Positioning Paper

A distributional analysis of the impact of direct and indirect housing assistance

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EXECUTIVE SUMMARY

This paper provides an overview of the indirect assistance provided to housing, the major component of which is that provided to owner-occupiers through the federal tax system. A broader assessment of the magnitude and structure of the major forms of housing assistance than that provided through the Commonwealth State Housing Agreement and through Commonwealth Rent Assistance is important for a number of reasons.

- Households in owner-occupation represent the majority of households in Australia and, whilst owner-occupation is predominantly a tenure for more advantaged households, issues of housing affordability are as relevant for owner-occupiers as they are for public or private renters. This is particularly so for the significant numbers of older households who are on benefit levels of income and for whom owner-occupation is a major factor in preventing after housing poverty.
- There have been significant changes both in the tax system and in the revenue sharing arrangements between the Commonwealth. Amongst these are the introduction of the GST, the change in the structure of income tax and changes in the treatment of capital gains and the re-introduction and later extension of a First Home Owners Grant (FHOG). In this paper, these changes are assessed against a changing pattern of outright home ownership and home purchase. They are also assessed against the broader economic changes that have taken place.

The results presented provide an update of the seminal work on housing subsidies in Australia undertaken by Flood and Yates (1987). Flood and Yates provided the first detailed estimates of the tax expenditures associated with owner-occupied housing and the first estimates of the distributional impact of all forms of housing assistance. These estimates were updated by Flood (1993) as background for an Industry Commission report on Housing Assistance (Industry Commission, 1993).

Chapter 1 of this paper provides an overview of the tax changes that have affected the indirect assistance provided to home ownership since the Flood and Yates study. These arise from the introduction of the GST, from changes in the treatment of capital gains and from changes in tax rates changes associated with these tax base and tax mix changes. Chapter 1 also provides time series estimates of the gross and net values of the stock owner-occupied housing in Australia over the past decade and estimates of the gross and net rental values obtained from both the owner-occupied and rental housing stock. One objective of the paper was to outline a simple methodology for generating gross and net values of the stock of owner-occupied wealth from official estimates of total housing wealth. This is also provided in Chapter 1.

Application of this methodology suggests that the gross value of owner-occupied housing in Australia was just over $1,000 billion (in $2001) and the net value was just under $800billion in 2001. Real gross housing wealth increased at an annualised rate of just under 4 per cent per annum over the 11 years from 1990 to 2001. Over the same period, the real value of the outstanding mortgage debt increased by just over 8 per cent per annum. Net equity in owner-occupied housing decreased from 87 per cent in 1990 to 76 per cent in 2001.

National accounts data indicate the gross rental value of the owner-occupied housing stock was $54billion in 2001. The associated net rent (after operating costs) is estimated at $42 billion in 2001 with net rent less interest costs at $25 billion.

The capital gains associated with the growth in the value of owner-occupied dwellings and the services provided by these dwellings (reflected in their rental value) provide the basis of the indirect assistance provided through the tax system.

A second objective of the paper was to provide a simple methodology for determining the tax expenditures associated with owner-occupied housing. Chapter two provides an overview of the debates associated with measuring the extent of tax expenditures that arise as a result of exemptions, deductions, rebates, imposition of a lower rate of tax or deferred liabilities. It examines the extent of these under a hierarchy of definitions: Treasury's 'commonly accepted" structure; a tenure neutral structure and a tax neutral structure. It uses international comparisons to illustrate the problems with the first of these. Under tenure neutrality, the tax

expenditures for owner-occupied housing are derived by comparing the tax treatment of owner-occupied housing with the tax treatment of non owner-occupied housing (that is, rental housing). Under a tax neutral treatment, tax expenditures are assessed against what has been defined in the tax literature as an ideal, or comprehensive, measure of income.

In Australia, a tenure neutral benchmark implies that the primary assistance to owner-occupiers arises from the income tax system through the non-taxation of capital gains and the non-taxation of imputed rent (that is, the estimated rental value of their dwelling). This latter benefit, however, is offset by their inability to deduct their housing expenses. There are no tenure neutral tax expenditures associated with the GST. A tax neutral benchmark, on the other hand, would define the zero rating of rents (or imputed rents) as a tax expenditure under the GST for both rental and owner-occupied housing. It would also include the benefits derived from negative gearing under the income tax system although this is not a tax expenditure that accrues to housing alone. The difficulties associated with implementation of a tax neutral benchmark are discussed in Chapter 2 and provide the rationale for limiting the assessment of tax expenditures to those that arise from application of a tenure neutral benchmark rather than the broader tax neutral benchmark. The implications of the changes in the treatment of the taxation of capital gains are covered in the section on tax neutrality.

Chapter 3 outlines a methodology for determining the aggregate value of tax expenditures from time series data such as that presented in Chapter 1 and using Australian Tax Office data on taxation statistics to derive appropriate marginal tax rates.

For 2001, application of this yields the following tax expenditure estimates

- $9 billion to $13 billion arising from the non-taxation of capital gains depending on whether the pre 1999 (indexation) or post 1999 (discount) method was employed.
- $8 billion arising from the non-taxation of imputed rent, consisting of a $13 billion benefit from the non-taxation of net imputed rent and a $5 billion cost from the non-deductibility of mortgage interest costs.

On a per household basis, the total tax expenditures for owner-occupied housing in 2001 amount to $4,200 per household. In real terms, this is almost double the $1,2000 benefit (in $2001) estimated for 1985. The increase in tax expenditures arise primarily from the exemption of owner-occupied housing when capital gains taxation was introduced.

The benefits of these tax expenditures for owner-occupied housing, however, are not distributed evenly across the population. The costs of the negative expenditures are borne solely by home purchasers. The benefits of the positive expenditures are enjoyed by all owners.

The distributional impact of the indirect assistance provided to owner-occupiers is estimated from the survey data available from the 1999 Australian Housing Survey.

Net rental values are determined by applying a 5 per cent gross rental rate of return to the capital values recorded in the survey and by subtracting the operating costs that are recorded. Capital gains have been estimated on the basis of a conservative average 3 per cent growth rate in nominal house prices. These procedures are based on extremely conservative assumptions (the basis of which are outlined in the text) and result in average tax expenditures estimated from the survey data that are significantly lower than the per household estimates based on aggregate data. In the results presented in this paper, no attempt is made to reconcile the survey estimates with the aggregate data since the focus of the survey results is on the distribution of the benefits rather than on their absolute values.

The survey data show that the benefits of the tax expenditures to home ownership result in low income owners receiving zero benefits (because their low incomes mean that they do not pay any tax) and high income owners in the top household income quintile receiving more than twice as much as households in the fourth quintile and more than three times as much as households in the third quintile. The indirect assistance to home owners provided through the tax system has a progressive impact only for households in the second income quintile (largely as a result of benefits provided to the high proportion of older outright owners whose current income is relatively low).

On average:

- Outright owners receive more than five times the amount of assistance provided to purchasers. High income outright owners receive a total tax benefit of close to $9,000 per household per year.
- Home purchasers in the bottom 80 per cent of the income distribution receive a benefit of less than $500 per household per year through the tax system.

In broad terms, those who benefit most are high income households who live in high valued dwellings and have little housing debt. While the benefits to high income older households are considerably greater than those enjoyed by younger households, households with a head over 65 years old make up just 4 per cent of high income home owners. Conversely, young lower income purchasers aged between 25 and 45 with incomes in the three lowest quintiles, who account for only 14 per cent of purchasers in this age range, receive minimal assistance. It is this group of households for whom 1986 and 1996 census data indicate that home purchaser rates declined the most dramatically over the decade (Yates 2000). It is this group who are most in need of assistance if home ownership policies are to expand home ownership.

The direct assistance provided for home purchase through the First Home Owners Grant introduced in July 2000 has provided considerable assistance to a number of first home buyers. However, this assistance is provided with no means test on income and no restrictions on the value of property that can be bought. There has been little attempt to justify it as a solution to the problems of access to home ownership faced by many young lower income households.

This scheme provides a once-off grant, rather than the continuing assistance provided by the tax expenditures described above. Some indication of the relative size of its impact in relation to tax expenditures of approximately $4,000 per household can be seen averaging the annual expenditure over all owner-occupier households. On this basis, the annual grant of approximately $1 billion has provided the equivalent of $200 per owner-occupier household per year since 2000.

The total value of approximately $1b per annum in direct assistance to home ownership plus $17 billion in indirect assistance can be contrasted with outlays of just under $2b for rent assistance to private renters and just under $1b for capital outlays on public housing. Thus, the indirect assistance dominates direct assistance by a factor of four or more. Direct assistance to tenures other than home ownership is targeted to low income households. Assistance to home owners, on the other hand, primarily benefits higher income households.

CHAPTER 1. HOUSING POLICY AND HOUSING WEALTH IN AUSTRALIA

1.1 Background

During 2001, AHURI was engaged by the Housing Ministers' Advisory Committee to undertake the National Housing Policy project aimed at stimulating discussion about the context and direction of housing policy in Australia. This was to identify issues and options in the context of the renegotiation of the Commonwealth State Housing Agreement from mid 2001 (AHURI 2001b). The aim of the project was to report on a series of workshops designed to explore: the drivers of change in the housing market, the role of government and the private sector in the provision of housing assistance and preferred directions for the future of housing assistance.

In order to place the work presented in this paper in context, this section provides a brief overview of the outcomes of the AHURI National Housing Policy project.

1.1.1 Drivers of change

Drivers of change were classified as exogenous (outside of the housing sector) and endogenous (within the housing sector). Exogenous drivers of change included demographic change, the impact of economic globalisation and associated changes in investment preferences. Included amongst these exogenous drivers of change were a potential decline in home ownership amongst younger households, with changing preferences regarding savings, compulsory superannuation, higher education debts and changing lifestyle preferences seen as possible factors affecting home ownership rates. Taxation reform was listed as an exogenous factor only in relation to its impact on Commonwealth State fiscal relations.

Endogenous factors included lack of growth of affordable rental housing (in both the public and private sectors) and shifts in the profile of social housing clients as a result of increased targeting of public housing. This list of endogenous factors is extremely narrowly defined in light of a stated concern about "the lack of a whole-of-housing-system view in various aspects of government policy on housing" and an expressed desire for "vision across the whole housing system." (AHURI, 2001b:6) One of the issues raised in relation to the need for such a vision was a concern that "tax concessions and direct support for home ownership and private rental housing may fail to complement, and have contrary distributive effects to, the targeting of social security and social housing programmes."

1.1.2 Role of government

In Australia, issues concerning the role of government in relation to housing policy are muddied by the existence of a federal system. The question of which government should be responsible needs to be addressed alongside the question of what is the role for government. Whilst the States have constitutional responsibility for housing, currently the Commonwealth plays a major role in relation to funding, both directly through budgetary outlays on housing and indirectly through the tax system. Foreshadowed changes in the Commonwealth's role will be discussed in the following sub-section.

Currently the two major components of ongoing Commonwealth budget outlays are grants paid to the States under a Commonwealth State Housing Agreement (CSHA) and Commonwealth Rent Assistance (CRA) paid through the social security system to income support recipients and eligible low income families who are renting privately.[1] In 1998-00, for example, Commonwealth funding under the 1996 CSHA resulted in a total of just under $1.3b being available to the States (AIHW, 2001).[2]. In the same year, the Commonwealth paid out

[1] All pensioners, allowees and those receiving more than the base rate of Family Tax Benefit Part A who rent in the private rental market may be eligible for RA. Details of eligibility conditions can be found at the following website: http://www.facs.gov.au/internet/facsinternet.nsf/aboutfacs/programs/house-rentassist.htm

[2] In 1998-99, under a matching requirement specified in the Agreement, the States provided approximately $1 for every $2 of Commonwealth base funding. In 1998-99, approximately 80 per cent of this was base funding that could be used for any housing related purpose, whilst the remainder was tied to specific programs. Base funding was $700m with matching grants of $380m. In addition, $91m was allocated to the Aboriginal Rental Housing Program (ARHP), $64m for the Community Housing Program (CHP) and $40m to the Crisis Accommodation program. Data taken from Table A.1 in the Housing

$1.5b to social security pensioners and beneficiaries (FaCS, 2001b). Both the increasingly important rent assistance program and CSHA funds assist in providing affordable housing for low income households.[3]

These programs have been supplemented at various stages with deposit assistance programs for first home buyers, funded by the Commonwealth government, and with various home loan schemes funded both by CSHA funds and with additional funds from various State governments[4]. In the main, the various deposit or home purchase assistance schemes that have been introduced have been targeted to marginal first home buyers. However, the most recent scheme, the First Home Owners Grant, which was introduced in July 2000 and which has been funded entirely by the Commonwealth (although implemented by the States), is a notable exception to this generalisation. In 2000-01, just over $1b was allocated to this latest form of assistance to first home buyers with a similar amount foreshadowed for 2001-2002.[5]

The view that an appropriate role for government is to assist households likely to face affordability problems in the absence of intervention is one that continued to recur through the consultations AHURI undertook for its Australian Housing Policy Project. This is despite acceptance of a trend towards a much less pervasive role for government in the last few decades of the 1990s (AHURI, 2001b). Other roles that emerged related to the coordinating role of government in relation to non-housing objectives (such as stronger families and communities)[6] and its function as a partner with the private and community sectors in working towards efficient realisation of mutually agreed aims. Concerns also were raised about the "gaps, overlaps and inefficiencies" that can arise as a result of a federal structure of government. No attempt, however, was made to identify what these might be. As will be discussed below, one prime contender is the role of the government in relation to its taxation of housing.

1.1.3 Issues relating to preferred directions in housing assistance

Issues arising from an attempt to identify preferred directions in housing arising from this consultation exercise were dominated by a concern about future level and type of funding for housing and housing assistance. In large part, this arises from the fall out from the tax reform that has been undertaken in Australia over the past few years. In July 2000, a new tax system (ANTS)[7] was introduced. The specific reforms introduced will be discussed in more detail below. The aspect of the reforms relevant here relates to the associated change in federal financial relations.

Background

As indicated above, most housing assistance programs, whilst implemented by the States, have been funded by the Commonwealth. In large part, this emerged as a result of a significant fiscal imbalance between the States and the Commonwealth. Since the 1940s, when the Commonwealth took over responsibility for income taxation, and prior to the changes that took place in 2000, the Commonwealth typically has raised just under 80 per cent of government revenue with over two thirds of this being raised by income taxes. At the same time, the Commonwealth has been responsible for just over 50 per cent of expenditure (eg, Warren, 1998). Conversely, the States have raised less than 20 per cent of total revenue but been responsible for almost 50 per cent of total expenditure. This gap in State finances has been met by a series of revenue sharing arrangements in the form of Financial

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Assistance Act Annual Report for 1998-99 (FaCS, 2001a). These CSHA data are the latest published. Budget estimates for both programs suggest CSHA funding has, at best, been maintained whilst CRA funding is estimated to increase to $1.7b in 2000-01.

[3] Trends in these housing assistance programs will be considered in the final report.

[4] Throughout this paper, the term ‘States’ will be used for the six States and two Territories.

[5] Data taken from 2001-02 budget papers reflects minimum amount guaranteed, Commonwealth Treasury (2001, Table 26). Details of this scheme will be provided below.

[6] In fashionable "third way" rhetoric, described as the "joined up" nature of government policies.

[7] Details of The New Tax System can be found in Costello (1998), via the tax reform links on Treasury's home page http://www.treasury.gov.au/ or on the tax reform website, http://www.taxreform.gov.au/.

Assistance Grants (FAGs) which have taken the form of both general purpose and specific purpose payments (tied grants for a designated purpose). Since the 1970s, however, there has been a persistent trend towards removing the restrictions on grants to the States, with the result that the CSHA is one of the last remaining significant tied programs.[8]

A key component of the 2000 tax reform was the introduction of a broad based goods and services tax (GST) with a concomitant reduction in the reliance on income taxes as a source of government revenue and the abolition of a range of narrow based indirect taxes by both the Commonwealth and the States. Associated with this was a major reform in the financial relations between the Commonwealth and the States which resulted in the earmarking of all GST revenue to the States. The Commonwealth has agreed to ensure that no State will be worse off after the implementation of the GST until such time that GST revenue exceeds the funds they would have been received under past revenue sharing arrangements. Top up funds under these transitional arrangements are anticipated to continue through until 2007 (at which point the Commonwealth is likely to reassess its involvement in any State managed programs). The intent of this change in financial relations was to provide the States "with access to a secure and growing source of revenue and the capacity in the medium to long term to allocate additional funding for services, such as health and education." (Costello, 1998:17) Details of the impact of the GST package on federal financial relations can be found in Collins (2000).

There are two ways in which these changes might have an effect on housing and housing policy. The first is in relation to the changes in revenue sharing arrangements. As a result of these changes, the future of specific purpose grants has been called into question and it is no longer clear that the Commonwealth will continue with its program of capital funding. The second is in relation to the changes as a result of tax reforms that have resulted in changes in the tax mix and in tax rates for both consumption and income taxes. These have an indirect effect through their impact on the preferential treatment accorded to owner-occupied housing as a result of long established tax concessions. They have a direct effect through the First Home Owners Grant that was introduced to compensate for the anticipated increase in the price of residential housing as a result of the GST.

Preferred policies

Against this background, consideration of preferred policies during the AHURI consultation process has focussed on protecting current programs.

Whilst the issue of assistance to home owners and the role of tax concessions to home ownership appeared in the report on the findings of the Australian Housing Policy Project, no mention of these issues made it to the summary of outcomes that was provided alongside the final report. The only related point raised was the question of whether government assistance should be extended to ownership, and even this was only in the context of expanding the supply of affordable housing (AHURI, 2001c:10). However, insufficient support for home ownership was listed as a weakness of current housing policy and the decline in home ownership was listed as one of the big issues in the messages from the Housing Policy Project. (AHURI, 2001d)

1.1.4 Purpose of study

These observations provide a starting point for the issues to be raised in this paper. This paper focuses on the major forms of housing assistance that were generally ignored in the consultations undertaken for the Australian Housing Policy Project – namely the support provided to owner-occupiers, the bulk of which is provided through the tax system.[9] Households in owner-occupation represent the majority of households in Australia and, whilst owner-occupation is predominantly a tenure for more advantaged households, issues of

[8] Recurrent funding for health and education are the two major tied programs, accounting for just under $13b of the $16b allocated to or through the States for specific purpose payments in 2000-01. Funding under the CSHA accounts for less than $1b of this total but is the largest payment for capital purposes (Budget Paper No. 3, 2000-01, Table A.1).

[9] A second contender, outside of the scope of this paper, arises from the operation of the current pension system. Pension eligibility has been means tested on income since its inception (in 1909). An assets test was introduced in 1985. Owner-occupied dwellings are exempt from this assets test and compensating equivalents for non-home owners are well below median dwelling values. In 2000, for example, a single person could have just $91,000 more in non housing assets than a home owner to be eligible for a full pension. A couple could have just $62,000 more (FaCS, 2001d).

housing affordability are as relevant for owner-occupiers as they are for public or private renters. This is particularly so for the significant numbers of older households who are on benefit levels of income and for whom owner-occupation is a major factor in preventing after housing poverty.

The ultimate aim of the project of which this paper forms a part is to provide a comprehensive assessment of the magnitude and distributional impact of the major forms of housing assistance provided by the Commonwealth. These include both direct assistance provided through the CSHA, Commonwealth Rent Assistance and subsidies to first home buyers and indirect assistance provided through tax concessions to owner-occupiers such as the non-taxation of imputed rent and the non-taxation of capital gains for owner-occupiers. The results will provide a measure of the effectiveness of alternative forms of housing assistance. In particular, they will provide an indication of the extent to which implicit subsidies for low income households in home ownership (likely to be predominantly aged households) are more or less costly on a per household basis than those provided for low income households in rental housing.

This project will, therefore, provide an update of the seminal work on housing subsidies in Australia undertaken by Flood and Yates (1987). Flood and Yates provided the first detailed estimates of the tax expenditures associated with owner-occupied housing and the first estimates of the distributional impact of all forms of housing assistance. These estimates were updated by Flood (1993) as background for an Industry Commission report on Housing Assistance (Industry Commission, 1993). Relevant results from these studies will be discussed below, along with a discussion of the methodologies used to measure tax expenditures. Despite the considerable changes that have taken place since those early studies, however, there has been no subsequent attempt to examine the structure of housing subsidies in Australia. There also has been no attempt to examine the extent to which the changes that have taken place in the magnitude and structure of direct assistance provided by Commonwealth funding have been reflected or offset by changes in the magnitude and structure of indirect assistance.

1.2 Changes affecting assistance to home ownership

The Flood and Yates study, which provided background material for the renegotiation of the CSHA in 1989, was undertaken at a time when Commonwealth outlays on housing through the CSHA exceeded those on rent assistance by a factor of four to one. It also immediately followed a period of generous home purchase assistance programs, interest rate ceilings on home loans and long standing tax concessions towards home ownership. It showed that the cost of concessions associated with the direct and indirect assistance to home owners far outweighed assistance to public and private tenants. It pointed to significant disparities in the level of support provided to households in public rental, private rental and owner-occupation and to significant disparities in the targeting of these subsidies.

Since that work was undertaken, funding for public housing through the CSHA has declined, although it is not as immediately obvious what has happened to housing assistance provided to households in public housing because of changes in the value of the stock.[10] Commonwealth Rent Assistance has increased by a significant amount due to both increased payments and expanded eligibility requirements, but the effectiveness of the increased level of assistance has been moderated by increases in rents. Both forms of assistance have been targeted increasingly to those most in need of assistance. Until the re-introduction of the First Home Owners Grant in 2000, direct assistance to home purchasers had all but ceased, in part because it did not meet the needs of moderately low income households excluded from home ownership because of affordability constraints. Throughout the past decade, however, the favouritism that has been accorded to the housing sector through various tax concessions has remained largely untouched despite several major reforms of the tax system. These concessions primarily apply to owner-occupied housing, which accounts for approximately 70 per cent of Australia's housing stock. They will be outlined below.

[10] Increases in the value of the stock result in increased rental values and increases in the gap between the income related rent households are required to pay and the market value of their dwellings.

With the demise of the federally funded deposit assistance schemes and state based home lending schemes[11] in the early 1990s, however, there has been relatively little attention paid to the assistance provided to home owners. A number of policy changes suggest the effectiveness of the in-kind assistance provided to home ownership needs to be revisited. Amongst these are the introduction of the GST, the change in the structure of income tax and changes in the treatment of capital gains and the re-introduction and later extension of a First Home Owners Grant (FHOG). These changes need to be assessed against a changing pattern of outright home ownership and home purchase. These will be considered below. They also need to be assessed against the broader economic changes that have taken place. These will be considered in the following section.

1.2.1 Tax reform

Since the last estimates of housing tax expenditures were undertaken in the late 1980s and early 1990s, Australia has experienced a number of significant changes to its tax system. The introduction of a comprehensive goods and services tax in 2000 reflected only a part of the on-going tax reform that has taken place since the major reforms of the mid 1980s. These changes relate to the tax base, to tax rates and to the tax mix[12]. This section is limited to a documentation of the relevant changes that have taken place since the last comprehensive study of housing subsidies was undertaken. The tax concessions for housing arising from the tax system and the issues associated with measuring these will be considered in chapter 2.

Tax base changes

The introduction of the GST had the effect of replacing a narrow based wholesale sales tax system with its complex system of tax rates with a broad based consumption tax in which the vast majority of, but not all, goods and services are taxed at a flat rate of 10 per cent rate. The tax is a value added tax with credits received for any GST already paid. There are two types of exemptions from the tax: GST free in which supplies are not taxed and credit is available for any embedded GST (this is equivalent to zero rating) and tax exempt (or input taxed), in which supplies are not taxed, but no credit is available for any embedded GST. Residential rents and sale of residential dwellings are input taxed.[13]

The failure to zero rate residential housing led to concerns that dwelling prices of new houses would rise as would rents over all because of the effect of higher input costs. Official estimates suggested the impact of the GST would increase the price of new homes by 4.7 per cent (Costello, 1998: 97). The First Home Owners' Grant (to be outlined below) was introduced to compensate for this projected increase.

Along with the broadening of the consumption tax base, tax reforms have also broadened the income tax base. In terms of their potential impact on housing, changes to the income tax base as part of the tax reform measures are likely to be more significant than changes in the consumption tax base. The most significant of these relates to changes in capital gains taxation as a part of the Review of Business taxation (the Ralph Report, 1999). These changes, however, built on more significant changes introduced in 1985 as a result of an earlier reform of the tax system (Keating, 1985).

Prior to 1985, capital gains in Australia were untaxed. The reforms of 1985 introduced taxation of real capital gains as a part of various measures to broaden the income tax base. When introduced, the capital gains tax applied to real, realised capital gains made on assets purchased after 19 September 1985. Any capital gains over an indexed cost base were

[11] Examples of federally funded schemes are the original First Home Owners' Scheme or its predecessor, the Home Deposit Assistance Schemes and the Home Savings Grant Scheme. Details of these schemes can be found in the relevant Parliamentary Annual Reports. The most notorious of the state based schemes is most probably the NSW Home Fund Scheme but programs with similar objectives were implemented by other States. Details of State based schemes up to 1989 can be found in Yates and Flood (1989).

[12] Tax mix refers to the proportion of tax revenue raised from income, consumption (or sales) and other tax bases.

[13] Warren (1998:37) suggests rents are typically exempted "because not to do so would favour home owner-occupiers (where rent implicitly paid is not easily identified) over renters for whom rent paid is easily identified."

included in taxpayer's income and were taxed at the appropriate (marginal) rate of personal or company tax.[14] Owner-occupied housing was exempt from this broadening of the income tax base.

In 1999, as a result of the Business Tax Review, indexation of the cost base of the asset was frozen as at 30 September 1999 and a discount approach to estimating capital gains tax was introduced.[15] This new system applies to all assets purchased after 30 September 1999 but owners of existing assets were given a choice of capital gains tax regimes. As with the 1985 tax reforms, owner-occupied housing remained exempt from capital gains tax.

At present, therefore, two methods can be employed for calculating the tax liability associated with a capital gain for assets owned before September 1999 and owned for 12 months or more: the indexation method or the discount method. For CGT assets acquired before 21 September 1999, the indexation of the cost base of an asset has been frozen as at 30 September 1999. For assets purchased after 21st September 1999, only the discount method applies.[16]

Under the indexation method, initially introduced with the 1985 tax reforms, the cost of acquisition is indexed (by the change in the CPI up to September 1999) to determine the so-called cost base of acquisition. Capital gains are measured against this indexed cost base. Effectively this approach results in only real capital gains being added to taxable income.

Under the discount method, introduced with the 1999 reforms, there is no indexation of the cost base, but capital gains are discounted by 50 per cent for individuals and trusts. Effectively this approach results in 50 per cent of nominal capital gains being added to taxable income (which is then taxed according to the current income tax scale).

The taxpayer may use whichever method is most advantageous. Over time, the discount method is likely to be more attractive as a result of freezing the indexation factor. The relative benefit provided by the new discount method over the old indexation method will vary with the level of inflation and the extent of real capital gains. Wood (2000:17) shows that, unless rates of property price inflation are more than double the rate of inflation, property owners will have a higher capital gains tax liability under the 1999 tax system than they would have had under the indexation method prior to the freezing of the indexation factor.

Tax mix and tax rate changes

The additional revenue raised from the introduction of a broad based consumption tax and by the broadening of the income tax base, was partly used to fund cuts to income tax rates from 1st July 2000. These cuts increased the tax free threshold from $5400 to $6000 and decreased the lowest marginal tax rate on incomes up to $20,000 from 20 per cent to 17 per cent. They also reduced the marginal income tax rate on incomes between $20,000 and $50,000 from 34 per cent (up to $38,000) or 43 per cent (above $38,000) to 30 per cent across this whole middle income range. A small change from a marginal tax rate of 43 per cent to one of 42 per cent was applied for incomes from $50,000 to $60,000 and marginal income tax rates on incomes above $60,000 remained unchanged at 47 per cent. A Medicare levy of 1.5 per cent applies to most residents where taxable income exceeds a relatively low threshold and a 1% surcharge applies to high income households who do not have private health insurance. Prior to these changes for 2000-01, tax rates had been unchanged since 1993-1994 when they were reduced for middle income earners. Detailed information on the personal tax rates that have applied since 1989-90 is presented in chapter 2.[17]

[14] Arrangements were put in place for any capital losses to be offset against future capital gains but not against current income.

[15] The ways in which these operated will be outlined below.

[16] Current information can be obtained from the Australian Tax Office website, www.ato.gov.au

[17] In addition to these changes, a superannuation surcharge on higher income individuals was introduced in 1996. The rate of superannuation surcharge tax varies between 0% and 15% of surchargeable superannuation contributions, depending on adjusted taxable income. Adjusted taxable income is usually taxable income plus the value of the surchargeable superannuation contributions reported to the Australian Taxation Office (ATO). In 1996 the threshold income at which the charge applied was $70,000 and the maximum rate applied to incomes of $85,000 or more. By 2002 these limits had increased to $85,000 and $104,000. Details of the surcharge can be found from the ATO website.

At the time when they were introduced, personal income tax cuts were estimated to result in a loss of $13b in tax revenue for the Commonwealth in 2000-2001 (Costello 1998). This was to be offset by a reduction of $18b in Financial Assistance Grants to the States. In return for this reduction in FAGs, the States were to gain an equivalent amount in net revenue from the GST (after the abolition or reduction in various State taxes).

1.2.2 The First Home Owners Grant

As indicated above, after a decade or so of no Commonwealth assistance for first home buyers the First Home Owners Grant (FHOG) was reinstated on 1 July 2000 in order to offset the anticipated impact on house prices of the introduction of the GST. These grants, funded by the Commonwealth but administered by the States, provided first home buyers with a one-off $7,000 payment which was seen as providing more than adequate compensation for expected price increases on dwellings with a construction cost (that is, excluding land value) of up to $150,000 (Costello, 1998:97). There was no means test on applicants and no restriction on the value of property that could be purchased with this assistance. The only eligibility restrictions, in addition to no previous property ownership, related to citizenship or residency and to the requirement that the home be a principal place of residence, occupied within a reasonable period. Eligible applicants were also entitled to an additional grant of $7,000 if they purchased or built a new home between 9 March 2001 and 31 December 2001. This additional grant was reduced to $3,000 on 1 January 2002.[18]

1.2.3 Other relevant changes

In addition to these policy changes, there are a number of other key changes which also are likely to affect the estimates of housing assistance at the end of the 1990s compared with the estimates provided by Flood and Yates using data from the mid 1980s. Besides changes in the socio-economic and demographic structure of the population, the most relevant of these for this paper relate to the significant growth in the value of owner-occupied housing wealth over the period. This is the focus of the following section.

1.3 Housing wealth in Australia

More than many countries, Australia experienced a period of unprecedented economic growth over the past decade. A combination of declining interest rates, increased availability of mortgage finance and rising household income contributed to a decade long boom in house prices with a rising trend in the ratio of house prices to income and to increasing housing wealth.[19] This is attributed to a natural consequence of improving living standards, the growth in the number of two income households and to an adjustment to a low inflation environment. Also, it has been assisted by an increase in borrowing capacity arising from lower interest rates and a reduction in the front loading constraint associated with standard mortgage instruments (RBA 2002:31). At the same time, however, these factors have encouraged increasing household debt.

1.3.1 Capital values

Aggregate estimates

A number of estimates of Australia's housing wealth are regularly published. The two most readily accessible are those produced for the National Balance Sheets produced annually by the ABS (ABS, 2000b), and those produced for the Economic Roundup publications produced regularly by Treasury (Department of Treasury, 2001a). The ABS data give gross wealth data for households broken down by the major financial and non-financial assets and total liabilities broken down by major components but not specifically for housing.[20] Data are

[18] Details of this scheme and subsequent changes to it can be found on the FHOG website, http://www.firsthome.gov.au.

[19] In the May 2002 quarterly Statement on Monetary Policy, the Reserve Bank of Australia reports an increase in the house price to average earnings ratio from 5.5 in 1990 (down from it previous peak of 6.5 in 1989) to just under 8 in 2001. (RBA, 2002a)

[20] These estimates are based on what is described as a perpetual inventory method (PIM) or approach. Full details can be found in ABS (2000a). The PIM involves the compilation of a 'rolling' inventory of capital stocks. In any particular period investment in capital assets is added to stocks, and retired assets are deducted. The decline in the share of housing wealth has arisen as a result of the increasing importance of financial assets. Despite what might be regarded as conventional wisdom regarding the growth of household share holdings, these have increased only from 0.5 per cent in 1991 to just over 1 per cent in 2000. Baekgaard (1998) argues that, although there has been a dramatic increase in the number of Australians who own

provided for the gross value of dwellings (excluding land) and for land for all purposes (residential and otherwise). Thus, these data provide an upper estimate of the value of gross housing wealth but do not enable net housing wealth to be identified. The Treasury data give independently derived estimates of gross housing wealth, but this is private sector wealth with data for households and businesses combined. However, as households are the major owners of dwelling assets, this distinction is unimportant for broad trend data.[21] Despite its broader coverage in relation to land holdings, the ABS data is the more conservative of the two (with gross values that are approximately 80 per cent of the Treasury values). For this reason it will be used here.

Net housing wealth data can be estimated by deducting total mortgage loans outstanding from gross housing wealth. Data on household debt can be obtained from the credit aggregates produced monthly (for bank and nonbank financial intermediaries) or quarterly (for securitised loans) by the Reserve Bank. Because of the increasing importance of securitisation, both sources need to be used.

Aggregate data on the value of both housing and total assets and liabilities are shown in Table 1 and their growth is illustrated in Figure 1. The relevant shares of housing aggregates are shown in Table 2. From Table 1, it can be seen that, in 2001, the total value of housing wealth in Australia was equal to $1,364 billion. This represents 49 per cent of gross household wealth, down from 53 per cent in 1990. It represents an increase in real housing wealth of just under 50 per cent over the 11 years from 1990 to 2001, with an annualised growth in real housing values of just under 4 per cent per annum.[22]

Table 1: Household housing and total wealth and liabilities ($2001)

	gross housing wealth	total household gross wealth	total mortgage loans outstanding	total household liabilities	net housing wealth	total household net worth
	$b	$b	$b	$b	$b	$b
1990	926	1,732	104	233	822	1,498
1991	941	1,759	112	236	830	1,523
1992	935	1,774	123	244	812	1,530
1993	973	1,865	141	252	832	1,614
1994	1,022	1,988	168	280	854	1,708
1995	1,031	2,000	186	297	845	1,704
1996	1,035	2,055	202	329	832	1,725
1997	1,105	2,259	226	362	880	1,898
1998	1,174	2,401	255	407	919	1,994
1999	1,257	2,592	283	448	974	2,144
2000	1,324	2,728	323	499	1,001	2,229
2001	1,364	2,775	355	516	1,009	2,258

source: Australian National Accounts Household Balance Sheet ABS Cat. No. 5204,Table 46
RBA Statistical Tables (rba.gov.au) Tables B16+D02 (mortgage loans outstanding only)

shares, many have relatively small portfolios and the influx has had little impact on total ownership. However, he does estimate that equities represented 12 per cent of household net wealth in 1998. Kelly (2001) raises concerns about the ABS data on several grounds. Firstly the definition of the household sector includes unincorporated enterprises and non-profit institutions. Secondly, the household sector is often the residual sector in the National Accounts data. Neither of these concerns are likely to create major distortions in relation to the ownership of dwellings data that is the focus of this paper given the pattern of dwelling ownership in Australia.

[21] National Accounts data on income from dwellings provides a breakdown into income for persons and other. In 2000, the former accounted for approximately 98.5 per cent of all income, up from 98.0 per cent in 1990. This same assumption, however, does not apply to the liabilities data because intersectoral lending is netted out. Bacon (1998) uses both Treasury and ABS data sources to provide estimates of net household wealth but does not indicate what assumptions are made to breakdown the gross ABS data for households or the Treasury data for the private sector or how loans outstanding have been treated.

[22] This represents a faster rate of growth than the 2 per cent per annum suggested by house price index data. In part this arises from the 1.4 per cent per annum growth rate in the number of households over the period (ABS 1999b). It may also reflect some quality increases that have occurred in the dwelling component of the land and dwelling package recorded in the housing value data but these are also likely to have been included in commonly used sales based price index data. It may reflect an increase in the proportion of households with a second dwelling (such as a holiday home).

Figure 1: Housing assets and liabilities (1990 = 100)

source:

RBA Statistical Tables (B16+D02), rba.gov.au

Australian National Accounts Household Balance Sheet, ABS Cat No 5204.0

Household and Family Projections, ABS Cat No 3236.0

Total mortgage loans outstanding, on the other hand, amounted to $355b in 2001, having increased from 45 per cent of total household liabilities in 1990 to 69 per cent in 2001. The real value of outstanding mortgage debt more than doubled over this period with an annualised growth rate of just over 8 per cent per annum (more than twice that of the underlying asset that provides the collateral for these loans).

Table 2: Housing as a share of total assets and liabilities

	ratio gross housing to total wealth	ratio total mortgage loans to loans outstanding	ratio net housing to total net wealth	net equity in housing
	%	%	%	%
1990	53	45	55	89
1991	54	47	54	88
1992	53	50	53	87
1993	52	56	52	85
1994	51	60	50	84
1995	52	63	50	82
1996	50	61	48	80
1997	49	62	46	80
1998	49	63	46	78
1999	48	63	45	78
2000	49	65	45	76
2001	49	69	45	74

source:

Australian National Accounts Household Balance Sheet, ABS Cat No 5204.0

RBA Statistical Tables (B16+D02), rba.gov.au

This growth in mortgages outstanding has meant that net equity in housing has declined from 89 per cent in 1990 to 74 per cent in 2001. Some of the implications of this will be considered below.

Owner-occupied housing wealth

Because these estimates include both owner-occupied and rental dwellings, they need to be scaled down to generate a figure for owner-occupied net wealth. The ABS Year Book (ABS 1999) claims that 85 per cent of the total value of dwellings and land held by households was for dwellings owned by owner-occupiers with the remainder being dwellings owned for rental investment or other uses but give no source for this.[23] Applying this scale factor to the above ABS data gives an estimate of $1,159 billion for owner-occupied net housing wealth for 2001.

On the other hand, the National Accounts consumption data (to be reported below), suggest that approximately 75 per cent of total gross rental income was generated from owner-occupied housing[24]. This is broadly consistent with the respective shares of owner occupied and rental housing owned by persons.[25] This provides a readily available conservative and consistent approach to estimating gross owner-occupied housing wealth from total housing wealth. These shares are shown in Table 3. Likewise, whilst data on outstanding mortgages are not available separately for owner-occupied and other housing, data on lending are available with this breakdown.[26] These shares are also shown in Table 3. Applying the scale factors reported in Table 3 to, respectively, gross housing wealth and mortgage outstanding data gives the results presented in Table 4. This gives an estimate of $1017 billion for owner-occupied gross housing wealth for 2001 and an estimate of $771 billion for net housing wealth with a resultant 76 per cent equity in owner-occupied housing. Because of the size of the owner-occupied sector, these data mirror those in Table 1.

Table 3: Owner-occupation as a share of housing income and finance

	share gross income from dwellings owned by persons	share housing finance to persons
	%	%
1990	76	86
1991	76	83
1992	76	83
1993	76	82
1994	76	81
1995	76	80
1996	75	79
1997	75	77
1998	75	74
1999	75	72
2000	75	69
2001	75	69

Source:

System of National Accounts, ABS Cat. No. 5204.0. Table 57

RBA Statistical Tables (rba.gov.au) Table D05

[23] The National Accounts consumption data, on the other hand, suggest that 73% of total gross rental income was generated from owner-occupied housing. Use of this scale factor gives an estimate of $750 billion for owner-occupied net housing wealth for the ABS data for 2000 which is considerably lower.

[24] Consumption data in the National Accounts incorporate an assessment of what households would have had to pay for their dwelling if they had rented rather than owned it. The rationale for including the rental value of owner-occupied dwellings and procedures for estimating it are discussed in section 1.3.2.

[25] That is, excluding the 5-6 per cent of social housing.

[26] If landlords maintain higher gearing ratios than owner-occupiers, use of the lending data proportions is likely to overstate owner-occupied mortgage debt outstanding.

Table 4: Owner-occupied gross and net housing wealth ($2001)

	gross housing wealth	total mortgage loans outstanding	net housing wealth	net equity in owner occupied housing
	$b ($2001)	$b ($2001)	$b ($2001)	%
1990	703	89	614	87
1991	715	93	622	87
1992	712	102	609	86
1993	742	116	626	84
1994	780	137	643	82
1995	788	149	639	81
1996	777	160	617	79
1997	829	174	655	79
1998	879	189	691	79
1999	940	202	738	78
2000	989	223	766	77
2001	1,017	246	771	76

source:

RBA Statistical Tables (B16+D02), rba.gov.au

Australian National Accounts Household Balance Sheet, ABS Cat No 5204.0

This approach also provides an equivalent estimate for landlords, shown in Table 5. This shows the extent to which investors in rental housing have increased their leverage in the past decade. These data are generally outside of the scope of this paper but, on the assumptions made, they reinforce the conventional wisdom that landlords are more highly geared than are owner-occupiers.

Table 5: Landlord gross and net housing wealth ($2001)

	gross housing wealth	total mortgage loans outstanding	net housing wealth	net equity in owner occupied housing
	$b ($2001)	$b ($2001)	$b ($2001)	%
1990	223	15	208	93
1991	226	18	207	92
1992	223	21	203	91
1993	231	25	206	89
1994	242	31	210	87
1995	243	36	206	85
1996	258	43	215	83
1997	276	52	225	81
1998	295	66	229	78
1999	317	80	236	75
2000	335	100	235	70
2001	346	109	237	68

source:

derived from Tables 1 and 4

Snapshot checks on the approximations for owner-occupied housing can be obtained from periodic survey data. Data from the 1999 Australian Housing Survey, for example, gives an estimate of gross owner-occupied housing wealth of $1100b and outstanding mortgage debt for owner-occupiers of just over $200b with an average equity of 81 per cent in owner-occupied housing. In $2001, these are equivalent to approximately $1200b and $230b, respectively. The results in Table 4 give $2001 times series estimates for 1999 as $940b for gross owner-occupied housing wealth and $202b for outstanding mortgage debt. The direction of the differences in these aggregates is consistent with the expected and conservative biases in the approach used to generate time series data. The potential sources of bias in the survey results are discussed in chapter 3.

One of the aims of this research project was to establish a robust methodology for providing indicative estimates of the tax expenditures associated with owner-occupied housing on an annual basis. A pre-condition for this is establishing a robust methodology for estimating gross and net owner-occupied wealth based on readily available published data. The above provides a means whereby this can be done.

1.3.2 Rental values

Data on the value of services provided by housing in Australia are much less problematic. The National Accounts data produced by the Australian Bureau Statistics provides data on actual and imputed rent as a key component of household final consumption. Census data are used for the number of owner-occupied and rented dwellings and for information on rents paid for the latter. Rent for owner-occupied dwellings is imputed by multiplying average rents (adjusted to exclude rents at less than market value) reported in the census for unfurnished privately rented dwellings in various categories (major urban, other urban, rural; cross classified by structure of dwelling and number of bedrooms) by the number of owner-occupied dwellings in the same categories. In other words, estimates of market rent vary by size and type of dwellings but are averaged across highly aggregated spatial regions. Yates (1994) suggests this level of spatial aggregation results in the approach employed providing an underestimate of the imputed rental value of owner-occupied dwellings[27].

The rent of owner-occupied dwellings is one of the more important components for which an imputed value is included in the Australian System of National Accounts.[28] The following rationale is given for its inclusion:

> *"This treatment is considered necessary because, if a large number of rented houses were sold to their occupiers and if estimates of imputed rent were not calculated for owner-occupied dwellings, then there would be an apparent decrease in gross domestic product without any decrease in the provision of housing services. In effect, owner-occupiers (like other owners of dwellings) are regarded as operating businesses; they receive rents (from themselves as consumers), pay expenses, and make a net contribution to the value of production which accrues to them as owners."* (ABS, 2001:108)

Estimates of total dwelling rent (imputed plus actual) for intercensal periods are obtained by multiplying an estimate of the stock of dwellings by an estimate of the average rent of rented dwellings. The stock is estimated by extrapolating the benchmark estimate using data on additions adjusted for demolitions which, in turn, are estimated from comparing data on completions and actual intercensal change (ABS, 2000a:178).

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[27] Briefly, this arises from differences in the spatial concentration of rental and owner-occupied dwellings according to their size and type. In Sydney, for example, compared with owner-occupied dwellings, rented dwellings are disproportionately medium density dwellings in the inner and middle regions. Separate houses for rent are disproportionately found in the outer regions. Thus, estimates of the rental value of owner-occupied medium density dwellings are dominated by rents of dwellings with high location premiums and those of owner-occupied houses are dominated by rents of dwellings with relatively poor location premiums.

[28] Other cases are the income received in the form of contribution by government employers to unfunded superannuation schemes and the income on the financial assets of households in those schemes, fringe benefits, or income received in kind and goods and services produced and consumed by persons outside of their normal occupation (that is, 'backyard production').

As the definition moves from expenditure or gross rent data to income or net rent data, the measures employed in the Australian System of National Accounts data become less clearly defined. Gross income from dwellings owned by persons or gross operating surplus (GOS) is defined as gross rent (GR) less operating costs (C) associated with rates, insurance, maintenance etc.[29] That is,

$$GOS = GR - C$$

Income from dwelling rent, however, is defined as gross operating surplus less consumption of fixed capital (or depreciation on the dwelling structure) (D) and less interest payable (interest on outstanding loans) (I).

$$\text{Net income} = GR - C - D - I$$

In other words, the loss of income associated with depreciation of the structure is included, but any gain in income associated with appreciation of the land on which the structure stands is excluded. Capital gains taxes on any such gains, however, are included in the relevant sector accounts in the period in which they become payable. (ABS, 2000a:316).

Dwelling values recorded in gross wealth data, however, reflect the combined effect of structure depreciation[30] and whatever change in land value has taken place. In the data presented below and in the following chapters, therefore, structure depreciation is not identified separately from changes in the underlying market value of the dwelling and land package.

Gross rent data is split into that derived from owner-occupied dwellings and from other dwellings. Data on net income from rent, however, is available only as a combined figure for all dwellings. Table 6 provides the ABS estimates of the various components of dwelling rent. Table 7 presents estimates for owner-occupied dwellings only based on the assumption that the split in costs between owner-occupied and other dwellings is proportional to the split in the gross rent data. Figure 2 provides an overview of the trend in the real values of these aggregates.

[29] A small additional adjustment accounting for approximately 1.5 per cent of the total value of gross operating surplus is made for the ownership of dwellings by sectors other than households.

[30] Or appreciation in cases where there has been investment in the dwelling that has resulted in an increase in quality.

Table 6: Income from ownership of dwellings ($2001)

	Owner occupied dwellings	Other dwellings	Total gross rent	Total operating costs[a]	Net rent [b]	Interest	Net rent less interest
	$b ($2001)	$b ($2001)	$b ($2001)	$b ($2001)	$b ($2001)	$b ($2001)	$b ($2001)
1990	38	12	50	10	40	16	24
1991	40	13	53	10	42	16	25
1992	42	13	55	11	43	13	29
1993	43	13	56	12	43	12	31
1994	44	14	57	12	44	12	32
1995	44	14	58	13	44	15	29
1996	45	15	59	13	45	18	27
1997	47	16	63	13	49	17	32
1998	50	17	66	13	53	17	36
1999	52	18	70	14	55	18	37
2000	54	18	72	14	57	20	37
2001	54	18	72	15	56	23	33

a: operating costs equal rates, land rent, insurance, maintenance, consumption of financial services, commissions, less subsidies

b. defined as gross operating surplus in the national accounts; excludes data for dwellings owned by sectors other than households

Source: System of National Accounts, ABS Cat. No 5204, Table 57

Table 7: Income from owner-occupied dwellings[a] ($2001)

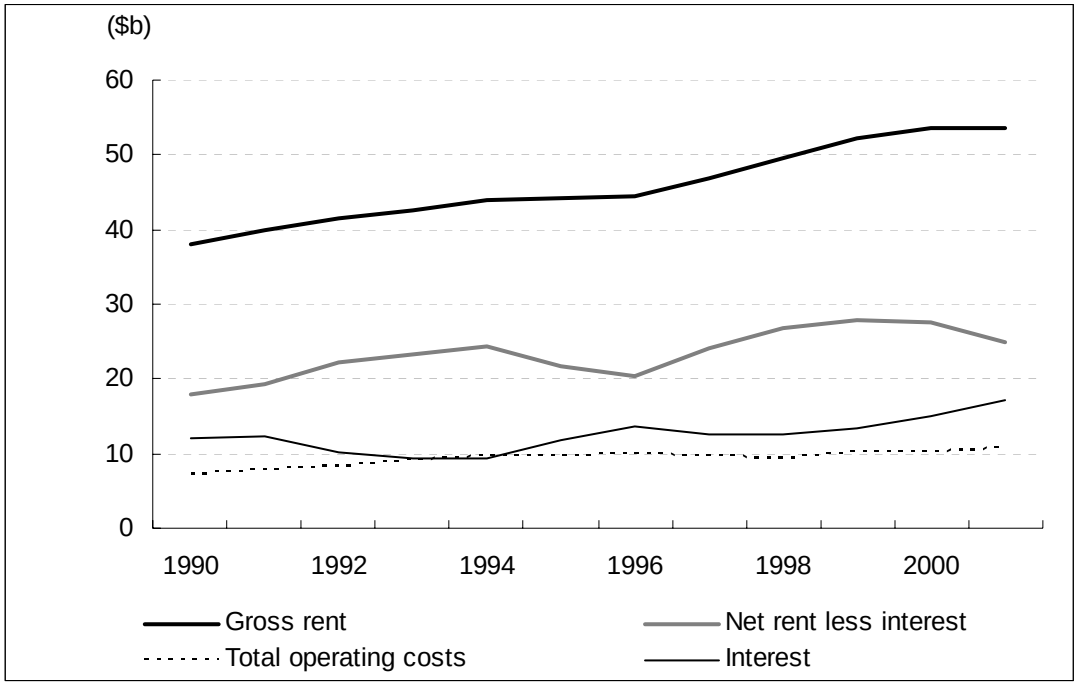
	Owner occupied dwellings	Total operating costs	Net rent	Interest	Net rent less interest
	$b ($2001)	$b ($2001)	$b ($2001)	$b ($2001)	$b ($2001)
1990	38	7	30	12	18
1991	40	8	32	12	19
1992	42	8	33	10	22
1993	43	9	33	9	23
1994	44	10	34	9	24
1995	44	10	34	12	22
1996	45	10	34	14	20
1997	47	10	37	12	24
1998	50	9	39	13	27
1999	52	10	41	13	28
2000	54	10	43	15	28
2001	54	11	42	17	25

a: derived from Table 6 with pro-rata adjustment for operating and interest costs,

based on ratio of owner-occupied share of gross rent

Source: System of National Accounts, ABS Cat. No 5204, Table 57

Figure 2: Income and expenses for owner-occupied dwellings[a] ($2001)



a: based on pro-rata adjustment of total operating and interest costs in national accounts, equal to ratio of owner-occupied share of total gross rent

Source: System of National Accounts, ABS Cat. No 5204, Table 57

CHAPTER 2. INDIRECT ASSISTANCE ARISING FROM THE TAX SYSTEM

The growth in the real value of housing wealth and in the value of services provided by Australia's housing stock along with the changes to the tax system highlight the need for a reassessment of the extent and form of indirect and direct assistance provided to home owners. As indicated above, indirect assistance at a national level is provided primarily through the tax system in the form of tax expenditures arising from exemptions, deductions, rebates, imposition of a lower rate of tax or deferred liabilities.

Determination of the extent of assistance provided by the tax system requires definition of a benchmark against which to assess the treatment of housing. However, the question of what this benchmark should be is by no means clear-cut. In its most recent annual estimate of tax expenditures that are provided through the Australian tax system, for example, Treasury provide the following caution. "There is an element of judgement involved in identifying which elements of the tax system constitute tax expenditures and which elements are structural features, given the diversity of taxation arrangements. For this reason, international comparisons of tax expenditures can be difficult to interpret." In their view, "not all tax concessions are necessarily classified as tax expenditures. This is because some concessions are considered to be structural features of the taxation system and hence are incorporated in the benchmark." (Department of Treasury, 2001b:13) In part, this view provides an explanation of differences in what is and what is not defined as a tax expenditure in the literature.

In their initial study of housing subsidies, Flood and Yates (1989) described a hierarchy of benchmarks that could be regarded as progressively reducing distortions in the tax system. The first benchmark was the 'commonly accepted' tax structure suggested by Treasury. The second and third were a 'tenure neutral' benchmark and a 'tax-neutral' benchmark.[31] Under tenure neutrality, owner-occupiers would be treated in the same way as other owners of housing. Under tax neutrality housing, regardless of who lived in or who owned it, would be treated in the same way as other forms of consumption and investment. Whilst these definitions traditionally have been applied to the treatment of housing under the income tax system, the same principles apply when considering the treatment of housing when any other tax base is considered.[32]

As Hancock and Munro (1992), following Hills (1991), have pointed out, tax neutrality is difficult to define because housing can be regarded as entering any one of the tax bases in common use - income, consumption, wealth, savings or transactions. Haffner (2002), for example, suggests that imputed rent taxation in the Scandinavian countries has been replaced by introduction of a property tax and Hendershott and White (2000) raise questions about what is the appropriate base on which to tax housing. This broader view suggests a fourth step in the Flood and Yates benchmark hierarchy. This would be the inclusion of an optimal tax system in which the desired equity and efficiency plus all other relevant outcomes are assessed in relation to the whole tax system rather than just in relation to one tax base and one period at a time. Slemrod (1990) provides an accessible overview of some of the implications of such an approach and Heady (1993) discusses issues associated with using this as a guide to determining tax policy. This paper, however, stays with the more commonly imposed constraints imposed within the housing literature and limits its consideration to the issues associated with the treatment of housing under the three stage hierarchy.

[31] A more detailed but less readily available version of this work can be found in Flood and Yates (1987).

[32] Tax expenditures arising from a less than comprehensive consumption tax base will be considered below. Even though the GST revenue collected by the Commonwealth is passed through to the States, the tax applies at a national level and individual States do not have the power to change the rate that applies in their State. Property and transaction taxes, however, are State taxes. Of the more important of these, rates and stamp duties are, in broad terms, tenure neutral (with some exceptions for aged owners and for first home buyers). Land taxes, however, are non-tenure neutral as a result of an exemption for the principal place of residence in most States. Yates (1997) provides an overview of the treatment of housing under each of the major tax bases given the tax system in operation in Australia in the early 1990s.

2.1 Assistance to home owners under a commonly accepted benchmark

One of the problems with 'a commonly accepted' tax structure as a benchmark is that there is little that is common. In Australia, Treasury limits its estimates of housing tax expenditures to small amounts for zone rebates[33], to exemptions from fringe benefit tax for employer provided housing in remote areas and to the discount applied to capital gains tax liabilities for individuals (which affects owners of residential property). None of these constitute benefits to owner-occupiers. The only benefit to owner-occupiers listed as a tax expenditure is the exemption of the principal place of residence from the capital gains tax. This expenditure, however, is not costed in the annual Tax Expenditures Statement.

Bourassa and Grigsby (2000), Haffner (2002), Haffner and Oxley (1999) and Hendershott and White (2000) all provide examples of current and past commonly accepted tax structures in countries other than Australia that differ from this narrow official definition employed in Australia. Haffner and Oxley, for example, in their study of housing subsidies in 6 European countries in the early to mid 1990s, provide a table that shows that Belgium, Denmark and the Netherlands either fully or partially taxed imputed rent, and these three countries as well as France, England and Germany either fully or partially allowed owner-occupiers to deduct mortgage interest before determining their income tax liability. None of these countries generally taxed capital gains on owner-occupied housing although there were special circumstances under which this might occur. Haffner (2002) extends and updates this analysis. The outcomes are shown in Tables 8 and 9.[34]

Table 8: Changes in capital gains taxation since 1990

No change	Changed to Dual Income Tax system
Italy (1988)	
United Kingdom (1988)	
Belgium (1989)	
	Denmark (1987)
Finland (1989)	Finland (1993)
Switzerland (1990)[a]	
Germany (1990)	
Netherlands (1990)	Netherlands (2001)[b]
France (90s)	
	Norway (1992)
	Sweden (1991)

a. Harmonisation of local and regional income taxes

b. Partial move only

Source: Haffner (2002), Table 1

These tables highlight the problem of defining a benchmark on a 'commonly accepted' basis. There is neither consistency across countries, nor consistency over time. This observation points to the rationale for the broader definitions of what constitutes assistance to home owners employed in the tenure or tax neutral benchmarks. These broader definitions are defined against ostensibly more objective comparisons; namely how housing is treated according to who owns it or compared with other goods. However, as the data in Tables 8 and 9 clearly indicate, these benchmarks for comparison can differ between countries and over time.

[33] Zone tax offsets may be claimed by residents of remote regions of Australia. They are given in recognition of the disadvantages that taxpayers are subject to because of the uncongenial climatic conditions, isolation, or high costs of living in comparison to other areas of Australia. (http://www.ato.gov.au/)

[34] The basis of the DIT or dual income tax system will be covered in the following sub-section.

Table 9: Treatment of imputed rent taxation

	Taxation of imputed rent	Mortgage interest rate deduction
Belgium	Still exists	Still exists (limited)
Denmark	Replaced by property tax in 2000	Still exists (unlimited, lower tax rate applies)
Finland	Replaced by property tax in 1993	Still exists (unlimited)
France	Removed in 1965	Removed in 1997 for construction, 1998 for existing dwellings
Germany	Removed in 1987	Removed in 1987, other deductions extended
Italy	Still exists, deductions negated impact in 2000	Still exists (limited)
Netherlands	Still exists	Still exists (unlimited)
Norway	Still exists	Still exists (unlimited)
Sweden	Replaced by national property tax in 1991	Still exists (unlimited)
Switzerland	Still exists, but abolition proposed	Still exists (limited in 2001, further limit proposed)
United Kingdom	Removed in 1963	Removed in 2000

Source: Haffner (2002), Table 2

In the following section on tenure neutrality, the tax treatment of the income from rental housing in Australia will be taken as the benchmark for determining tax expenditures for owner-occupied housing in Australia. This benchmark will change whenever the tax treatment of rental housing changes. Changes in the benchmark and the implication of these changes regarding the difference in the treatment of housing depending on who owns it are considered in the following section.

2.2 Assistance to home owners under a tenure neutral benchmark

Under a tenure neutral benchmark, the tax reforms that have taken place in the Australian tax system since the original Flood and Yates study have both introduced new forms of assistance to owner-occupiers as well as maintaining past forms of assistance.

Within the income tax system, new forms of assistance have arisen through the introduction of the capital gains tax (CGT) in 1985 and its subsequent reformulation in 1999. This tax applied to all assets other than owner-occupied housing. Unequivocally, this introduced a tax concession to owner-occupiers that had not been present prior to the broadening of the income tax base brought about by capital gains taxation. Whilst no estimates of the value of the CGT owner-occupier exemption are provided in the annual Tax Expenditure Statements, it is recognised explicitly by Treasury as a deviation from the 'commonly accepted tax structure' (Department of Treasury, 2001b).

Under the pre-1999 regime, when the tax applied to real, realised gains on assets purchased after 1985, the value of this tax expenditure is likely to be affected by two key factors: the extent of real gains and the growth and turnover of the holding of principal places of residence. Because the tenure neutral benchmark compares the treatment of owner-occupiers with other owners of housing, only owner-occupied dwellings purchased after 1985 can be regarded as benefiting from the tax expenditures associated with the pre-1999 regime. Over time, however, the proportion of owner-occupied dwellings covered by the tax

exemption will gradually increase. Since 1999, when cost indexation was frozen, and the capital gains tax applied (at a discounted rate) to nominal realised gains, the key factor affecting the extent of the CGT concession increasingly will be the extent of house price inflation. The benefits that arise from the deferral of the capital gains tax liability and those that arise from the discount provided to individuals, because they apply to all owners of housing and not just to owner-occupiers, form part of the tax neutral benchmark considered below.

An offset to this benefit was also introduced in 1985 with the introduction of a 4 per cent depreciation allowance for the construction costs of income-producing buildings. This allowance is available to landlords but not to owner-occupiers. It was reduced to its current value of 2.5 per cent in 1987. Where ownership of the building changes, the right to claim any undeducted construction expenditure for capital works passes to the new owner for a period of 40 years.[35]

The existing forms of assistance that have been maintained within the income tax system arise from the non-taxation of imputed rent (and the non-deductibility of expenses incurred in earning that income). Imputed rent is included in the 'commonly accepted' definition of the income tax base in only a limited number of countries. Haffner (2002) provides a good overview of the current and changing tax treatment of imputed rent in 11 European countries. Hendershott and White (2000) and Bourassa and Grigsby (2000) provide a less detailed overview but for a broader range of OECD countries. Merz (1977) provides an overview of practices that pre-date the reforms of the 1980s. In many countries, for example, imputed rent is not taxed but the costs associated with the expenses incurred in earning this imputed income (generally mortgage interest and property taxes) are deductible. The lack of a consistent treatment of imputed rent taxation has contributed to some debate over what is the associated tax expenditure.

The issues associated with the definition and measurement of the tax expenditures associated with imputed rent have been well rehearsed in the literature. A series of papers by Follain, Ling and McGill (Follain and Ling, 1991; Ling and McGill, 1992; and Follain, Ling and McGill, 1993) provide a review of much of the earlier literature on this and provide an overview of the conceptual framework that underpins it. Anderson and Roy (2001) provide a review of the literature that has focussed on distributional issues. More recent US literature has focussed on whether or not the concession associated with mortgage interest deduction should be retained or eliminated in light of institutional changes that have eroded its value for lower income households. Bourassa and Grigsby (2000) provide an overview of these arguments. Their analysis focuses on four factors expenditures that contribute to non tenure neutrality in the US tax system: the non-taxation of imputed income, the exemption of capital gains, and the deductibility both of mortgage interest and of real estate taxes. They examine the case made for and against each of these and come down in favour of retaining the first two whilst abolishing the second two. In other words, they effectively recommend adoption of what is the current practice in Australia. Responses to their conclusions will be covered in the concluding sections of this paper.

In Australia, Treasury (2001b:14) state that a "practical approach to defining benchmarks has been adopted … since the adoption of an ideal benchmark based on the pure SHS [Schanz-Haig-Simons] definition of income would result in many additional tax expenditures of little policy relevance. In particular, provisions considered to be intrinsic to the operation of the tax system have been incorporated into the benchmarks, rather than being classified as tax expenditures themselves…."

Whilst this application of a 'commonly accepted' benchmark explains Treasury's decision not to include the concessions arising from the non-taxation of imputed rent in its tax expenditure statements, it does not eliminate the non-tenure neutral treatment arising from this concession to owner-occupiers. In Australia owner-occupiers, unlike landlords, are not required to declare the (imputed) income deriving from the rental value of their owner-occupied dwellings in their income tax returns. At the same time, however, unlike landlords,

[35] Any benefits derived, however, are recaptured under the capital gains tax (Wood, 2001)

they cannot claim the expenses incurred in earning that income.[36] The first of these confers a positive benefit on owners, which increases with the gross rental value of the dwelling and with the owner-occupier's income. The second, however, offsets this, with the cost being larger, the larger is the value of the mortgage debt outstanding and the higher is the interest rate being paid on this. The effect on the net benefit of this tax concession, therefore, will depend on the extent of leverage a home owner has and on the relation between net rent earned and interest paid. The possibility that the costs associated with earning of rental income might exceed the income received has led to the possibility that landlords might benefit from what has been called 'negative gearing' in Australia. Negative gearing refers to the ability to offset losses from rental housing against other income from other sources. Its benefit arises from an asymmetric or non-neutral tax system. This will be discussed below.[37]

The second major change that has taken place in the tax system is in relation to the introduction of the GST. The issues arising from this change will be considered below.

2.3 Assistance to home owners under a tax neutral benchmark

The above discussion has focussed on factors that contribute to owner-occupied housing's tax favoured status as a result of a non tenure neutral tax system. However, there are other aspects of the tax system that also confer tax advantages on housing. These contribute to what is described as a non-neutral tax system. They arise primarily from pragmatic solutions to the difficulties of implementing the Schanz-Haig-Simons definition that was regarded as the ideal measure of income when the tax reforms of the 1980s were being undertaken. Several key problems with this definition, however, have remained unresolved. Amongst these are the distortions that arise in a tax system where nominal rather than real income is taxed and where realised rather than accrued capital gains are taxed. The former is more significant when inflation is high than at present when inflation is relatively low. The latter raise broader issues about the tax treatment of income from labour and capital.

In their recent survey of the US literature on taxation and subsidisation of owner-occupied and rental housing that followed the 1986 Tax Reform Act and subsequent simplifications to the internal Revenue Code, Hendershott and White (2000) provide a summary of these problems as they relate to housing. They set out four principles that follow from the assumption that real economic income should be taxed. First, if nominal interest is deductible, then nominal capital gains should be taxed but if only real interest is deductible then inflationary gains should not be taxed. No allowance need be made for depreciation since this will be absorbed into lower appreciation rates. Second, capital gains should be taxed on accrual. Again, no allowance need be made for depreciation if this is the case. If capital gains are taxed on realisation rather than accrual, they suggest that the loss of depreciation allowances is compensated for by the benefits of tax deferral.[38] Third, in a non-indexed system based on realised capital gains, depreciation allowances should be allowed only if the inflation rate is less than the depreciation rate. Finally, all capital goods should be taxed similarly.

The issue of negative gearing, raised above, provides a clear example of the failure to adhere to these principles. Under the Australian system of taxing personal income, the tax liability on income from capital is taxed at a lower rate than income from other sources (either through indexation or through discounting) and the liability is deferred until realisation. The nominal value of expenses, however, is allowed as a deduction in the period in which they occur. This

[36] Mortgage interest deductibility was introduced from 1 July 1982 as a subsidy for first home buyers. This was available for the first five years of the loan and applied only to loans taken out before 30 September 1983 (DHC, 1987:17). In effect, therefore, it operated only for 5 years.

[37] Wood (2001) provides a formal analysis of the relative benefits and costs associated with the differential treatment of landlords and owner-occupiers under the Australia income tax system. Following Gordon, Hines and Summers (1987), he shows that high bracket taxpayers have a comparative advantage over low bracket taxpayers in obtaining benefits from tax expenditures. If high bracket rental investors pass these benefits on in lower rents, then, in the absence of agency costs, this tax arbitrage can allow low bracket taxpayers to obtain rental housing at a cost lower than would be incurred if they purchased the same quantity of housing for owner occupation. The tax rate at which an individual is indifferent between renting and owning can be defined as a break-even rate. Wood shows that, once agency costs are taken into account, housing at the low value and rent end of the market typically exhibit negative breakeven tax rates. Even individuals in the lowest income tax bracket find renting such property financially unattractive.

[38] Taxation on accrual means that the taxpayer has a tax liability even if there is no associated cash flow. Taxation on realisation means that the taxpayer has use of the non-taxed income until the tax is paid.

effectively enables investors who have expenses in excess of income from capital (such as investment income) to reduce their current tax liability on income from other sources (such as labour income). When capital gains eventually are realised, they will pay tax at a discounted rate on this income from capital.

This asymmetric treatment of income and expenses, however, is a benefit to all investors who derived capital gains from the sale of their assets. It applies equally, for example, to income from shares and from holdings of unit trusts. Thus, it is not specifically a tax expenditure that accrues to housing alone. As such, it will not be treated here as a housing specific tax concession.

The differential treatment of the income from capital, however, is still relevant in relation to the non-tenure neutral treatment of owner-occupiers vis a vis landlords. The question of whether the differential tax treatment of the income from capital and from labour constitutes a tax expenditure or forms a part of the benchmark against which tax expenditures are assessed highlights the difficulties in specifying benchmark.

Official estimates of tax expenditures in Australia include the benefits that accrue to individuals from the 50 per cent discount applied to the taxation of non-exempt capital gains. The benefit is estimated relative to full nominal taxation at the individual's marginal tax rate.

Many countries, however, either have had a tradition of, or have moved towards, a dual tax system in which the income from capital and from other sources are separated and treated differentially. Haffner (2002) provides a brief discussion of such income tax reforms in a number of European countries. She distinguishes between reforms that have led to what she calls a global income tax, in which the same marginal tax rate is applied regardless of the source of income, or to a dual income tax in which a lower marginal tax rate applies to income from capital. Under either system, however, the determination of tax expenditures against a tenure neutral benchmark is unchanged. It is only the determination of what constitutes the relevant income tax benchmark that is affected.

This change in the treatment of capital gains structure from the mid 1980s to the late 1990s reflects a basic division that is emerging in the tax treatment of income - the issue of dual versus comprehensive income taxation (OECD, 2001, p29). Reforms that have led to differential tax treatment of certain forms of income have resulted in a dual income tax (DIT) system. These have been predominant in the Nordic countries. Reforms that have broadened the tax base have been driven by a belief in the equity and efficiency characteristics underpinning the Schanz-Haig-Simons notion of a comprehensive income tax. Whilst the latter underpinned many of the early reforms in the mid 1980s, the former have been justified on pragmatic grounds.

"The DIT aims to strike a balance between equity concerns and revenue needs on the one hand and efficiency and neutrality on the other. As capital income tends to be concentrated in the upper income brackets, the DIT may be conflicting both with horizontal and vertical equity objectives. However, in a comprehensive income tax system, interest expenditure (eg stemming from mortgage loans) is normally deductible against the top marginal personal income tax rate, whereas this is deductible against the (low) capital income tax rate in a DIT. As a result, in effective terms, the DIT may be as equitable as a comprehensive tax system." (OECD, 2001:29)

Lower taxes on income from capital as opposed to income from labour also are justified on efficiency grounds because of the higher international mobility of capital, its greater elasticity of supply and because lower taxes reduce the distortion between present and deferred consumption. As such, they are seen as a pragmatic compromise between an income tax and a consumption tax.

Different issues arise in relation to calls for replacement of the income tax system with a comprehensive consumption tax.[39] Under a consumption tax, the question of whether capital gains should be taxed and whether mortgage interest and other costs should be allowable costs is irrelevant as these are components of income. However, the question of whether

[39] An illustration of a formal model that examines the implications of such a change in the US context can be found in Bruce and Holtz-Eakin (1999).

imputed rent should be included in the consumption base is one that remains as rent paid for housing services is a component of consumption. This question can be answered in terms of the distinction made in this section between tenure and tax neutrality. If both actual rent paid by renters and imputed rent for owner-occupiers are ignored when all other forms of consumption are included in the tax base, this would result in a non-neutral tax system in which housing was favoured vis a vis other goods. If imputed rent was exempted but actual rent was taxed, this would result in a non-tenure neutral tax system.

This same issue arises in relation to the tax mix change that occurred in Australia with the introduction of the GST and that has occurred elsewhere with the increasing importance of consumption vis a vis income taxes. In Australia, residential rents are input taxed with the result that both landlords and owner-occupiers are unable to claim the tax paid on any expenditures associated with the operating costs associated with dwelling ownership. In this sense, the treatment of housing is tenure neutral. However, the exemption of rent, whether actual or imputed, from the sales tax base adds a tax advantage to housing vis a vis other goods and services on a tax neutral benchmark.

CHAPTER 3. ESTIMATES OF ASSISTANCE TO HOME OWNERSHIP

The above discussion has highlighted the current sources of assistance that are provided currently to owner-occupiers in Australia. Broad time series estimates of most of these can be obtained from the data presented in Tables in chapter 1. An indication of how this assistance is distributed between households and regions, however, requires more detailed survey data.

3.1 Aggregate estimates of tax expenditures from time series data

Estimates of aggregate tax expenditures are necessarily approximate because they require an assumption to be made about what would have been the relevant tax rate had this untaxed income from owner-occupiers been treated in the same way as taxed income from other owners of housing. This is further complicated by the fact that income is taxed at an individual level which means the income derived from owner-occupied housing has to be assessed at an individual level. At the aggregate level a conservative approach is to apply the marginal tax rate that applied to average taxable income for individuals in each of the years under consideration.[40] Information on average taxable income is available in the annual taxation statistics provided by the Australian Tax Office. This follows the approach employed by Flood and Yates who used a 32 per cent marginal tax rate for their study in 1987.

For the time period covered by this study, average taxable income increased (in current prices) from approximately $20,000 in 1990 to approximately $35,000 in 2001. This represents an increase in the real value of taxable incomes of approximately 2.5 per cent per annum.[41] The tax scales that applied across this range are shown in the third tax bracket in Table 10. Table 10 also shows the effect of tax reforms that broadened the income tax base and reduced the proportion of total revenue raised from income taxes. Marginal tax rates on average incomes declined from (38 + 0.15) per cent prior to 1993 to (30 + 1.5) per cent by 2001.

Table 10: Marginal personal income tax rates

tax bracket	**<1993**	**1993-1994**	**1994-2000**	**2000-2001**
	%	%	%	%
$1-$5400	0	0	0	0
$5401-20700	20	20	20	17
$20701-36000	38	35.5	34	30
$36001-38000		38.5		
$38001-50000	46	44.125	43	
$50001-60000	47	47	47	42
$60001+				47
Medicare levy[a]	0.15	1.4	1.5	1.5

a. Applies to all incomes with a marginal tax rate of .20 or above and some below

Source: Annual Tax Packs and Budget Papers, various years

[40] Use of existing tax scales presumes that these would remain unaffected by the inclusion of currently untaxed income. Issues arising from assessing tax expenditures at the disaggregate level will be covered in the following section.

[41] Data on average taxable income have been taken from Taxation Statistics for various years (www.ato.gov.au). Because of an increasing share of households not in the work force and a changing share of households with no person employed, these income data provide an over-estimate of population wide average per capita incomes. The breadth of the tax bracket that applies at this level of income, however, suggests that some considerable variation can occur in average income before there is a change in the marginal tax rate that applies. The impact of the superannuation surcharge is ignored because assessment of its impact requires information on superannuation contributions. Ignoring it means that tax expenditures are underestimated on average and for high income taxpayers.

Table 11 presents aggregate estimates of the tax expenditures arising from exempting owner-occupied housing from the capital gains tax. These estimates are based on the assumption that annual gains provide an estimate of the annualised value of the cumulative value of accrued capital gains. As such, they assume the benefits associated with the deferral of tax liability are greater than the investor's personal discount rate.[42]

The results in Table 11 suggest that the tax expenditures associated with the discount method are both lower and less volatile than those associated with the indexation method. Under the indexation methods, the average real value of the tax expenditures associated with CGT was $10 billion per year, compared with what would have been an average of $8 billion per year had the discount approach been implemented from the start. The standard errors, that provide an indication of volatility, are respectively 8.6 and 4.1. These estimates suggest that this tax concession accorded to owner-occupied housing alone is equivalent to more than 1 per cent of GDP, and is of the same order of magnitude as that accorded to superannuation. The concessions to superannuation, in turn, represented 30 per cent of total tax expenditures (estimated by Treasury to have a value of $30 billion in 2001).

Table 12 provides aggregate estimates of the tax expenditures associated with the non-taxation of imputed rent, based on the same tax rates as those used for the capital gains tax estimates. For 2001, this exemption provides a net benefit of approximately the same order of magnitude as that provided by the capital gains tax exemption.[43] To some extent, the increasing value of the value of the exemption of the net rental value (that is, less operating costs) has been offset by increasing mortgage interest costs that are non-deductible. As with the capital gains tax exemptions, the concession to owner-occupied housing provides a net benefit of the same order as that provided by the tax concessions to superannuation. If included in Treasury estimates, together they would account for just under 40 per cent of total tax expenditures.

[42] Consider, for example, the case where capital gain for the year is $10,000 (5 per cent of a $200,000 dwelling) and the marginal tax rate is 30 per cent. If gains were taxed on an accrued basis using the discount method, there would be a tax liability of $1,500 (that is, half of the non-discounted liability of $3,000). If this tax liability is deferred because gains are taxed on realisation, the taxpayer gains from retaining access to the funds that would have been used to pay tax due (or from not having to borrow to pay this tax). An approximation of this benefit is the current market rate of interest on the amount owed. In the short run, ignoring the grandfathering effect of the CGT will provide an over-estimate of the size of tax expenditures if this is regarded as being a part of the tax benchmark. One possible effect of the grandfathering clause is that it has created a lock-in effect with the result that landlords who owned rental dwellings before 1985 have been encouraged to hold on to these. It is possible that this limits the extent of upward pressure on market rents and so is reflected in lower estimates of the tax expenditures that arise from the non-taxation of imputed rent. However, the limited evidence that does exist suggests that an increasing proportion of landlords have entered the market since 1985. Only 13.7 per cent of investors first rented their property before 1988 (ABS, 1998b:18). Consideration of this, however, is beyond the scope of this paper.

[43] The down turn in the real value of both housing wealth and gross rental value in 2001 can be attributed to a once off spike in the consumer price index as a result of the introduction of the GST in 2000.

Table 11: Tax expenditures from capital gains tax exemption

	marginal tax rate	gross housing wealth[a]	real gross wealth[a]	nominal capital gains	real capital gains	tax expenditures[b]			
						indexation method		discount method	
		$b	$b($2001)	$b	$b ($2001)	$b	$b ($2001)	$b	$b($2001)
1990	38.15	539	703	48	13	4	5	9	12
1991	38.15	567	715	28	13	4	5	5	7
1992	38.15	571	712	4	-4	-1	-1	1	1
1993	38.15	606	742	35	30	9	12	7	8
1994	36.9	648	780	42	38	12	14	8	9
1995	35.5	684	788	36	8	2	3	6	7
1996	35.5	696	777	11	-11	-4	-4	2	2
1997	35.5	745	829	49	52	17	18	9	10
1998	35.5	795	879	50	50	16	18	9	10
1999	35.5	859	940	64	61	20	22	11	12
2000	35.5	933	989	74	49	16	17	13	14
2001	31.5	1017	1017	84	28	9	9	13	13

a: data for 1989 approximated from Treasury data

b: based on assumption of realisation of gains; indexation method ignores 1999 quarantining

Source: as for Table 4 and Table 10

Australian National Accounts Household Balance Sheet ABS Cat. No. 5204,Table 46

Annual Tax Packs and Budget Papers, various years

Table 12: Tax expenditures from imputed rent exemption

	Non taxation net imputed rent	Non deductibility of interest	Net effect of imputed rent exemption
	$b ($2001)	$b ($2001)	$b ($2001)
1990	11	-5	7
1991	12	-5	7
1992	12	-4	9
1993	13	-4	9
1994	12	-3	9
1995	12	-4	8
1996	12	-5	7
1997	13	-4	9
1998	14	-5	9
1999	15	-5	10
2000	15	-5	10
2001	13	-5	8

Source: as for Table 7 and Table 10

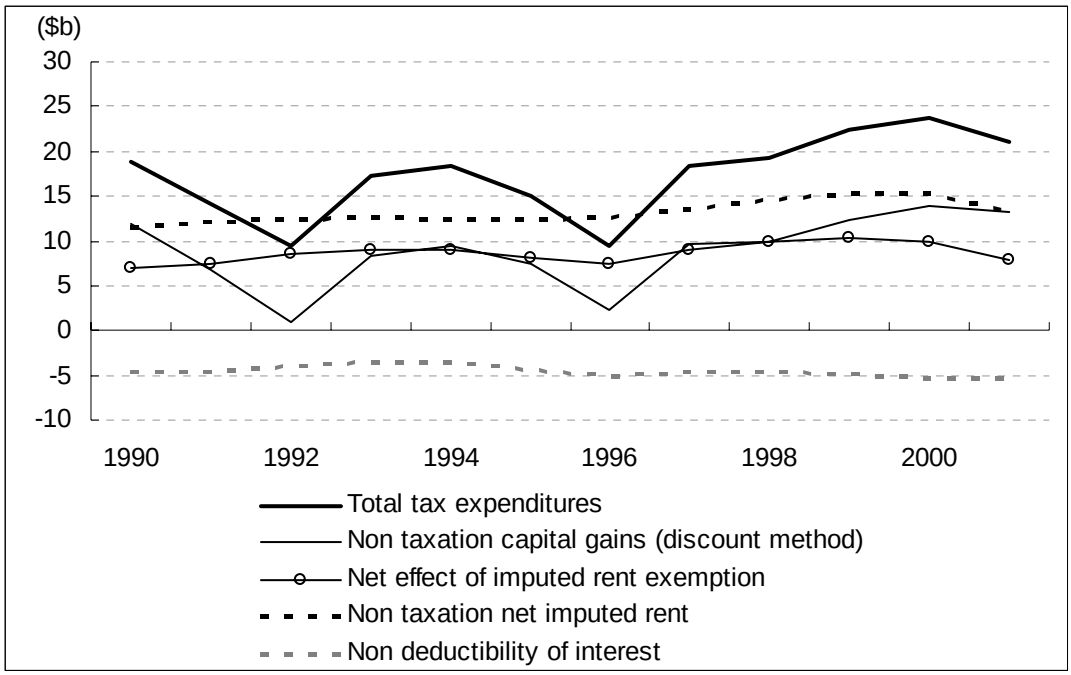
Annual Tax Packs and Budget Papers, various years

System of National Accounts, ABS Cat. No 5204, Table 57

Figure 3 illustrates the trend in the real values of the various components of the tax expenditures that are the source of owner-occupied housing's tax favoured status. Some of the volatility arising from the use of actual rather realised gains can be eliminated by converting the estimates in Table 11 to a 5 year rolling average. This has not been done here because of the dominating effect of the increases in dwelling values in the early part of the period as a result of the 1988-1989 house price boom.

Figure 3 shows that, despite the underlying volatility of the estimates and despite the offsetting effect of the non-deductibility of increasing mortgage interest costs, there has been a general upward trend over the decade in the real value of tax expenditures to owner occupation.

Figure 3: Indirect assistance to owner-occupied housing



Source: Tables 11 and 12.

In part, of course, this arises because there has been an increase in the number of owner-occupier households. Table 13 presents the equivalent data on a per household basis. ABS have estimated that, between 1990 and 2001, the number of households in Australia grew from 6 million to just over 7 million, with an underlying growth rate of 1.4 per cent per annum (which is greater than the population growth rate). Given a stable underlying home ownership rate of approximately 70 per cent, this gives a growth in the number of owner-occupier households from just over 4 million to approximately 5 million.[44]

These data show that, in 2001, the indirect assistance provided to owner-occupier households amounted to $4,200 per household, consisting of $2,600 per household for the non-taxation of imputed rent, -$1,100 for the non-deductibility of mortgage interest and $2,600 for the CGT exemption.

[44] Yates (2000) provides evidence that shows the overall home ownership rate has remained stable despite declining home ownership rates amongst younger households because of the aging of the population. Because of the relatively slow growth in the number of households, the pattern of tax expenditures on a per household basis is more or less the same as illustrated in Figure 3.

Table 13: Per household tax expenditures

	Non taxation net imputed rent	Non deductibility of interest	Net effect of imputed rent exemption	Non taxation capital gains - discount method	Total
	$ pa($2001)	$ pa($2001)	$ pa($2001)	$ pa($2001)	$ pa($2001)
1990	2,700	-1,100	1,600	2,800	4,400
1991	2,800	-1,100	1,700	1,600	3,300
1992	2,800	-900	1,900	200	2,100
1993	2,800	-800	2,000	1,800	3,800
1994	2,700	-700	1,900	2,000	4,000
1995	2,500	-900	1,700	1,600	3,200
1996	2,500	-1,000	1,500	500	2,000
1997	2,700	-900	1,800	2,000	3,700
1998	2,800	-900	1,900	2,000	3,900
1999	2,900	-1,000	2,000	2,500	4,500
2000	3,000	-1,100	2,000	2,800	4,700
2001	2,600	-1,100	1,600	2,600	4,200

Source:

As for Table 11 and Table 12 for tax expenditures, as for Figure1 for household numbers

Annual Tax Packs and Budget Papers, various years

Australian National Accounts Household Balance Sheet ABS Cat. No. 5204,Table 46

System of National Accounts, ABS Cat. No 5204, Table 57

Household and Family Projections, ABS Cat No 3236.0

Using the same basic methodology as employed above, Flood and Yates (1987) estimated that total tax expenditures on housing amounted to $4.4 billion measured in current $2001 values, an implied estimate of the real value of assistance of $1,200 per household. This was made up of a positive benefit of $2,400 from the non-taxation of net imputed income and a $1,200 cost associated with not being unable to deduct their mortgage costs.[45] These 2001 estimates for the tax benefit associated with the non-taxation of net imputed rent are higher than the 1985 estimates. The cost associated with the non-availability of the mortgage deduction, however, is similar. The former is consistent with increased real value of the housing stock over the period. The latter can be attributed to lower mortgage debt but higher interest costs in 1985 compared with 2001. Overall, the results suggest that the real values of the tax expenditures that were untouched by the tax reforms that have taken place since 1985 have increased gradually over time but are broadly of the same order of magnitude in 2001 as they were in 1985.

At this aggregate level of analysis, the major difference between the 1985 and 2001 results, however, arises from the additional tax expenditure introduced with the post 1985 reforms. In real terms, the total tax expenditures for owner-occupied housing, at $4,200 per household, are now almost double those that applied in 1985.

The benefits of these tax expenditures for owner-occupied housing, of course, are not distributed evenly across the population. The costs of the negative expenditures are borne solely by home purchasers. The benefits of the positive expenditures are enjoyed by all owners. It is not clear, on a priori grounds, what the overall implication of this is likely to be. Home purchasers, in general, tend to have higher incomes than those who do not or cannot enter owner-occupation. Outright owners, on the other hand, may have high or low incomes, depending primarily on their life stage.

The following section examines the question of who benefits from the increasing indirect assistance provided to owner-occupiers under the Australian tax system.

[45] Their time series estimates were $2.28b for total tax expenditures in $1985(Flood and Yates, 1987:10). They also reported an estimate of $3.7b based on survey data for 1984-85 to allow for the much lower interest costs reported in the Household Expenditure Survey used for their distributional analysis (Flood and Yates, 1987:42). Scaling their aggregate results by the number of households (as recorded in the 1984 HES) implies a per owner household estimate of $633 for the lower estimate and $900 for the higher. The real ($2001) values of these estimates are, respectively, $1215 and $1727 per household. These are lower than the per household figures presented in their report and in the 1993 update (Industry Commission, 1993) because the latter include subsidies from all sources, not just from the tax expenditures reported here.

3.2 Distributional estimates of tax expenditures from survey data

Detailed distributional information on the benefits and costs of the tax expenditures associated with owner-occupied housing can be obtained from survey data. The most recent relevant survey in Australia is the 1999 Australian Housing Survey with a final sample of 13,800 households across Australia. An overview of this survey can be found in ABS (2000c).

As indicated in the previous chapter, the survey data yield an estimate of the gross value of owner-occupied dwellings that is approximately 25 per cent higher than that indicated for 1999 by the ABS data described in section 1.3 in chapter 1 (but is almost identical to the more broadly defined Treasury data). The estimate of outstanding mortgage debt, however, is of the same order of magnitude as that reported by the ABS although it, too, is still at least 10 per cent above the data obtained from financial institutions presented in chapter 1.

There are a number of explanations that can be given for these discrepancies. The first, and most obvious, is that the procedures used to derive data for owner-occupied housing from the aggregate data might have underestimated the relative contributions of the owner-occupied sector. The breakdown of the aggregate estimates of mortgage debt outstanding into that for owner-occupation and that for other dwellings, for example, was based on the proportions of lending data for these purposes. If, however, investors repay their loans more rapidly than do owner-occupiers, this would underestimate the outstanding mortgage debt on owner-occupied housing. Similarly, if owner-occupied housing has a higher average value than rental housing, then the use of the ratios of imputed to total rental income would underestimate gross owner-occupied wealth.

A second explanation is that the survey data is inaccurate. Survey data rely on self-reporting. A recent study by Kiel and Zabel (1999) studied the accuracy of owner-provided estimates of house values by comparing reported values with sales data. They suggest that the average owner overvalues by 5 per cent, which might explain some of the difference but is not sufficient to explain all of the difference observed here. Their analysis, however, did show that this bias is not related to the characteristics of either the household or the dwelling. They concluded, therefore, that owner-provided estimates do provide an accurate estimate of house price indexes. Earlier studies have yielded similar conclusions.[46]

The comparisons of survey and time series data suggest the absolute value of the tax expenditures presented in the previous section are more likely to be under-estimated rather than over-estimated. However, in order to determine the distributional impact of the subsidies identified above it is the relative rather than absolute reliability of the data that is important. In the absence of objective data to anchor the estimates, and because it is the relative rather than absolute results that are of interest, this section makes no attempt to adjust either the survey aggregates to ensure they are consistent with the time series aggregates or to adjust the latter so that they are consistent with the survey aggregates.

Three steps are needed in order to determine the distributional impact of indirect assistance provided to housing through the tax system. In the first instance, net rental values need to be determined. This can be done by applying an appropriate gross rental rate of return to the capital values recorded in the survey and by subtracting the operating costs that are recorded. An alternative approach is to apply a net rate of return. Given that the data is available to allow the first approach to be employed and given that operating costs may vary systematically by the variables of interest, the first approach is taken here. Previous approaches to imputing rent for owner-occupied housing in Australia have used a relatively conservative 5 per cent figure for gross rental yields (Yates, 1994). This is consistent with the gross rental rate of return that is implicit in the National Accounts data presented in Tables 4 and 6. For 1999, for example, the ratio of gross rental income for owner-occupied dwellings to the gross value of owner-occupied dwellings gives implied gross rental return of 5.5 per cent and that for the decade varies only from 5.3 per cent to 5.8 per cent. It is also the value that was employed for the one time that Australia did impose a tax on imputed rental income.[47]

[46] Yates (1991) provides an overview of earlier studies.

[47] It was only with the advent of the first world war that the Commonwealth introduced an income tax although the states had first introduced income taxes during the late 19th century. Imputed rent was incorporated in the Commonwealth's income tax base from 1915 to 1923. An historical overview of Australia's experience with imputed rent taxation can be found in (Harris,

The most recent survey of rental investors (ABS, 1998b) supports the argument this is an extremely conservative estimate.[48]

The second step is to determine what are the costs associated with earning that income. In the housing survey, housing cost data for owners cover mortgage repayments, rates, taxes and expenditure on repairs and maintenance. No breakdown of the components or of the extent to which mortgage repayments cover principal as well as interest repayments is available. Interest payments can be approximated from the data on outstanding debt using the same broad methodology as outlined above for gross rents. From the data presented in Tables 4 and 6, the ratio of mortgage interest paid by owner-occupiers as derived from the National Accounts data to the value of mortgage debt outstanding recorded in Reserve Bank data yields an implied rate of interest of 6.6 for 1999. This is virtually identical with the 6.5 per cent variable bank mortgage rate on new lending for June 1999. Over the decade, the interest rates implied by the data presented in Tables 4 and 6 track the changes in actual rates closely (to within 0.5 percentage points). The results of employing this approach to estimate interest paid are included below as an indication of the relative importance of interest payments. In the absence of information on operating costs, however, it is not possible to identify the extent to which the total housing costs data includes non deductible mortgage principle repayments. As a conservative estimate, all housing costs will be deducted to derive a figure for net rent less interest costs. This overestimates allowable deductions under the tax system by an amount equal to the repayments of principal that are embodied in total mortgage repayments.[49] The effect of this, therefore, is to underestimate tax expenditures by this amount scaled by the relevant marginal tax rate.

Finally, capital gains need to be evaluated. Given that the tax benefit is based on realised rather than accrued gains, there is a strong argument for using trend rather than annual data for capital gains since the cumulative effect over time will even out the impact of troughs and cycles. The results presented above suggested a per household real growth in the value of dwelling assets of approximately 2.5 per cent per annum once household growth is taken into account. The ABS house price index data for established houses indicates an average nominal growth of just under 4 per cent per annum for the period from 1990 to 2001 and a real growth of just over 1 per cent per annum. These house price estimates are more conservative than those implied by the aggregate data and will be used to impute accrued capital gains in the survey data. A conservative 3 per cent nominal growth rate is employed. One advantage of using published price index data is that it can be spatially disaggregated to allow for different rates of capital gain when more disaggregated data is considered.

In the final report, the sensitivity of the results obtained to the assumptions made can be explored as can the impact of spatial differences in rates of house price inflation.

Table 14 provides the base data from which indicative estimates of the distributional impact of the tax based indirect assistance to home owners are derived for this report. Table 15 provides estimates of the tax expenditures identified in the previous section. Figure 4 illustrates these for all owners, outright owners and owner-purchasers.

2002) and Reece (1985). As recently as 1975, its reintroduction was proposed, with gross rental value being assessed at 7.5 per cent of capital value (Priorities Review Staff, 1975).

[48] Less than 10 per cent of investors reported a gross return of less than 5 per cent. Almost 50 per cent reported a gross return of 7 per cent or more. The survey data also suggests there is an inverse relationship between gross rents and dwelling value. The higher returns on lower value dwellings are likely to be offset by lower capital gains. These differences are taken into account by assuming a constant combined rental return plus capital gain for all dwellings. One possible rationale for employing a conservative assessment is that it compensates for ignoring structure depreciation. However, since maintenance costs are fully accounted for in operating expenses and depreciation is accounted for in observed capital gains, this explanation is unnecessary. A recent Reserve Bank paper (RBA, 2002b) suggests that gross rental yields have declined from around 8 per cent in the mid 1980s to around 5 per cent in the mid 1990s. However, these estimates are based on median rents and median house prices based on sales price data. As such, they do not take into account the different and changing compositions of rental dwellings and owner-occupied dwellings (that dominate sales price data).

[49] Data from the 1998-99 Household Expenditure Survey (Cat. No. 6536.0) suggests repayments of principal are of the same order of magnitude as interest repayments).

Table 14: Dwelling values, debt and housing costs, 1999

	income quintile[a]					
	1	2	3	4	5	total
all owners						
income ($pw)	201	438	781	1,204	2,243	1,051
dwelling value ($)	164,000	178,000	195,000	212,000	311,000	217,000
mortgage debt ($)	7,400	16,900	37,200	56,000	76,400	41,400
housing costs ($pw)	44	69	122	156	209	126
housing equity (%)	95	90	81	74	75	81
% all households[b]	62	64	66	75	83	70
outright owners						
income ($pw)	202	425	772	1,208	2,258	835
dwelling value ($)	163,000	187,000	228,000	235,000	333,000	218,000
mortgage debt ($)	0	0	0	0	0	0
housing costs ($pw)	31	38	51	51	77	46
housing equity (%)	100	100	100	100	100	100
% all households[b]	54	47	32	29	31	39
home purchasers						
income ($pw)	193	472	790	1201	2234	1318
dwelling value ($)	166,000	153,000	162,000	198,000	298,000	216,000
mortgage debt ($)	58,600	64,800	73,900	92,000	124,300	94,000
housing costs ($pw)	134	160	192	224	295	228
housing equity (%)	65	58	55	53	58	57
% all households[b]	8	17	34	46	51	31

a. Income quintiles are derived from on whole population, not just owners

b. Gives percentage share of each tenure in relevant income category

Source: Australian Housing Survey 1999, confidentialised unit record files

The average tax expenditures for all owners estimated from the survey data and shown in the final column of Table 15 are lower than the per household estimates based on aggregate data and presented in Table 13 because of the conservative assumptions employed in deriving them.[50] This notwithstanding, the results clearly show the strong bias towards outright owners in the current income tax system that arise from the positive benefits of the net imputed rent and capital gains exemptions. These concessions, which apply to all owners, are offset for purchasers by the non-deductibility of interest costs. Outright owners, on average receive more than 5 times the benefit than do purchasers. Outright owners on lower incomes receive proportionally higher benefits. The impact of age on these results will be shown in the following set of tables.

[50] The total per household tax expenditures based on the aggregate data reported in Table 13 amounted to $4,500 for 1999 (in $2001), consisting of $2,000 from the net imputed rent exemption and $2,500 from the capital gains tax exemption. If average rather than annual capital gains data had been employed, this would have been reduced to $3,900 per household for 1999. The $2001 equivalent of the data presented in Table 16 is $3,000, consisting of $1,700 from the net imputed rent exemption and $1,300 from the capital gains tax exemption.

Table 15: Tax benefits by household income and tenure, 1999

	income quintile					
	1	2	3	4	5	total
all owners						
gross rent ($pa)	8,200	8,900	9,700	10,600	15,600	10,900
interest ($pa)	500	1,100	2,500	3,700	5,000	2,700
net rent less interest	5,900	5,300	3,400	2,500	4,700	4,300
capital gains	4,900	5,300	5,800	6,400	9,300	6,500
imputed rent tax[a]	0	1,100	700	900	2,300	1,500
capital gains tax[b]	0	500	600	1,100	2,300	1,200
total tax benefit	0	1,600	1,300	2,000	4,500	2,700
benefit as % income	0	7	3	3	4	5
outright owners						
gross rent ($pa)	8,200	9,300	11,400	11,800	16,600	10,900
interest ($pa)	0	0	0	0	0	0
net rent less interest	6,500	7,400	8,800	9,100	12,700	8,500
capital gains	4,900	5,600	6,900	7,100	10,000	6,500
imputed rent tax[a]	0	1,500	1,800	3,200	6,100	3,000
capital gains tax[b]	0	600	700	1,300	2,400	1,200
total tax benefit	0	2,000	2,400	4,500	8,600	4,200
benefit as % income	0	9	6	7	7	10
home purchasers						
gross rent ($pa)	8,300	7,600	8,100	9,900	14,900	10,800
interest ($pa)	3,900	4,300	4,900	6,100	8,200	6,200
net rent less interest	1,300	-700	-1,900	-1,700	-500	-1,100
capital gains	5,000	4,600	4,900	5,900	8,900	6,500
imputed rent tax[a]	0	-100	-400	-600	-200	-400
capital gains tax[b]	0	500	500	1,100	2,200	1,200
total tax benefit	0	300	100	400	1,900	800
benefit as % income	0	1	0	1	2	1
marginal tax rate[d]	0	0.2	0.2	0.355	0.485	0.355

a. tax benefit based on marginal tax rate of half household income applied to non-taxed income

b. tax benefit based on half of marginal tax rate applied to non-taxed gains (discount method)

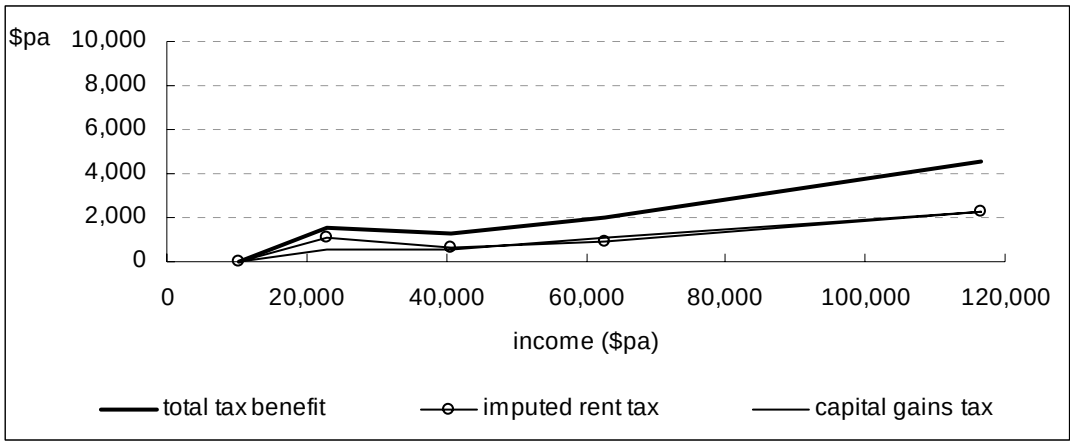
c. weights tax expenditure for owners by proportion of owners in population

d. estimated as marginal tax rate on half household income

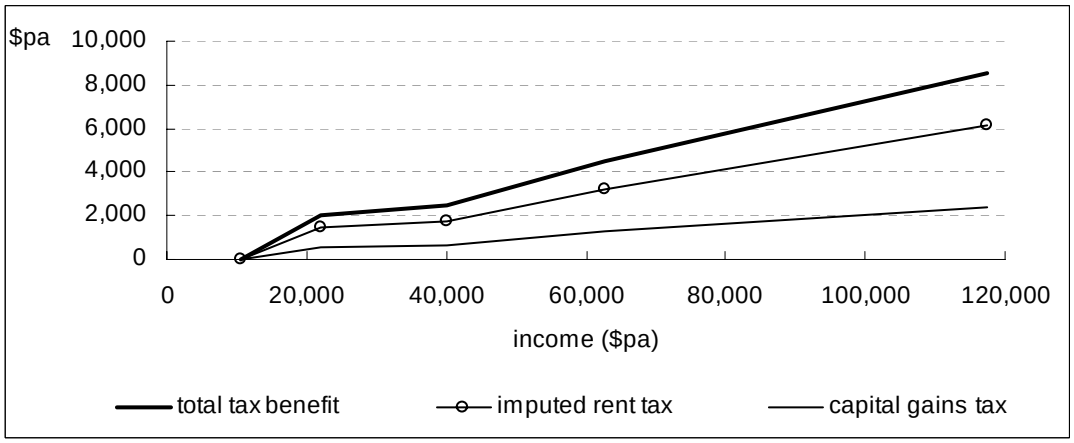
Source: Australian Housing Survey 1999, confidentialised unit record files

Figure 4: Tax benefits by household income and tenure type, 1999

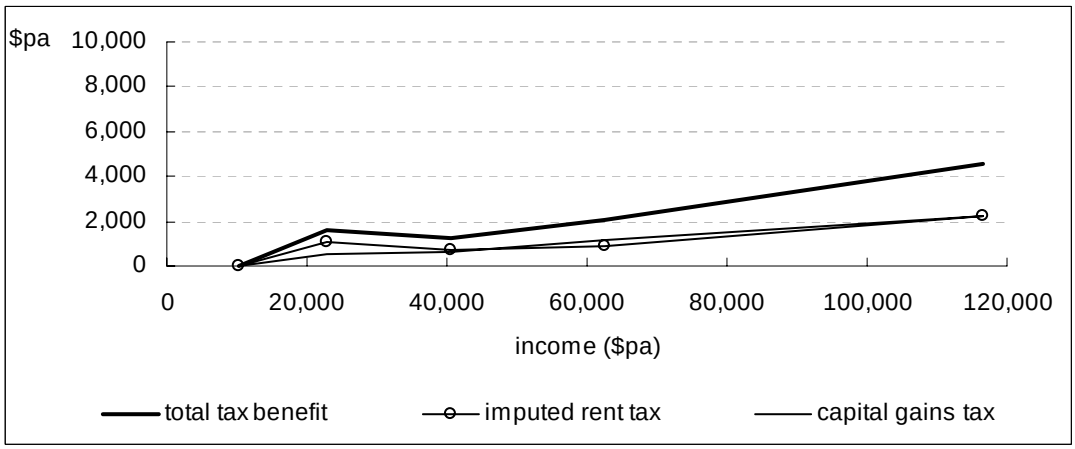
All owners



Outright owners



Home purchasers

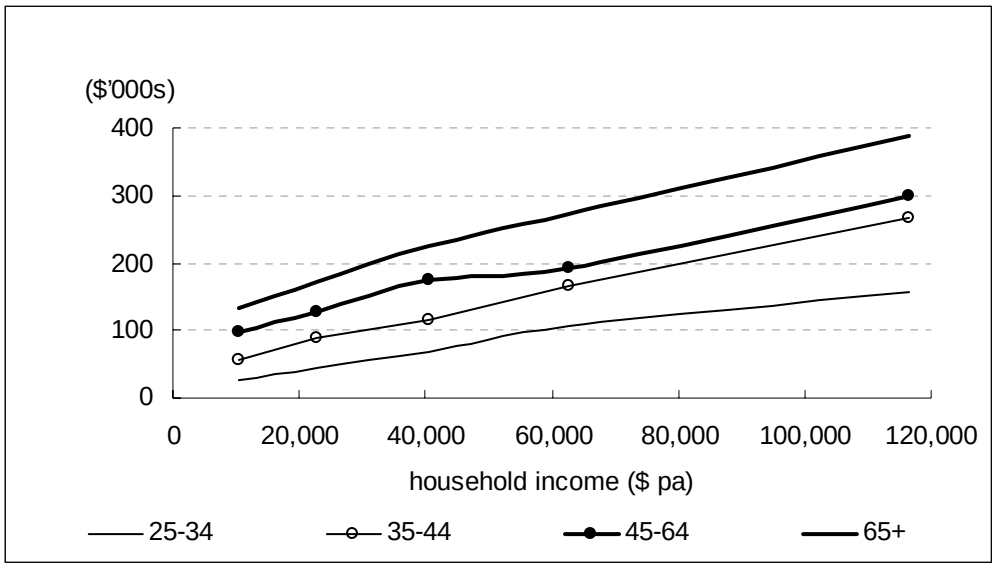


Source: Australian Housing Survey 1999, confidentialised unit record files

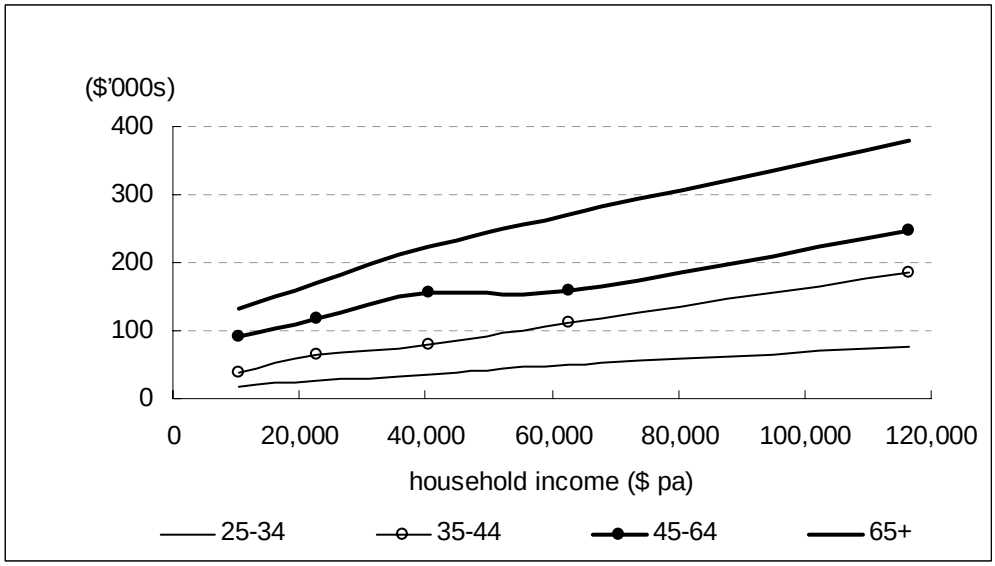
The results also show the strong distributional effects of the indirect assistance provided to owner-occupation. Households in the bottom quintile, because their income is presumed to be below the tax threshold, receive no benefits from this form of assistance. Households in the top income quintile receive average benefits that, in absolute terms, are three times higher than those received by households in the second and third income quintiles. Outright owners in the top income quintile receive a benefit that is four times higher than the benefit received by low income outright owners. Purchasers in the top income quintile receive a benefit that is more than six times that received by purchasers in lower income quintiles and more than four times that received by purchasers with moderate to high incomes.

Figure 5: Dwelling value and equity by age and income, 1999

Dwelling value



Equity



Source: Australian Housing Survey, confidentialised unit record files

Table 16: Dwelling values, debt and housing costs, 1999: all owners by household income and age

	income quintile[a]					
	1	2	3	4	5	total
25-34 years						
income ($pw)	175	477	785	1,215	2,050	940
dwelling value ($)	127,000	140,000	164,000	194,000	231,000	171,000
mortgage debt ($)	41,000	37,800	42,000	54,100	71,200	49,200
housing costs ($pw)	97	116	138	186	260	160
housing equity (%)	68	73	74	72	69	71
% all owners[b]	3	9	17	18	15	13
35-44 years						
income ($pw)	177	467	790	1,204	2,347	997
dwelling value ($)	149,000	162,000	170,000	218,000	326,000	205,000
mortgage debt ($)	40,300	36,300	36,400	44,800	64,700	44,500
housing costs ($pw)	119	114	123	133	208	140
housing equity (%)	73	78	79	79	80	78
% all owners[b]	6	15	26	33	28	22
45-64 years						
income ($pw)	191	451	786	1,212	2,278	984
dwelling value ($)	167,000	164,000	211,000	220,000	318,000	216,000
mortgage debt ($)	27,400	26,100	32,700	41,100	55,700	36,600
housing costs ($pw)	78	86	107	122	160	111
housing equity (%)	84	84	85	81	83	83
% all owners[b]	28	31	39	40	53	39
65+ years						
income ($pw)	213	414	773	1,137	2,869	1,081
dwelling value ($)	168,000	180,000	214,000	246,000	408,000	243,000
mortgage debt ($)	13,900	11,200	11,700	21,000	60,300	23,600
housing costs ($pw)	58	53	67	88	162	86
housing equity (%)	92	94	95	91	85	90
% all owners[b]	64	44	15	7	4	25
all owners						
income ($pw)	201	438	781	1,204	2,243	1,051
dwelling value ($)	164,000	178,000	195,000	212,000	311,000	217,000
mortgage debt ($)	7,400	16,900	37,200	56,000	76,400	41,400
housing costs ($pw)	44	69	122	156	209	126
housing equity (%)	95	90	81	74	75	81
% all owners[b]	100	100	100	100	100	100
% all households[c]	62	64	66	75	83	70

Source: Australian Housing Survey, 1999, confidentialised unit record files

a. Income quintiles are derived from on whole population, not just owners

b. Gives contribution to home ownership of each age group in relevant income category

c. Gives proportion of owners in relevant income category

Table 17: Dwelling values, debt and housing costs, 1999: outright owners by household income and age

	income quintile[a]					
	1	2	3	4	5	total
25-34 years						
income ($pw)	187	463	788	1,228	2,044	1,018
dwelling value ($)	135,000	145,000	188,000	210,000	209,000	184,000
mortgage debt ($)	0	0	0	0	0	0
housing costs ($pw)	51	51	53	102	156	85
housing equity (%)	100	100	100	100	100	100
% all outright owners[b]	1	3	4	6	4	3
35-44 years						
income ($pw)	171	456	790	1,209	2,499	1,233
dwelling value ($)	148,000	161,000	177,000	235,000	337,000	228,000
mortgage debt ($)	0	0	0	0	0	0
housing costs ($pw)	52	47	60	54	116	69
housing equity (%)	100	100	100	100	100	100
% all outright owners[b]	3	8	15	20	17	11
45-64 years						
income ($pw)	187	442	768	1,216	2,233	1,078
dwelling value ($)	142,000	176,000	234,000	225,000	326,000	230,000
mortgage debt ($)	0	0	0	0	0	0
housing costs ($pw)	32	38	48	46	64	47
housing equity (%)	100	100	100	100	100	100
% all outright owners[b]	26	32	51	56	69	43
65+ years						
income ($pw)	209	409	766	1,176	2,089	470
dwelling value ($)	173,000	197,000	252,000	279,000	419,000	206,000
mortgage debt ($)	0	0	0	0	0	0
housing costs ($pw)	30	36	51	46	66	36
housing equity (%)	100	100	100	100	100	100
% all outright owners[b]	70	57	29	18	10	42
all outright owners						
income ($pw)	202	425	772	1,208	2,258	835
dwelling value ($)	163,000	187,000	228,000	235,000	333,000	218,000
mortgage debt ($)	0	0	0	0	0	0
housing costs ($pw)	31	38	51	51	77	46
housing equity (%)	100	100	100	100	100	100
% all outright owners[b]	100	100	100	100	100	100
% all households[c]	54	47	32	29	31	39

Source: Australian Housing Survey, 1999, confidentialised unit record files

a. Income quintiles are derived from on whole population, not just owners

b. Gives contribution to home ownership of each age group in relevant income category

c. Gives proportion of owners in relevant income category

Table 18: Dwelling values, debt and housing costs, 1999: owners purchasers by household income and age

	income quintile[a]					
	1	2	3	4	5	total
25-34 years						
income ($pw)	162	492	782	1,203	2,055	1,233
dwelling value ($)	119,000	136,000	139,000	178,000	253,000	183,000
mortgage debt ($)	82,000	76,000	84,000	108,000	142,000	107,000
housing costs ($pw)	144	181	224	271	365	271
housing equity (%)	31	44	40	39	44	41
% all purchasers[b]	12	26	30	26	22	25
35-44 years						
income ($pw)	183	478	790	1,199	2,195	1,305
dwelling value ($)	149,000	164,000	162,000	201,000	314,000	222,000
mortgage debt ($)	81,000	73,000	73,000	90,000	129,000	96,000
housing costs ($pw)	187	182	187	213	301	229
housing equity (%)	46	56	55	55	59	57
% all purchasers[b]	25	34	37	42	34	36
45-64 years						
income ($pw)	194	460	804	1,208	2,324	1,459
dwelling value ($)	192,000	152,000	188,000	215,000	310,000	242,000
mortgage debt ($)	55,000	52,000	65,000	82,000	111,000	87,000
housing costs ($pw)	124	135	167	197	256	205
housing equity (%)	71	66	65	62	64	64
% all purchasers[b]	41	29	29	30	43	34
65+ years						
income ($pw)	218	418	781	1,099	3,648	598
dwelling value ($)	163,000	163,000	176,000	213,000	396,000	181,000
mortgage debt ($)	28,000	22,000	23,000	42,000	121,000	32,000
housing costs ($pw)	86	71	83	130	259	94
housing equity (%)	83	86	87	80	70	82
% all purchasers[b]	22	7	1	0	0	3
all purchasers						
income ($pw)	193	472	790	1,201	2,234	1,318
dwelling value ($)	166,000	153,000	162,000	198,000	298,000	216,000
mortgage debt ($)	59,000	65,000	74,000	92,000	124,000	94,000
housing costs ($pw)	134	160	192	224	295	228
housing equity (%)	65	58	55	53	58	57
% all purchasers[b]	100	100	100	100	100	100
% all households[c]	8	17	34	46	51	31

Source: Australian Housing Survey, 1999, confidentialised unit record files

a. Income quintiles are derived from on whole population, not just owners

b. Gives contribution to home ownership of each age group in relevant income category

c. Gives proportion of owners in relevant income category

Figure 5 illustrates the strong income and life-cycle effects that are associated with the net housing wealth. The detailed data that underpins these figures are presented in Tables 16, 17 and 18. Figure 6 shows the total tax benefits that accrue as a result of these holdings.[51] The detailed data that underpins these figures are presented in Tables 19, 20 and 21.

These data show that the benefits of the tax expenditures to home ownership result in low income owners receiving zero benefits (because their low incomes mean that they do not pay any tax) and high income owners in the top household income quintile receiving more than twice as much as households in the fourth quintile and more than three times as much as households in the third quintile. The indirect assistance to home owners provided through the tax system has a progressive impact only for households in the second income quintile (largely as a result of benefits provided to the high proportion of older outright owners whose current income is relatively low).

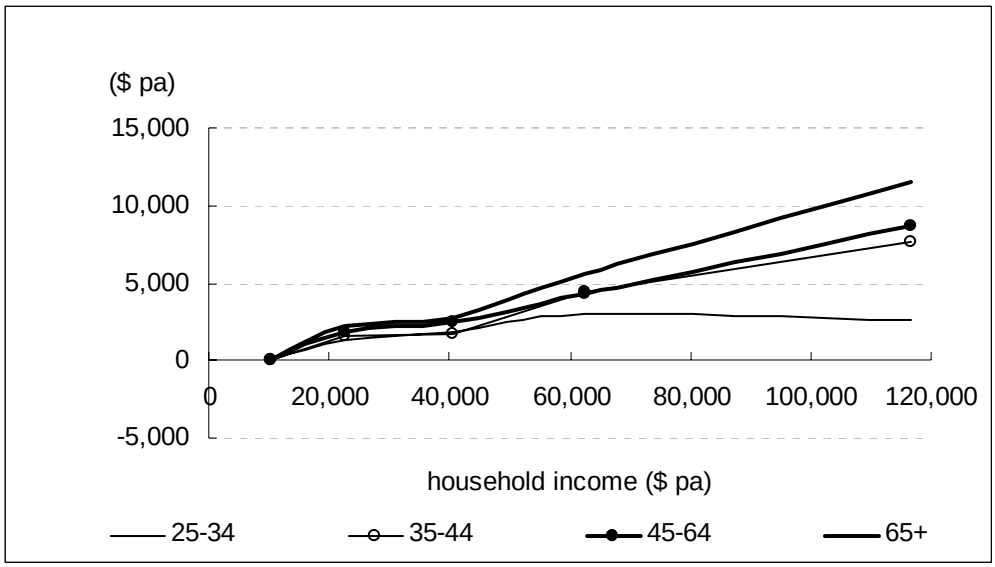
On average, outright owners receive more than five times the amount of assistance provided to purchasers with high income outright owners receiving a total tax benefit of close to $9,000 per household per year. Home purchasers in the bottom 80 per cent of the income distribution receive a benefit of less than $500 per household per year through the tax system.

The survey data highlight the distributional implications of the structure of indirect assistance provided to home ownership in Australia at present. Those who benefit most are high income households who live in high valued dwellings and have little housing debt. While the benefits to high income older households are considerably greater than those enjoyed by younger households, households with a head over 65 years old make up just 4 per cent of high income home owners, as can be seen from the detailed data in Table 16. Households aged between 35 and 64 years old account for 81 per cent of all high income owners and two thirds of all high income households. Conversely, young lower income purchasers aged between 25 and 45 with incomes in the three lowest quintiles, who account for only 14 per cent of purchasers in this age range, receive minimal assistance. It is this group of households for whom 1986 and 1996 census data indicate that home purchaser rates declined the most dramatically over the decade (Yates 2000). It is this group who are most in need of assistance if home ownership policies are to expand home ownership.

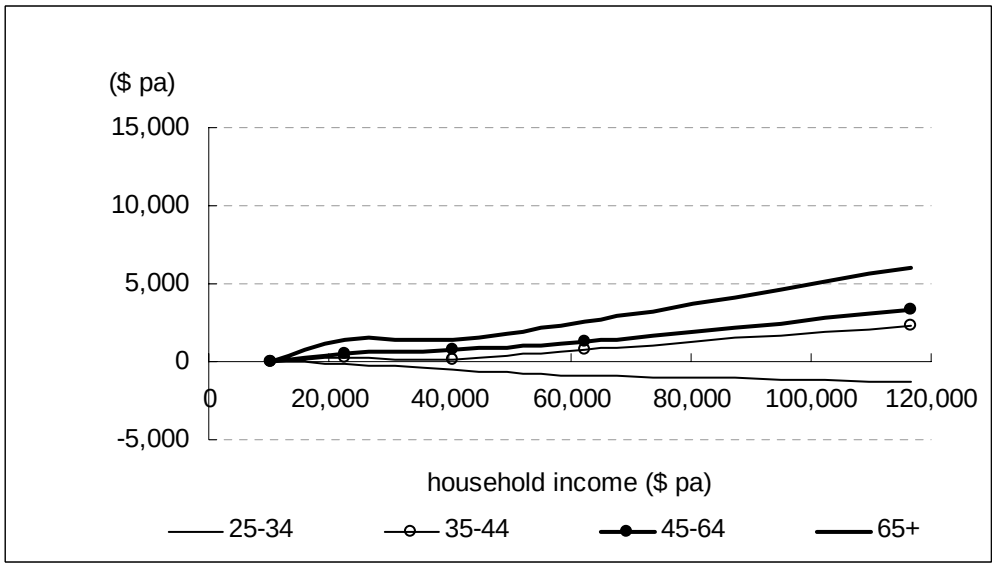
[51] Data for households aged less than 25 years old are not presented because small sample sizes at this level of disaggregation reduce their reliability.

Figure 6: Tax benefits by age and household income, 1999

Outright owners



Purchasers



Source: Australian Housing Survey, confidentialised unit record files

Table 19: Tax benefits by household income and age: all owners, 1999

	income quintile					
	1	2	3	4	5	total
25-34 years						
gross rent ($pa)	6,300	7,000	8,200	9,700	11,500	8,600
interest ($pa)	2,700	2,500	2,800	3,600	4,700	3,200
net rent less interest	1,300	1,000	1,000	0	-2,000	300
capital gains	3,800	4,200	4,900	5,800	6,900	5,100
imputed rent tax[a]	0	200	200	0	-1,000	100
capital gains tax[b]	0	400	500	1,000	1,700	900
total tax benefit	0	600	700	1,000	700	1,000
benefit as % income	0	4	3	3	2	4
35-44 years						
gross rent ($pa)	7,400	8,100	8,500	10,900	16,300	10,200
interest ($pa)	2,700	2,400	2,400	3,000	4,300	2,900
net rent less interest	1,200	2,200	2,100	4,000	5,400	3,000
capital gains	4,500	4,900	5,100	6,500	9,800	6,100
imputed rent tax[a]	0	400	400	1,400	2,600	1,100
capital gains tax[b]	0	500	500	1,200	2,400	1,100
total tax benefit	0	900	900	2,600	5,000	2,100
benefit as % income	0	6	3	6	6	6
45-64 years						
gross rent ($pa)	8,400	8,200	10,600	11,000	15,900	10,800
interest ($pa)	1,800	1,700	2,200	2,700	3,700	2,400
net rent less interest	4,300	3,700	5,000	4,700	7,600	5,100
capital gains	5,000	4,900	6,300	6,600	9,600	6,500
imputed rent tax[a]	0	700	1,000	1,700	3,700	1,800
capital gains tax[b]	0	500	600	1,200	2,300	1,200
total tax benefit	0	1,200	1,600	2,800	6,000	2,900
benefit as % income	0	7	6	6	7	8
65+ years						
gross rent ($pa)	8,400	9,000	10,700	12,300	20,400	12,200
interest ($pa)	900	700	800	1,400	4,000	1,600
net rent less interest	5,400	6,200	7,200	7,700	12,000	7,700
capital gains	5,000	5,400	6,400	7,400	12,200	7,300
imputed rent tax[a]	0	1,200	1,400	2,700	5,800	2,700
capital gains tax[b]	0	500	600	1,300	3,000	1,300
total tax benefit	0	1,800	2,100	4,100	8,800	4,000
benefit as % income	0	11	7	9	8	9
all households						
gross rent ($pa)	8,200	8,900	9,700	10,600	15,600	10,900
interest ($pa)	500	1,100	2,500	3,700	5,000	2,700
net rent less interest	5,900	5,300	3,400	2,500	4,700	4,300
capital gains	4,900	5,300	5,800	6,400	9,300	6,500
imputed rent tax[a]	0	1,100	700	900	2,300	1,500
capital gains tax[b]	0	500	600	1,100	2,300	1,200
total tax benefit	0	1,600	1,300	2,000	4,500	2,700
benefit as % income	0	9	5	5	6	7

Source: Australian Housing Survey, 1999, confidentialised unit record files

a. tax benefit based on marginal tax rate of half household income applied to non-taxed income

b. tax benefit based on half of marginal tax rate applied to non-taxed gains (discount method)

Table 20: Tax benefits by household income and age: outright owners, 1999

	income quintile					
	1	2	3	4	5	total
25-34 years						
gross rent ($pa)	6,700	7,300	9,400	10,500	10,400	9,200
interest ($pa)	0	0	0	0	0	0
net rent less interest	4,100	4,600	6,700	5,200	2,300	4,700
capital gains	4,000	4,400	5,600	6,300	6,300	5,500
imputed rent tax[a]	0	900	1,300	1,800	1,100	1,700
capital gains tax[b]	0	400	600	1,100	1,500	1,000
total tax benefit	0	1,400	1,900	3,000	2,600	2,700
benefit as % income	0	7	6	6	4	7
35-44 years						
gross rent ($pa)	7,400	8,100	8,800	11,700	16,800	11,400
interest ($pa)	0	0	0	0	0	0
net rent less interest	4,700	5,600	5,700	8,900	10,800	7,800
capital gains	4,400	4,800	5,300	7,000	10,100	6,800
imputed rent tax[a]	0	1,100	1,100	3,200	5,300	2,800
capital gains tax[b]	0	500	500	1,200	2,500	1,200
total tax benefit	0	1,600	1,700	4,400	7,700	4,000
benefit as % income	0	9	5	9	8	8
45-64 years						
gross rent ($pa)	7,100	8,800	11,700	11,300	16,300	11,500
interest ($pa)	0	0	0	0	0	0
net rent less interest	5,400	6,800	9,200	8,900	13,000	9,000
capital gains	4,300	5,300	7,000	6,800	9,800	6,900
imputed rent tax[a]	0	1,400	1,800	3,100	6,300	3,200
capital gains tax[b]	0	500	700	1,200	2,400	1,200
total tax benefit	0	1,900	2,500	4,300	8,700	4,400
benefit as % income	0	11	8	9	10	10
65+ years						
gross rent ($pa)	8,600	9,900	12,600	14,000	21,000	10,300
interest ($pa)	0	0	0	0	0	0
net rent less interest	7,100	8,000	10,000	11,600	17,500	8,400
capital gains	5,200	5,900	7,600	8,400	12,600	6,200
imputed rent tax[a]	0	1,600	2,000	4,100	8,500	3,000
capital gains tax[b]	0	600	800	1,500	3,000	1,100
total tax benefit	0	2,200	2,800	5,600	11,600	4,100
benefit as % income	0	13	9	12	13	21
all outright owners						
gross rent ($pa)	8,200	9,300	11,400	11,800	16,600	10,900
interest ($pa)	0	0	0	0	0	0
net rent less interest	6,500	7,400	8,800	9,100	12,700	8,500
capital gains	4,900	5,600	6,900	7,100	10,000	6,500
imputed rent tax[a]	0	1,500	1,800	3,200	6,100	3,000
capital gains tax[b]	0	600	700	1,300	2,400	1,200
total tax benefit	0	2,000	2,400	4,500	8,600	4,200
benefit as % income	0	12	8	9	9	12

Source: Australian Housing Survey, 1999, confidentialised unit record files

a. tax benefit based on marginal tax rate of half household income applied to non-taxed income

b. tax benefit based on half of marginal tax rate applied to non-taxed gains (discount method)

Table 21: Tax benefits by household income and age: purchasers, 1999

	income quintile					
	1	2	3	4	5	total
25-34 years						
gross rent ($pa)	6,000	6,800	6,900	8,900	12,600	9,200
interest ($pa)	5,400	5,000	5,500	7,100	9,400	7,100
net rent less interest	-1,500	-2,600	-4,700	-5,200	-6,300	-4,900
capital gains	3,600	4,100	4,200	5,300	7,600	5,500
imputed rent tax[a]	0	-500	-900	-1,800	-3,100	-1,800
capital gains tax[b]	0	400	400	900	1,800	1,000
total tax benefit	0	-100	-500	-900	-1,200	-800
benefit as % income	0	1	0	0	1	0
35-44 years						
gross rent ($pa)	7,500	8,200	8,100	10,000	15,700	11,100
interest ($pa)	5,300	4,800	4,800	5,900	8,500	6,300
net rent less interest	-2,300	-1,300	-1,600	-1,000	100	-800
capital gains	4,500	4,900	4,900	6,000	9,400	6,600
imputed rent tax[a]	0	-300	-300	-400	0	-300
capital gains tax[b]	0	500	500	1,100	2,300	1,200
total tax benefit	0	200	200	700	2,300	900
benefit as % income	0	3	2	3	4	3
45-64 years						
gross rent ($pa)	9,600	7,600	9,400	10,800	15,500	12,100
interest ($pa)	3,600	3,400	4,300	5,400	7,400	5,700
net rent less interest	3,200	600	700	500	2,200	1,400
capital gains	5,800	4,600	5,600	6,500	9,300	7,300
imputed rent tax[a]	0	100	100	200	1,100	500
capital gains tax[b]	0	500	600	1,100	2,300	1,300
total tax benefit	0	600	700	1,300	3,300	1,800
benefit as % income	0	4	3	4	5	4
65+ years						
gross rent ($pa)	8,100	8,100	8,800	10,600	19,800	9,000
interest ($pa)	1,800	1,500	1,500	2,800	8,000	2,100
net rent less interest	3,700	4,500	4,500	3,900	6,400	4,100
capital gains	4,900	4,900	5,300	6,400	11,900	5,400
imputed rent tax[a]	0	900	900	1,400	3,100	1,500
capital gains tax[b]	0	500	500	1,100	2,900	1,000
total tax benefit	0	1,400	1,400	2,500	6,000	2,400
benefit as % income	0	9	5	6	5	11
all purchasers						
gross rent ($pa)	8,300	7,600	8,100	9,900	14,900	10,800
interest ($pa)	3,900	4,300	4,900	6,100	8,200	6,200
net rent less interest	1,300	-700	-1,900	-1,700	-500	-1,100
capital gains	5,000	4,600	4,900	5,900	8,900	6,500
imputed rent tax[a]	0	-100	-400	-600	-200	-400
capital gains tax[b]	0	500	500	1,100	2,200	1,200
total tax benefit	0	300	100	400	1,900	800
benefit as % income	0	3	1	2	4	3

Source: Australian Housing Survey, 1999, confidentialised unit record files

a. tax benefit based on marginal tax rate of half household income applied to non-taxed income

b. tax benefit based on half of marginal tax rate applied to non-taxed gains (discount method)

3.3 Estimates of direct assistance

Home purchasers have, in fact, been the prime target of the major form of direct assistance provided for home ownership and the only form provided by the Commonwealth government. Since the First Home Owners Grant was introduced in July 2000, an estimated total of $2.4 billion has been provided through the original and additional grants with over 300,000 grants to first home buyers being paid under the original scheme and 40,000 additional grants for new homes (Commonwealth Treasury, 2002). An additional $784m is expected to be paid out in 2002-03 (Costello, 2002).

As indicated in chapter 1, this assistance is provided to first home buyers with no means test on income and no restrictions on the value of property that can be bought. By explicit acknowledgement, its primary function has been one of fiscal stimulus, with a new contribution to the "war against terrorism" in the past year.[52] There has been little attempt to justify it as a solution to the problems of access to home ownership faced by many young lower income households.

Because there are no constraints imposed on these loans, no data is collected on how they have been distributed. A recent press report, however, did highlight some of the issues that are associated with it. It pointed to close to 250 Sydney houses valued at more than $1 million and that have been purchased with support from grants from the First Home Owner's Grant. Of those receiving grants, 16 were rich enough to pay more than $3 million for their first home. Six of these were aged between 17 and 20 years old (Wainwright, 2002). Whilst the $2m paid out to such purchasers is small in relation to the $2b total, it does highlight the fact that such grants are likely to be of most assistance to those who can afford home ownership without any assistance.

Whilst this scheme has provided assistance of up to $14,000 per first home buyer household, it provides a once-off grant, rather than the continuing assistance provided by the tax expenditures described above. Some indication of the relative size of its impact in relation to tax expenditures of approximately $4,000 per household can be seen averaging the annual expenditure over all owner-occupier households. On this basis, the annual grant of approximately $1 billion has provided the equivalent of $200 per owner-occupier household per year since 2000.[53]

3.4 Summary

The total value of approximately $1b per annum in direct assistance to home ownership plus $17 billion in indirect assistance can be contrasted with outlays of just under $2b for rent assistance to private renters and just under $1b for capital outlays on public housing.[54] Thus, the indirect assistance dominates direct assistance by a factor of four or more. Direct assistance to tenures other than home ownership is targeted to low income households. Assistance to home owners, on the other hand, primarily benefits higher income households.

This result is remarkably similar to the results obtained for the US. Swartz and Miller (2002), in their overview of welfare reform and housing, suggest that $155b was provided in housing assistance by the federal government in the US with about one quarter of those funds being targeted to low income individuals. The remaining funding was provided in the form of tax breaks.[55]

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[52] "Following a very sharp downturn in the second half of 2000 residential construction, aided by the First Home Owners Scheme and low interest rates, is expected to contribute strongly to growth in 2001-02." (Costello, 2001) "The hard work of the last six years helped to shield our country and keep people in work. It gave us the capacity to respond swiftly with measures to stimulate the economy like the additional First Home Owners Grant. It allowed us to respond swiftly with a major contribution to the War Against Terrorism." (Costello, 2002)

[53] This is an overestimate of the annual equivalent of the support provided if the scheme does not continue.

[54] The capital outlays provided for public housing are approximately equal to the service flow subsidies provided by that housing when these are measured against a market rent benchmark. Data on annual levels of assistance provided can be generated from Tables A.5 and A.6 in the Housing Assistance Annual Reports.

[55] The Australian total of $21b represents approximately 3 per cent of GDP in Australia. The US total of $155b represents 1.5 per cent of GDP in the US. To a large extent, the higher tax expenditures in Australia can be attributed to higher marginal income tax rates.

3.5 Future work

This Positioning Paper has focused on the current assistance provided to home ownership and pointed to considerable role of the indirect assistance provided through the tax system. It has provided an overview of the issues that arise in defining tax expenditures and has outlined a methodology that might be used to estimate the extent of these.

It has used this methodology to provide indicative results in order to highlight the assumptions made in generating these. The Final Report will provide further information on the sensitivity of the results to the assumptions made. It will also use the survey data to provide an assessment of the extent to which these benefits are unevenly distributed regionally, focusing in particular on the results for owners in high cost regions compared with those in regions where dwelling values have been more static.

The data in the Final Report will be supplemented by data on assistance provided to tenants in public and private rental through the major forms of direct assistance provided through CSHA funded public housing and Commonwealth Rent Assistance. Together this information will provide a comprehensive assessment of the magnitude and distributional impact of the major forms of housing assistance provided by the Commonwealth.

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