

Breaking the deadlock on Australian housing tax reform



Australian Housing
and Urban Research Institute

Based on AHURI Final Report No. 301:
Pathways to housing tax reform

What this research is about

The AHURI Inquiry into ‘Pathways to housing tax reform’ developed a set of reforms to the taxation of housing and property to contribute to a fairer and more sustainable housing system in Australia.

The context of this research

There is a growing consensus that Australia’s tax system has contributed to poor housing outcomes and economic inefficiency more generally, with suggestions that reforms such as abolishing transfer duty and reforming state land taxes, reducing the capital gains tax (CGT) discount and limiting negative gearing, and changes to the pension assets test would help improve housing affordability.

Despite such consensus, formidable barriers persist and to-date housing tax reforms have been piecemeal and ineffective. Housing tax policy in Australia is subject to political barriers and entrenched interests that hinder policy change, and there is widespread pessimism about the prospects for effective structural reform.

The key findings

Barriers to housing tax reform

The research identifies a number of barriers to housing tax reform:

- 1 The place of the home in Australian society has led governments to take a cautious approach to reform, stopping short of recommending

taxing capital gains derived from owner-occupied housing or including the family home in the pension asset means test.

- 2 Any significant decline in nominal house prices would affect long-term economic growth and even put Australia’s otherwise strong financial system under stress. These broader economic risks both act as a significant barrier to ambitious short-term reforms and add to the case for the incremental strategy advocated in this report.
- 3 There are concerns that policy changes may impact on private rental markets and adversely affect low income tenants.
- 4 State governments across Australia rely heavily on revenue raised through property-based transfer duties and therefore any tax reform pathway must address this political challenge.
- 5 Reform options have become politicised within Australia’s adversarial two-party system, with significant policy differences across major political parties such as the tax treatment of rental losses and capital gains on residential property investments, or the assessment of housing assets under Australia’s retirement savings regime.

- 6 Australia’s federal system, especially financial relations between the Commonwealth Government and the states, adds further complexity. For example, there is a risk that some states may be penalised for implementing subnational property tax reforms due to the operation of Australia’s fiscal equalisation regime.

“Significant tax reform can be achieved without causing short-term disruption to housing markets, government revenue or returns to mum and dad investors”

Specific recommendations for each area of housing tax reform

Significant tax reform can be achieved without causing short-term disruption to housing markets, government revenue or returns to mum and dad investors. The AHURI Inquiry puts forward a number of recommendations.

Income tax treatment of housing assets

Gradually reducing the generosity of CGT and negative gearing provisions over a decade would have only a modest impact on the after-tax return from housing investments, with the exact figures depending on wage income, interest rates and capital growth.

- 1 A cap on housing-related tax deductions should be phased in over a 10-year period, with an initial \$20,000 cap to be reduced by approximately \$1,500 per annum (the precise amount would depend on market conditions) until it reached \$5,000.
- 2 The CGT discount currently applying to residential property investments should be reduced incrementally over a 10-year period, with the discount rate to be cut by approximately two percentage points per annum (the precise amount would again depend on market conditions) until it reached 30 per cent. Lowering of the CGT discount rate should not be grandfathered to avoid 'lock-in' effects.
- 3 Revenue raised from reforms to negative gearing and CGT should be directed into the provision of social and affordable housing.

Housing in retirement

There is little evidence that decisions regarding the family home are influenced by the eligibility requirements of the age pension.

There is a clear case for including the value of the family home in the aged pension assets test, although any such reform should be phased in over time and include a comprehensive deferral scheme to ensure asset rich, income poor pensioners are not disadvantaged.

- 1 The value of the family home should be more accurately reflected in the pension asset test.
- 2 Taper rates, incentives and other provisions within the retirement income system which benefit households with substantial retirement funds should be reviewed with any savings being used to provide housing support to the growing number of Australians who will retire without housing assets.
- 3 Changes to the pension asset test should be complemented by a comprehensive deferral scheme to allow 'asset rich, income poor' pensioners to be able to access the aged pension to enable them to age in place.

Although changes to retirement income rules are politically sensitive, the findings establish that superannuation and age pension policy settings could be better designed to improve housing outcomes.

Pathways to state housing and land tax reform

There is agreement in the literature that state property taxes are poorly designed and require reform.

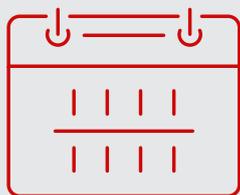
Transfer duties on property are inefficient, subject to housing market volatility, and responsible for under-utilisation of housing stock and constrained housing mobility.

Introducing a recurrent residential property tax on a broad base with few exemptions would provide a more stable, efficient source of revenue and bring Australia into line with approaches used in other OECD countries.

Local government rates are a stable, reliable and efficient source of revenue, but there are considerable inconsistencies in how they are set, administered and collected.

- 1 State governments, with Commonwealth support, should commence reform of the administrative foundations of the subnational property tax system and develop:
 - a national register of property ownership and use to enable governments to assess the distribution of property ownership and wealth in Australia and provide an efficient platform on which to implement a layered property tax regime
 - a nationally consistent approach to property valuation
 - further develop relevant interagency data-sharing
 - develop integrated approaches to state and local government property tax collection.

Figure 1: Principles of housing tax reform



Long-term approach to housing tax reform

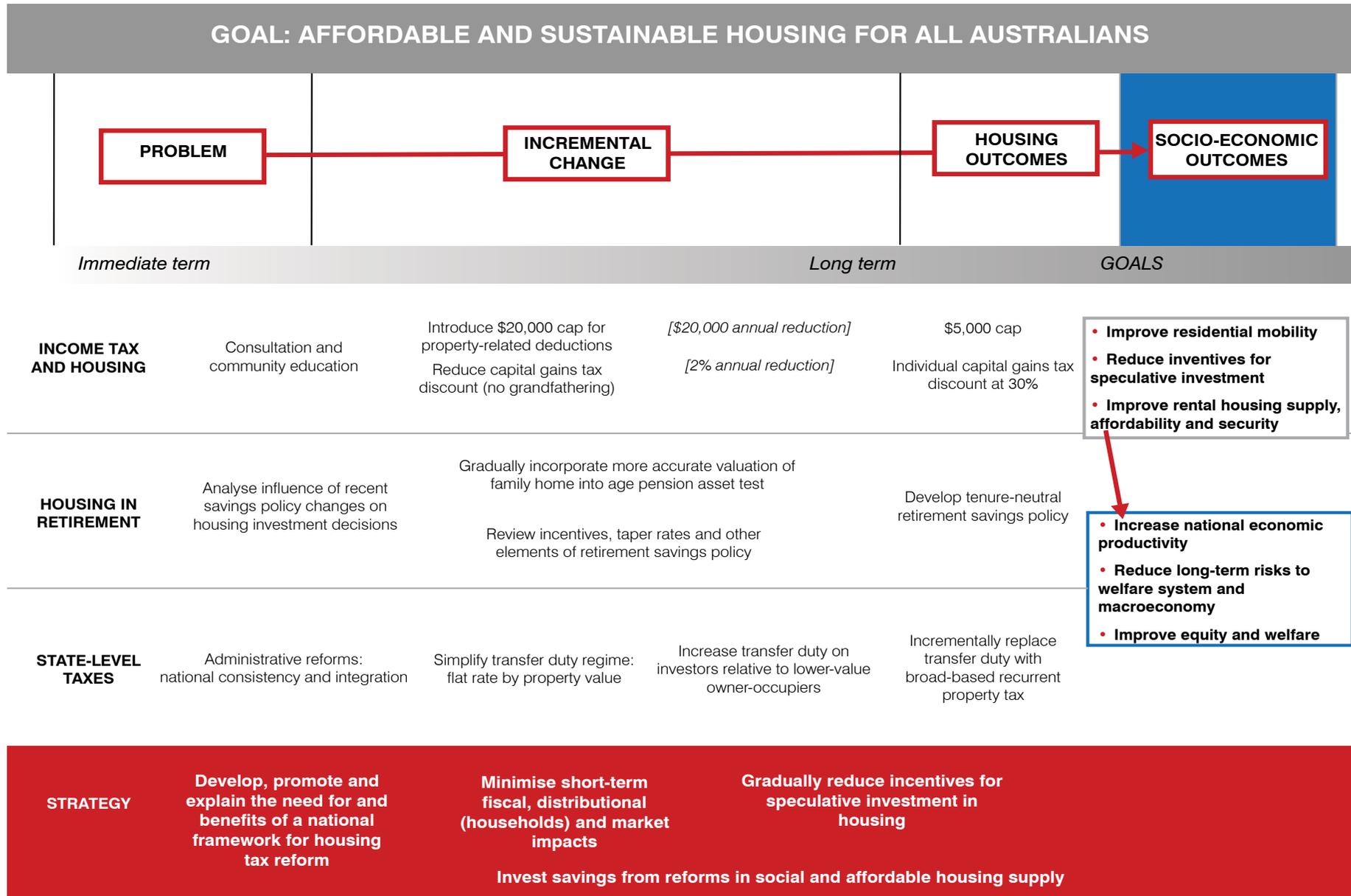


National reform agenda



Set and agree on national policy goals

Figure 2: Achieving affordable and sustainable housing



- 2 In the short term, state governments should simplify their current transfer duty systems by introducing a single flat rate with a tax-free threshold set as a percentage of the median house price. Building on this foundation, states can then, in the medium-term, adjust rates and thresholds as required for different categories of ownership and use.
- 3 In the longer-term, state governments should implement transitional arrangements to gradually phase in broad-based recurrent property taxes, with the proceeds used to phase out and potentially abolish transfer duties on residential property.

What this research means for policy makers

The reform program rests on the following principles:

- 1 Political and economic imperatives demand a coordinated, long-term approach to housing tax reform informed by shared objectives and a coherent framework for policy change.

- 2 A national reform agenda requires national leadership and, where possible, cooperation from state and local governments.
- 3 A reform strategy should initially focus on setting and agreeing to national policy goals and establishing the administrative foundations for reform. It should then move to gradually adjust policy settings to achieve long-term housing policy goals.

Methodology

This research was informed by a political economy approach that sought to reconcile the technical aims of housing policy and tax design with an appreciation of the political barriers to reform.

Tax policy reforms were selected, based on an assessment of the existing literature and extensive stakeholder engagement based on their potential to yield insights that could drive significant improvements in housing policy over time. These reforms were then analysed by the Inquiry's three connected research projects, using new and existing datasets and sophisticated modelling techniques.

Specifically, the three supporting projects respectively carried out:

- 1 Analysis integrating the Evaluation Model for Incomes and Taxes in Australia (EVITA) and the Australian Housing and Urban Research Institute Housing Market Microsimulation Model (AHURI-3M) to simulate the impacts of negative gearing and capital gains tax reforms respectively.
- 2 Analysis of the wealth module in the Household, Income and Labour Dynamics in Australia (HILDA) survey to retrospectively model behavioural responses to specific policy changes.
- 3 Analysis of transfer duty and property tax reform options using CoreLogic's database of all residential property values and transactions in Australia in 2015–16, arguably the most comprehensive set of property data currently available.

Further information

TO CITE THE AHURI RESEARCH, PLEASE REFER TO:

Eccleston, R., Verdouw, J., Flanagan, K., Warren, N., Duncan, A., Ong, R., Whelan, S. and Atalay, K. (2018) Pathways to housing tax reform, AHURI Final Report No. 301, Australian Housing and Urban Research Institute Limited, Melbourne.

↓ Available from the AHURI website at

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