



EXECUTIVE SUMMARY

Pathways to housing tax reform

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Related reports and documents

Eccleston, R., Warren, N., Verdouw, J. and Flanagan, K. (2017) *Pathways to state property tax reform*, AHURI Final Report No. 291, Australian Housing and Urban Research Institute Limited, Melbourne, <https://www.ahuri.edu.au/research/final-reports/291>, doi:10.18408/ahuri-4111301.

Duncan, A.S., Hodgson, H., Minas, J., Ong-Viforj, R. and Seymour, R. (2018) *The income tax treatment of housing assets: an assessment of proposed reform arrangements*, AHURI Final Report No. 295, Australian Housing and Urban Research Institute Limited, Melbourne, <https://www.ahuri.edu.au/research/final-reports/295>, doi:10.18408/ahuri-8111101.

Whelan, S., Atalay, K., Dynan, L. (2018) *Asset portfolio retirement decisions: the role of the tax and transfer system*, AHURI Final Report No. 298, Australian Housing and Urban Research Institute Limited, Melbourne, <https://www.ahuri.edu.au/research/final-reports/298>, doi:10.18408/ahuri-7311201.

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Each AHURI Inquiry is supported by a panel of experts drawn from the research, policy and practice communities.

The Inquiry Panel are to provide guidance on ways to maximize the policy relevance of the research and draw together the research findings to address the key policy implications of the research. Panel members for this Inquiry:

Peter Davidson	Australian Council of Social Services
Karen Doran	ACT Treasury
Saul Eslake	University of Tasmania
Glen Hepburn	Department of Treasury and Finance, Victorian Government
Brian Howe AO	University of Melbourne
Caryn Kakas	Department of Family and Community Services, NSW Government
Paul McBride	Department of Social Services, Australian Government
Greg Smith	University of Melbourne Law School
Peter White	Department of Health and Human Services, Tasmanian Government

Executive summary

Key points

- Lack of access to and secure tenure within affordable housing are significant problems in Australia. Local, state and national taxes currently applied to housing contribute to these poor outcomes.
 - There is a consensus that coordinated, well-designed reforms to the treatment of housing in the tax and transfer system can make a significant contribution to improving housing outcomes. However, the prospects of achieving significant reform are diminished by formidable political barriers.
 - The Inquiry proposes a housing tax reform pathway informed by a political economy approach that seeks to balance technical reform objectives with political imperatives. The pathway is organised into sequential phases over a 10–15 year timeframe. When implemented, reforms will contribute to enhancing residential mobility, improving housing accessibility and affordability, reducing incentives for short-term investment in residential property, and improving rental supply and security.
 - The pathway would proceed as follows:
 - establish the conceptual and administrative foundations for a national reform agenda while building community consensus around the broader objectives of reform
 - develop and implement new policy frameworks with settings designed to minimise the impact on government budgets and housing markets
 - incrementally modify policy settings to shift tax distribution to owners of high value properties to improve access and affordability in the Australian housing market.
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Key findings

Despite a sustained period of economic growth in Australia, housing affordability and accessibility have declined significantly in recent years. The resulting shortage of suitable, affordable housing is having an adverse effect on the housing needs and aspirations of many Australians and represents a growing risk to the Australian economy.

There is increasing evidence that tax policy settings are contributing to the problem, exacerbating intergenerational inequality, inflated housing prices and reduced mobility. In recent years there has been no shortage of credible proposals for change, most notably the comprehensive and integrated agenda set out by the Henry review (Henry, Harmer et al. 2009).

Although there is no uniform agreement on how best to progress them, there is considerable academic and policy consensus that a range of tax-related reforms can and should be made to promote housing affordability. But despite the consensus, reforms to date have been piecemeal and ineffective, and attempts at forging a national reform program, such as the 'Re:Think' consultation process (see Australian Government 2015), have had limited follow-through. Again, there is general agreement on the reasons for this: that it is due to the influence of entrenched

commercial interests on the political process, as well as the difficulties of coordinating reform across the federation and perceptions that policy change in this area will produce significant electoral backlash and therefore represents an untenable political risk.

This Inquiry sets out to respond to the following research question:

What are the best integrated housing tax reform pathways that are financially sustainable, politically viable, and address tax-related distortions in Australian housing markets?

Drawing on the findings (see below) of three connected empirical research projects, we propose in this Inquiry Final Report a coordinated, staged program of housing tax reforms.

These are designed to have minimal immediate impact on government or household budgets but will, over time, gradually shift the distribution of property taxes so that owners of higher value properties are paying proportionally more. The proposals, if implemented, will improve access and affordability in Australia's housing system while enhancing the efficiency of the national economy.

It was beyond the scope of any of the empirical projects or of this overarching Inquiry to conduct detailed modelling of the cumulative impact of the proposed reforms. However, the program is purposefully designed to allow for adaptation over time should the cumulative consequences prove problematic or external economic conditions change radically. The reforms also include measures to ensure that asset rich yet income poor households are not adversely affected. Additional revenue raised through the gradual reduction of income tax concessions available to property owners and investors should be invested in new social housing and rental supply.

Table: Key findings by empirical research project

Project: Income tax treatment of housing assets	Project: Asset portfolio decisions of Australian households	Project: Pathways to state housing and land tax reform
<p>The benefits of income tax concessions on housing investments flow disproportionately to more affluent households.</p> <p>Gradually reducing the generosity of capital gains tax and negative gearing provisions over a decade would have only a modest impact on the after-tax return from housing investments, with the exact figures depending on wage income, interest rates and capital growth.</p>	<p>Age pension eligibility does not appear to have a significant impact on housing decisions.</p> <p>There is a clear case for including the value of the family home in the aged pension assets test, although any such reform should include a comprehensive deferral scheme to ensure asset rich, income poor pensioners are not disadvantaged.</p>	<p>In the short term, it is possible to establish a simpler, fairer revenue neutral transfer duty regime in each of the states under which approximately 60 per cent of property buyers at the cheaper end of the market would pay less transfer duty than under existing arrangements.</p> <p>Over the longer term, it is possible for the states to transition from this reformed transfer duty regime to a broad-based recurrent property tax.</p>

Note. For further details, see Chapters 2, 3 and 4 respectively.

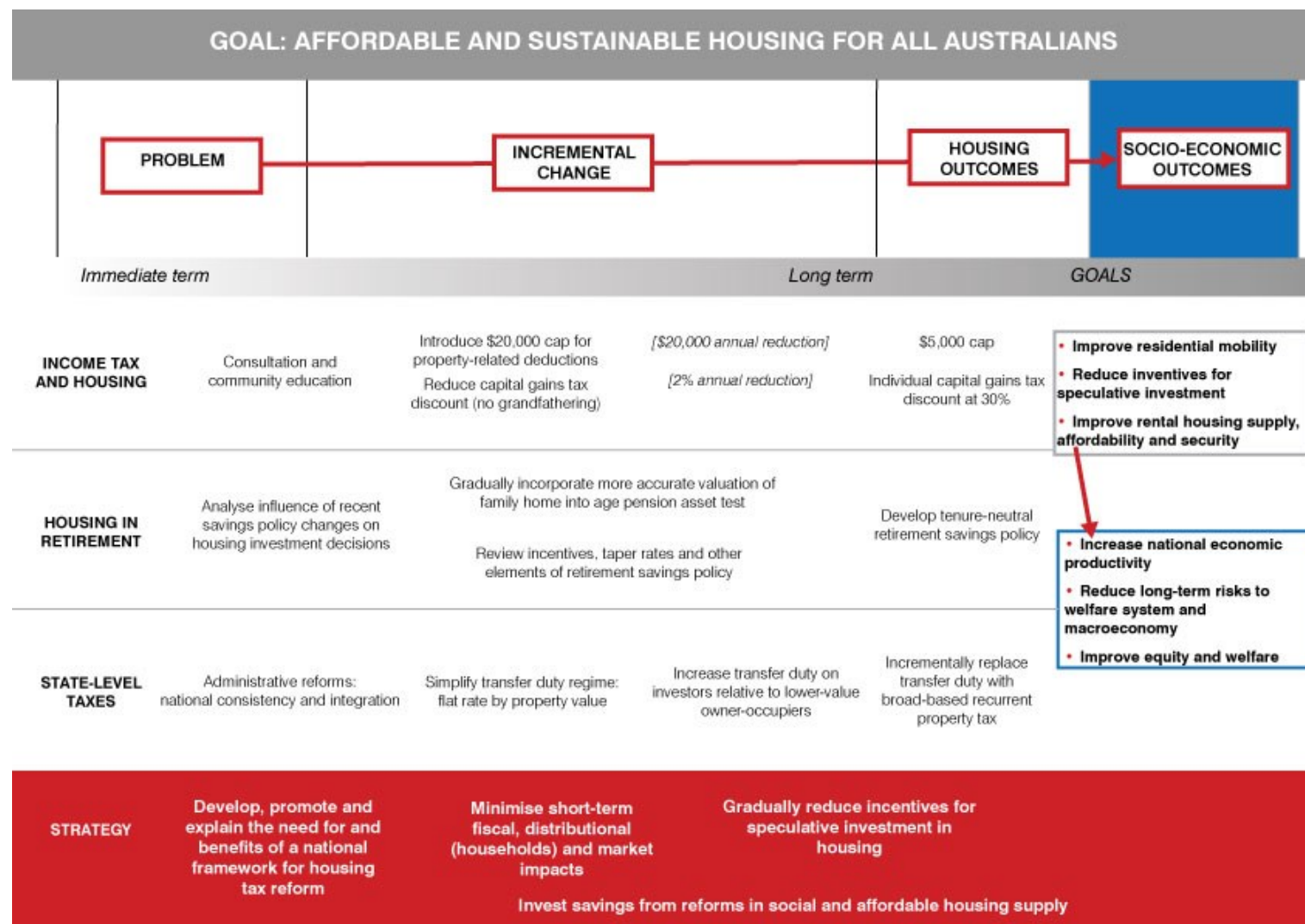
Source: Authors

Policy development options

The reform program summarised in the below figure rests on the following principles:

- Political and economic imperatives demand a coordinated, long-term approach to housing tax reform informed by shared objectives and a coherent framework for policy change.
- A national reform agenda requires national leadership and, where possible, cooperation from state and local governments.
- A reform strategy should initially focus on setting and agreeing national policy goals and establishing the administrative foundations for reform. It should then move to gradually adjusting policy settings to achieve long-term housing policy goals.

A coordinated reform pathway



Note: This Figure is further discussed in Section 5.1

Source: Authors.

The reform pathway described in the figure above is based on detailed analysis of the existing tax policy frameworks at all levels of Australian government combined with a detailed assessment of the prevailing political context and its implications for housing tax reform. This political analysis was then used to inform the design of the empirical research undertaken in each of the supporting projects.

The specific recommendations in each area of housing tax reform are:

Income tax and housing

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

Housing in retirement

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

State property tax reform

- 1** State governments, with Commonwealth cooperation, should immediately commence reform of the administrative foundations of the subnational property tax system and should develop:
 - a national register of property ownership and use
 - a nationally consistent approach to property valuation
 - further develop relevant interagency data-sharing
 - develop integrated approaches to state and local government property tax collection.
- 2** In the short term, state governments should simplify their current transfer duty systems by introducing a single flat rate with a tax-free threshold set as a percentage of the median house price. Building on this foundation, states can then, in the medium-term, adjust rates and thresholds as required for different categories of ownership and use.
- 3** In the longer-term, state governments should implement transitional arrangements to gradually phase in broad-based recurrent property taxes, with the proceeds used to phase out and potentially abolishing transfer duties on residential property.

The study

The analysis undertaken for this Inquiry was informed by a political economy approach that sought to reconcile the technical aims of housing policy and tax design with an appreciation of the political barriers to reform. It incorporated input from a range of stakeholders, including members of the Inquiry Panel, concerning both the political context and reform priorities.

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

Specifically, the three supporting projects respectively carried out:

- analysis integrating the Evaluation Model for Incomes and Taxes in Australia (EVITA) and the Australian Housing and Urban Research Institute Housing Market Microsimulation Model (AHURI-3M) to simulate the impacts of negative gearing and capital gains tax reforms respectively (see Chapter 2)
- analysis of the wealth module in the Household, Income and Labour Dynamics in Australia (HILDA) survey to retrospectively model behavioural responses to specific policy changes (see Chapter 3)
- analysis of transfer duty and property tax reform options using CoreLogic's database of all residential property values and transactions in Australia in 2015–16, which is arguably the most comprehensive set of property data currently available (see Chapter 4).

The Inquiry then drew together the findings, within the political economic framework to propose a coordinated, pragmatic and incremental approach to reform. This approach minimises the short-term impact on households, government budgets and housing markets, thereby mitigating political resistance to reform.

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