under the Economic Stimulus Plan in 2008

#### (2) increase supply of affordable rental housing;

- through extending and improving NRAS to address the 10 year constraint under which it currently operates

- by facilitating the development of instruments and institutions that will assist in the funding of affordable housing projects (eg by providing guarantees or other forms of credit enhancement to bond like instruments and/or setting up a housing finance trust to raise finance and distribute it to affordable housing providers).

#### (3) improve accessibility of currently less well located land

- through providing better transport infrastructure (which should not be funded on a user pays basis since this would negate the attempt to use this to flatten land price gradients in the large cities)

#### (4) increase capacity of lowest and most disadvantaged income households to pay for rental housing as proposed in the Henry Review

- through increasing CRA (potential pressures on rents would be reduced if there was a related affordable housing supply response)

- through providing a supplement to CRA for those with special needs