

Tax reform: agenda 2

HOUSING



We have got our policy wires crossed with housing and tax in Australia, writes Sarah Toohey.

When popular commentary turns to talk of tax and housing, stamp duty is inevitably singled out as the culprit making housing unaffordable. It's the most obvious, it's the tax everyone sees when they're contemplating buying a home and working out how much they can afford. But for this very reason it's not the tax that's causing the problem.

House prices, particularly for established housing, are set by what people are willing and able to pay. Because every prospective buyer for a property faces the same rate of stamp duty (barring first home owners in many states but more on that in a minute) it affects their purchasing power in the same way. Stamp duty cuts make very little difference in one buyer's advantage over another, so they simply get eaten up in higher base prices for housing.

This is demonstrated in the first home buyer market, where despite stamp duty cuts in many states, the average first home loan has continued to rise.

Abolishing stamp duties would make the housing market more technically efficient, by removing a barrier to moving house, which is a good thing, but if it isn't replaced with something, like a broad based land tax for instance, it will leave a gaping hole in state budgets across Australia, and some nasty cuts to schools, hospitals and kindergartens as a result.

So we should turn our attention to the taxes that don't get paid – through tax breaks such as negative gearing and capital gains – because it's the absence of tax, as Saul Estlake points out in the following pages, that distort the housing market and drive up housing prices.

Negative gearing, by allowing investors to deduct all the losses associated with purchasing and renting out that property from all of their income, encourages investors to make a loss, and reduces their tax

payable. Essentially negative gearing allows higher income earners to use rental housing as a tax shelter. It's the offshore account of the Australian tax system.

If that wasn't enough investors also get a 50 percent tax discount on any capital gain they make on the sale of the property. It means that any income gained through property appreciation gets taxed at half the rate of other income.

The really insidious effect of these two tax breaks is what happens when they get together. Negative gearing encourages investors to borrow more than they can afford, because they're really borrowing to make a loss on the cost of running the property, in anticipation of a capital gain pay-off. Because investors aren't constrained by what they can actually pay, they push up house prices, and get an unfair advantage over first home buyers, indeed all home buyers, who can only spend what they're able to afford based on their income.

This also causes problems in the rental market, where the majority of rental housing is provided by small scale landlords. Seventy three per cent of people claiming a loss on rental property investments have only one property. This means that a large proportion of rental housing is provided by investors who are there for the tax breaks not to provide secure affordable accommodation for tenants.

Together negative gearing and capital gains tax exemptions are conservatively estimated to cost Australian tax payers \$8 billion a year. That's more than the Federal Government will spend in the life of the current five year National Affordable Housing Agreement and more than was spent on social housing in the Nation Building Stimulus Package.

These tax breaks go to people who need it least, generally existing home owners with some wealth to spare. They encourage investment in established housing and do little to relieve the shortage of 493,000 rental properties that are affordable and available to people on low incomes.

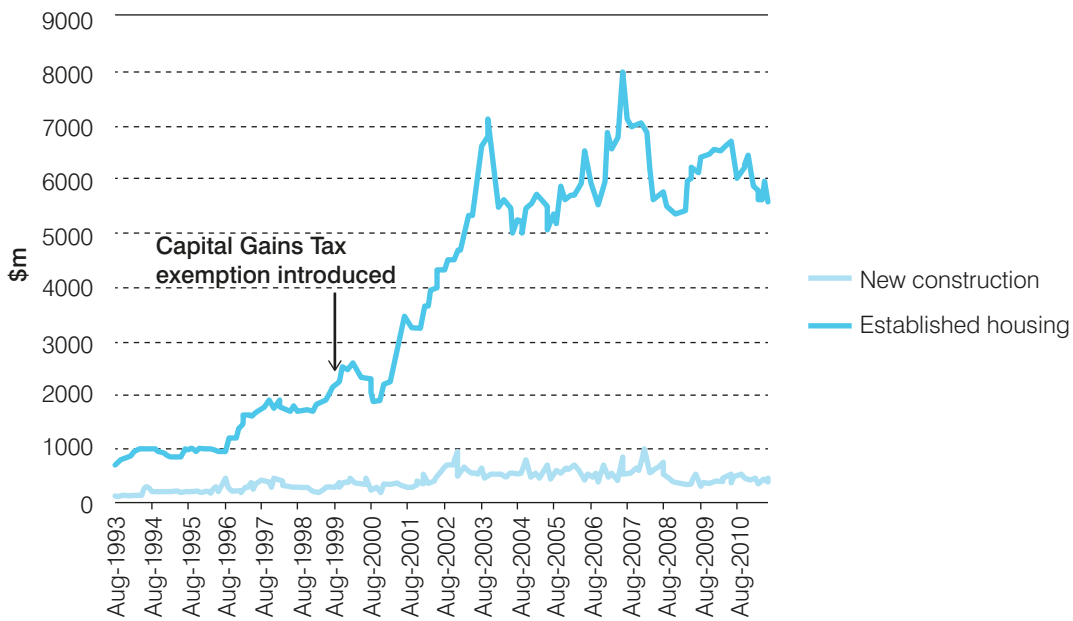
So what would a tax break that helped affordable housing look like? It would look something like the National Rental Affordability Scheme (NRAS) that was established in 2008. NRAS provides an annual tax discount for the construction of new housing, to be let at 80 per cent of market rents for 10 years. It's not a perfect scheme (in many markets 80 per cent of the going rent is hardly affordable), and it's not the only investment needed but it's a damn sight better than pouring tax dollars into housing investment with no defined outcome.

We have got our policy wires crossed with housing and tax in Australia. The only tax mechanism dedicated to affordable housing, NRAS, is capped at 50,000 properties, while the tax breaks provided through negative gearing and Capital Gains Tax exemptions are unlimited. It's time to make the tax system work for affordable housing.

Sarah Toohey is Campaign Manager for Australians for Affordable Housing.



Housing investors rush to established housing



Source: Reserve Bank of Australia, lending commitments - all lenders