

# Tax concessions and subsidies for Australian homebuyers and home owners

**HOME OWNERSHIP IN AUSTRALIA IS EXEMPT FROM CAPITAL GAINS TAX AND OTHER INCOME TAXES. THE VALUE OF THESE INDIRECT SUBSIDIES TO OWNER-OCCUPIERS IN 2001 WAS ESTIMATED TO AMOUNT TO \$21 BILLION.**

## KEY FINDINGS

- Direct subsidies to first homebuyers – the First Home Owners Grant (FHOG) amounted to \$1 billion in 2001.
- The tax concession to owner-occupiers of not taxing capital gains was estimated to be \$13 billion in 2001.
- The tax concession to owner-occupiers of not taxing imputed rent was estimated to be a net value of \$8 billion.

## CONTEXT

The home ownership rate in Australia is amongst the highest in the Western world. Subsidies to owner-occupiers from the Australian Government have contributed to this and have been justified by the widely recognised and valued social and economic benefits associated with home ownership. These subsidies have been in the form of direct assistance such as the current \$7000 FHOG, and indirect assistance, for example exempting the 'family home' from capital gains tax. Such tax exemptions, deductions or rebates are known as *tax concessions* or *tax expenditures*.

One way of judging whether the tax concessions to home ownership are at an appropriate level is to compare them with the tax treatment of private rental housing.

When landlords sell properties they pay capital gains tax – owner-occupiers do not.

When landlords receive rent, it is added to their income, and they pay income tax on that income. Owner-occupiers consume housing, but do not pay rent because they are both the landlord and the tenant. There is no actual rental income to be added to the owner-occupiers' taxable income. However, the notional value of the housing consumed by an owner-occupier can be calculated, based on the rental value of their house. This notional value is referred to as *imputed rent* and can be estimated to create a notional amount of income received by owner-occupiers. Owner-occupiers pay no tax on imputed rent. The non-taxation of imputed rent is thus a tax concession to owner-occupiers.

*Based on research by Judy Yates of the AHURI Sydney Research Centre. This project estimated the extent and distribution of the direct and indirect assistance provided by the Australian Government to owner-occupiers.*

Landlords can deduct their housing expenses (for example, mortgage payments and maintenance costs) from their income tax liability (so-called negative gearing) – owner-occupiers cannot.

Since 2000, the value of tax concessions to owner-occupiers has been affected by changes in the tax system arising from the introduction of the GST, changes in the treatment of capital gains and from associated changes in income tax rates.

## FINDINGS

Significant increases in the value of housing between 1990 and 2001 underlie increases in the value of tax concessions to owner-occupiers over this period.

By 2001, the growth in dwelling values had resulted in:

- a gross value of owner-occupied housing wealth of just over \$1000 billion
- a net value of owner-occupied housing wealth of just under \$800 billion
- a growth in real gross housing wealth of just under four per cent a year from 1990 to 2001
- a growth in the real value of outstanding mortgage debt of just over eight per cent a year from 1990 to 2001
- a decrease in net equity in owner-occupied housing from 87% in 1990 to 76% in 2001
- a gross rental value of the owner-occupied housing stock of \$54 billion
- a net rental value (after operating costs) of \$42 billion, with net rent less interest costs of \$25 billion.

Estimates of the value of direct and indirect assistance to owner-occupiers are detailed in Table I.

In real terms the average value per owner-occupier household of these tax concessions has trebled since 1985 when estimated to be \$1200 (in 2001 dollars). The increase arises primarily from the exemption of owner occupied housing from the capital gains tax when it was introduced in 1985.

These tax concessions are available to all owner-occupiers but are of more value to some than to others. One mechanism that creates this uneven outcome, or distributional effect, is the application of progressive marginal income tax rates.

Although the scale of income tax rates in Australia is progressive (the more you earn the higher the amount of income tax you pay), these scales become considerably less progressive once tax concessions provided to high income owners are taken into account. That is because the more you earn, the higher the value of the concessions. Also important is whether the dwelling is owned outright or being purchased with a mortgage. Both owners and purchasers receive the full value of any capital gains. Only outright owners benefit significantly from the non-taxation of imputed rental income. Any potential benefits to purchasers with a mortgage are offset by their inability to deduct the cost of interest payments from their income.

On average:

- outright owners receive more than five times the amount of assistance provided to purchasers;
- high-income (\$1210 to \$2260 per week in 1999 dollar terms) outright owners receive a total tax benefit of close to \$9000 per household per year;
- home purchasers in the bottom 80% of the income distribution (income levels at and below \$1200 per week 1999 dollar terms) receive a benefit of less than \$500 per household per year through the tax system.

**Table I: Value of direct and indirect assistance to owner occupiers, 2001**

|                                      | Direct Assistance |             | Indirect Assistance                |              |
|--------------------------------------|-------------------|-------------|------------------------------------|--------------|
|                                      | FHOG              | \$1 billion | Exemption from capital gains       | \$13 billion |
|                                      |                   |             | Non-taxation of imputed rent (net) | \$8 billion  |
| Total                                |                   | \$1 billion |                                    | \$21 billion |
| Average per owner occupier household |                   | \$200       |                                    | \$4200       |

In broad terms:

- most benefits go to high-income households who live in high valued dwellings and have little housing debt;
- benefits to high-income older households are considerably greater than those enjoyed by younger households;
- young, lower-income purchasers aged between 25 and 45 with incomes in the three lowest quintiles receive minimal assistance.

## CAVEATS

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 any imputed income derived from owner-occupied housing has to be assessed at an individual level. At the aggregate level, the estimates in this study assume the relevant tax rate is the marginal tax rate that applied to average taxable income for individuals in each of the years under consideration. At the disaggregate level the estimates use the marginal tax rate that would apply to half of household income. Both approaches assume that tax rates would not be changed if the income from owner-occupied housing was taxed and that household behaviour would not change with such a tax.

The results pre-date the rapid rise in house values since 2001. The increases in net housing wealth since then will have increased the value of the tax concessions to owner-occupiers beyond these estimates.

The distributional estimates are based on the ABS Housing Survey 1999, a sample of 13,800 households across Australia. The survey data yield an estimate of the gross value of owner-occupied dwellings that is approximately 25% higher than that indicated for 1999 by the ABS National Balance Sheets (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 in the ABS National Balance Sheets although it, too, is still at least 10% above the data obtained from financial institutions by the Reserve Bank.

## POLICY IMPLICATIONS

Home ownership is the dominant tenure in Australia, and it is a preferred tenure because it is widely regarded to assist family stability, neighbourhood cohesion, national savings and aged pension rates. However in the policy arena, it is good practice to regularly assess the extent and impact of direct and indirect subsidies to home owners/purchasers against the housing assistance provided to other tenures. Important in this comparison is that the different tenures provide different housing and other social and economic outcomes.

In 2001, \$1 billion in Australian Government funding was provided to the public rental sector, and just under \$2 billion was provided in Commonwealth Rent Assistance to income support recipients. These forms of direct assistance are well targeted to those with high housing need. The indirect assistance provided to owner-occupiers, estimated to be \$21 billion, is poorly targeted and primarily benefits those on higher incomes with more assets.

These results point to the significant, if unintended, impact of Australian Government tax policies on the housing system, and provide the data required for a broad interpretation of national housing policy.

Including estimates of the tax concessions to owner-occupiers in Treasury's annual Tax Expenditures statement would provide this valuable information on an ongoing basis and enable regular assessments of the value and impact of these concessions.

In the context of contemporary policy debates about housing affordability and a Productivity Commission Inquiry into First Home Ownership, these results point to the breadth of policy levers that could be considered in such a debate.

For example, potential first homeowners might be willing to trade off some or all of their medium term capital gains tax exemption for the short-term benefit of deducting their mortgage interest payments from their income tax.

## **FURTHER INFORMATION**

For more information about this research project, the following paper is available:

Final Report:

[www.ahuri.edu.au/attachments/60098\\_final\\_distributanalysis.pdf](http://www.ahuri.edu.au/attachments/60098_final_distributanalysis.pdf)

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