Federal Government - Housing Affordability Inquiry - August 2021

22 August 2021

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My submission is made as an Individual.

Summary

My paper outlines a few points about housing affordability.

- NSW Property Tax Proposal
- GST on new Housing
- Taxing the Family Home fully or partially in a Comprehensive Tax Reform.

The NSW Property Tax Proposal

The NSW Government has recently outlined the proposal of a property tax.

The governments preferred option is to “opt-in”.

The option continues to offer either stamp duty or property tax.

Stamp duty is a mechanism that creates rent seeking and lock-in behaviour. It drives up prices as the duty payment is not linked to future value of the land or property. And the longer the tenure, the more tax is avoided overtime. When land is rezoned to increase supply, owners also receive capital gains free uplift.

In a market like Sydney where price growth is high, most people would likely continue to pay stamp duty to avoid future payments.

A better option to provide equity between generations and increase supply is to implement a ‘credit scheme’ property tax. A credit scheme applies to all landholders from day one and accounts for stamp duty paid previously using it to offset land tax until it is exhausted. So all people are treated equally through the transition.

A credit scheme removes the asymmetry between a landholder’s current property tax and moving to another location. The decision to move is not made on tax. It’s made on what matters to their lifestyle needs.

As part of the submissions, the Young Liberal’s submission also advocates for removal of stamp duty completely, and be replaced with a credit scheme.

I have undertaken a ranking analysis to compare the four options outlined in the NSW Federal Financial Relations (NSWFFR). Opt-in ranks as the worst option, with the Credit scheme and Phase In/Out model (ACT Model) being the best.

Opt-In provides the worst outcomes for equity and efficiency. It leaves a large debt ($2.5Bn per year indefinitely) to the next generation, provides no guarantee of ever transitioning fully or partially to land tax, and creates a two speed market.

Ranking Assessment (My Own Judgement)

A Ranking Assessment of Options for Transition from Transfer Duty to a broad based Land Tax is shown in Table 1 below. This is based on the best information available from the NSWFFR document. The document did not present this assessment.

Table 1 – Ranking of Transition Options (1 = Best, 4 = Worst)

	Switch on Sale	**Opt-In**	**Credit Scheme**	**Gradual Phase In/Out (ACT Model)**
Equity (Equal Treatment of existing owners and new buyers)	3	4	1	2
Efficiency (Benefits from Land Tax, over time and value realised)	3	4	1	2
Impact on Government Revenue (**Intergenerational Equity**)	4	3	2	1
Increases Supply to create affordable housing (sooner scored better)	3	4	1	2
TOTAL	13 (3rd Best)	15 (4th Best)	5 (Preferred)	7 (2nd Best)

The ranking assessment shows that meeting the objectives of equity, efficiency and Intergenerational equity that are used in the NSWFFR show the Credit Scheme and Phase In/Out Model used by the ACT Government are best options.

An additional criteria of increasing supply is added to show the effectiveness of creating extra supply which the government continues to say is the answer to affordable housing. But they have picked the worst option for supply.

Implementation of a Credit Scheme

A credit scheme is the only real fair and efficient option. The credit scheme should fairly recognise owners past stamp duty.

But….

Consideration should be given to changing yearly taxes to be paid as lumps sums at the back end when selling. And this applies to all owners. This timing is no different than paying stamp duty for the next purchase and owners have their capital to pay their money. But if owners don't move, the lump sum will continue to increase as it is time based.

The big win for first home buyers is that there is no stamp duty upfront, and no yearly payments. Just a lump sum payment when they sell, and that's when they have the money to pay.

Unfortunately the State Government decided on the preferred option before consultation. So they didn't want to hear other ideas.

Also to note, when buying upfront, owners don't know how long they will be there. We live in an emergent world, and thus the best time to determine how long your tenure will be is at the end. i.e. when you know you're ready to sell and move. Only the land/property tax is adaptive to this as it ensures all owners are treated the same. This is the fatal flaw of stamp duty, as it's paid at the beginning, rather than at the end, and doesn't account for time of tenure.

Fiscal Impacts

The opt-in option has a reported shortfall of $2.5bn per year. This is $50bn over 20 years. How would this pass a business case gateway? The federal government should not support or fund this gap.

The Federal Government should only support options that remove barriers to supply.

GST applied to new Housing

A supply constraint on housing is that GST is applied to new housing, but not to existing housing.

If for example a house is built for $300,000, the GST could be considered to be $30,000. And is passed onto the purchaser.

Hence that is an incentive to buy an existing property.

An opportunity here is to reduce stamp duty / property taxes for new properties to offset the GST within the property sale. This could be a % reduction.

But when that property is sold to the 2nd owner, stamp duty/land tax would be payable, as it is an existing property.

Overall i see this as an acceptable option and implementation as being favourable.

This solution requires the co-operation of Federal and State Governments.

It is recommended that the Federal Government only support this initiative if only a land tax is in place.

Tax System – Problem Statement

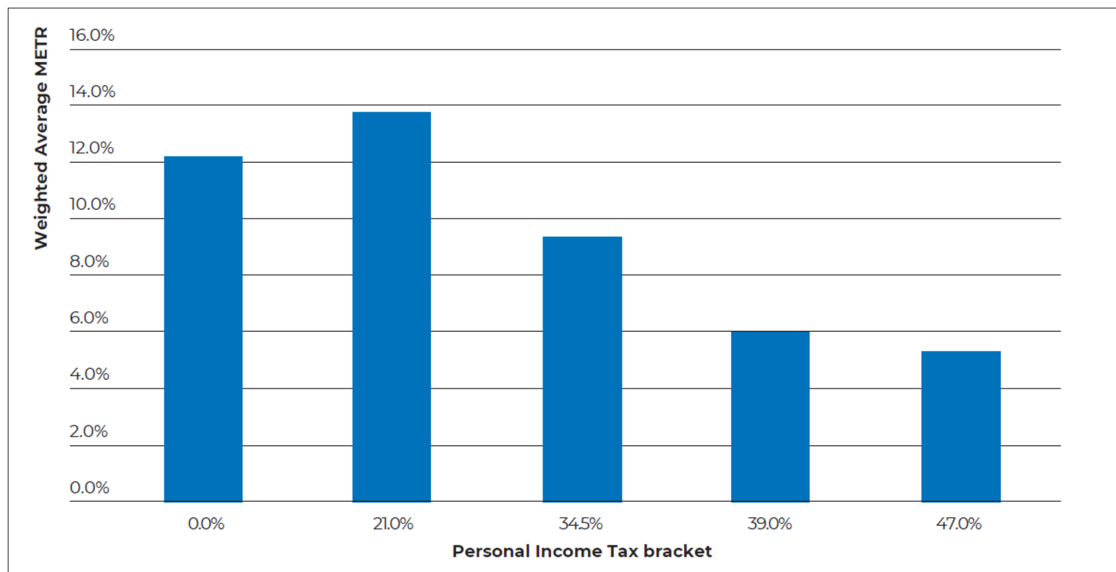
Australia's income tax system is **regressive**.

A report by the Tax and Transfer policy institute (authors Peter Varela, Robert Breunig and Kristen Sobeck) in 2020 outlined that the current tax system is distortionary, unfair and complex.

https://taxpolicy.crawford.anu.edu.au/taxpolicy-publications/reports

Varela, P., Breunig, R., and Sobeck, K. (2020), The Taxation of savings in Australia: Theory, current practice and future policy directions, Tax and Transfer Policy Institute (TTPI) Policy Report No. 01-2020,

Canberra, Australia.



It is important to look at the whole tax system when understanding what constrains and causes housing affordability and supply.

Although the report focuses on the total tax system, housing makes up a large portion of most people's wealth. As does superannuation.

The family home is capital gains tax free and untested for the age pension. This creates a distortion to over invest in housing.

Not taxing the family home means this asset class grows faster than other forms of assets classes that are taxed at the marginal tax rate. Hence this is also popular with investors.

Investors are incentivised with the asymmetrical treatment of gains and losses through negative gearing and the 50% capital gains tax introduced in 1999. And the bigger the loan the higher the exploitation of this arrangement. Hence a financial stability concern.

But most of all, the majority of investments have been focused on existing properties and not increasing supply.

The distribution of wealth has skewed towards existing owners, who are able to continue to further leverage, and thus out compete against first home buyers.

In cities like Sydney, we have created a society where home ownership makes more money than going to work and being productive. So it helps to have parents who own a home

already who have ridden the wave of falling interest rates. These parents are then passing on this wealth to get their children into the market.

We are also creating a society where wealth is perpetuated through generations by investing as much as possible into the family home that is capital gains tax free.

It is also of interest to note that Liberal Senator Gerard Rennick has outlined the need to tax the family home above $2m and use the revenue to lower income tax rates.

I agree with this in principal.

Put simply, the system does not work for the average person and needs to change.

A comprehensive change to the tax system is required.

And removing the tax free status of the family home is the key to removing the overinvestment in existing properties. Thus improving affordability. Especially for first home buyers entering the market.

Tax System Solution

A better system would be to tax all three ways of making money at the same marginal tax rates. i.e. a comprehensive tax system. These being:

1. investment capital gains (including family home),
2. investment income
3. wages

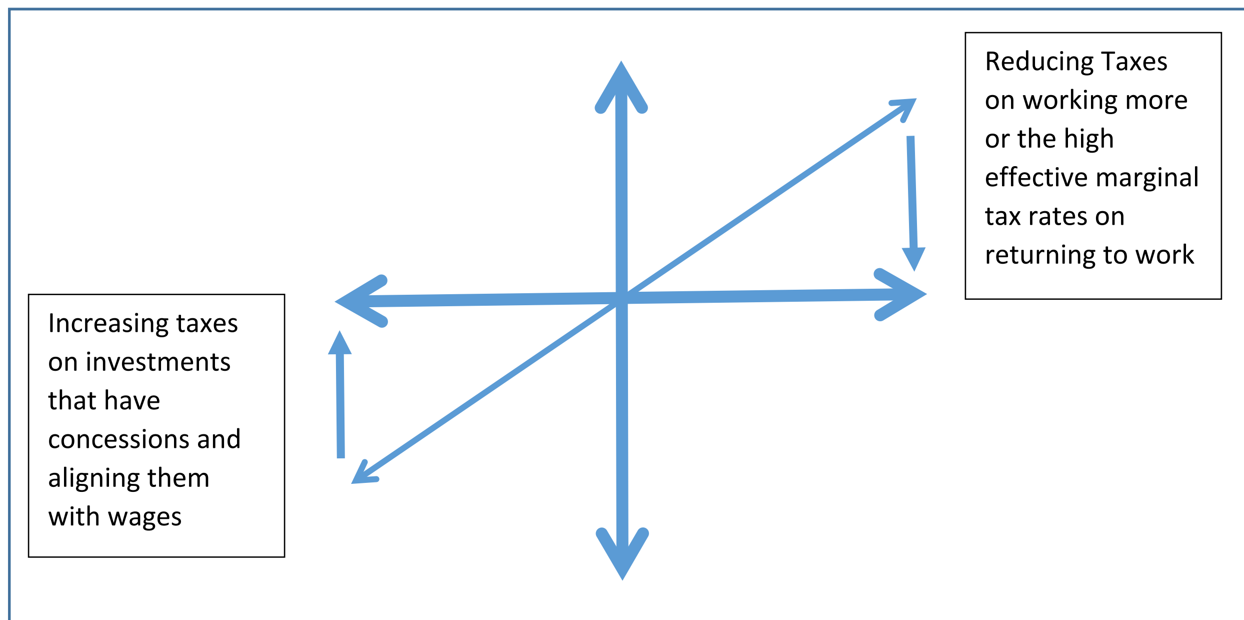
Yes it's idealistic, but what would it look like and what are the benefits.

I have put together a small piece of analysis, to show how lower taxes can be achieved.

What are the objectives of an 'Equalised' Tax System:

- Revenue Neutral Change
- A simple and equalised tax system
- A tax system with lower tax rates
- A tax system that is progressive
- A tax system that supports aspiration to work hard
- A tax system that treats people equally by taxing all asset classes equally (Horizontal Equity).
- Productive effort should not be taxed more than unproductive assets.
- The Corporate Tax Rate equal to the Top Marginal Tax Rate
- Reduces Tax Planning

Fixing Horizontal Equity



Analysis

The analysis looks at the Treasury taxation revenue of 2017-18, to determine the baseline tax revenue for income taxes. This equates to $312Bn at that time. It does state it includes profits and capital gains, but I have assumed that the $312bn figure is wages for simplicity.

Total taxation revenue, by level of government and category

	2013-14 $m	2014-15 $m	2015-16 $m	2016-17 $m	2017-18 $m	2018-19 $m
Commonwealth government						
Taxes on income, profits and capital gains	248 435	258 610	265 116	281 157	312 474	338 667
Taxes on employers' payroll and labour force	844	735	670	605	1 107	1 069
Taxes on property	-	-	-	-	-	-
Taxes on provision of goods and services	90 377	92 225	97 181	99 913	104 965	107 126
Taxes on use of goods and performance of activities	10 574	3 661	6 289	6 900	8 743	8 781
Total taxation revenue	**350 230**	**355 232**	**369 257**	**388 576**	**427 289**	**455 643**

Then the large tax concessions including the family home are removed. These include the following in the red box:

Chapter 4: Tax expenditures

Table 4.1: Large measured tax expenditures in 2017-18

	Tax expenditure	Estimate $m	
		Revenue forgone	Revenue gain
Large positive tax expenditures			
E6	Main residence exemption - discount component	40,500	n/a
E5	Main residence exemption	33,500	n/a
C4	Concessional taxation of superannuation entity earnings	19,250	18,300
C2	Concessional taxation of employer superannuation contributions	16,900	16,300
E13	Discount for individuals and trusts	10,270	n/a
H27	Food	7,100	6,900
H15	Education	4,550	4,100
H18	Health - medical and health services	4,100	4,050
H2	Financial supplies - input taxed treatment	3,400	3,400
A24	Concessional taxation of non-superannuation termination benefits	2,400	2,400
C6	Deductibility of life and total permanent disability insurance premiums provided inside of superannuation	2,370	n/a
B2	Local government bodies income tax exemption	2,210	n/a
A41	Exemption of Family Tax Benefit payments	2,070	2,070
B12	Exemption from interest withholding tax on certain securities	2,010	1,430

The removal of concessions for the family home, discounts on capital gains tax, concessions on super contributions and franking credits are removed. This results in a reduction of about 34%

Income and Concessions	**$ M**
Income Taxes	$312,474
E6 Main Residence exemption – discount	- $40,500
E5 Main Residence exemption	- $33,500
E13 Discounts for individuals and trusts	- $10,270
C2 Concessional Taxation of employer super contributions	- $16,900
Excess Franking Credits	- $5,000
Total	$206,304
Reduction in Income Tax	34%

Recasting the marginal tax rates using the future 2024-25 tax rates, all rates are reduced equally by 34%. These are shown in the table below. This excludes Medicare.

Marginal Tax Rates

	$0 to $18,200	**$18,201 to $45,000**	**$45,001 to $200,000**	**>$200,000**
2024-25 Marginal Tax Rates	0%	19%	30%	45%
Equalised Tax System Reduced by 34%	0%	12.5%	20%	30%

What are the benefits:

Working

The lower tax rate helps

- incentivise working extra hours
- Incentivise moving up to a higher paying job with more responsibilities without being punished at 37% and 45% tax rates.
- Reduce the effective marginal tax rate for those who transition back to work who are on allowances/payments.

The average worker between $45,000 to $200,000 p.a. will pay a 20% tax rate on their wages.

The maximum tax rate is 30% above $200,000.

Capital Gains Tax

The 50% discount on capitals gains is removed. There is no discount. Although inflation maybe considered based on the pre-1999 method, it is removed from this analysis to reduce tax rates as far as possible.

Shown below is a comparison of the equalised tax system capital gains tax rate compared with Labors 25% CGT discount. The equalised system provides a lower tax rate.

This means that making capital gains from shares will be treated the same as the family home. This shifts the balance of investment back to the centre, and more towards productive means. And thus ultimately jobs.

Removal of the capital gains discount means holding the investment for 1 year is not required anymore. Thus removing another distortion.

Comparison of Net Capital Gains Tax Rates

	$0 to $18,200	$18,201 to $45,000	$45,001 to $200,000	>$200,000
2024-25 Marginal Tax Rates	0%	19%	30%	45%
50% Discount	0%	9.5%	15%	22.5%
Equalised Tax System Reduced by 34%	0%	12.5%	20%	30%
Labors 25% CGT Discount on 2024-25 Marginal Tax Rates	0%	14.25%	22.5%	33.75%

Negative Gearing

Because the 50% discount on capital gains is removed, distortions with negative gearing are reduced as gains and losses maybe taxed at the same marginal tax rate.

For example a high income earner with an investment property will receive a 30% tax deduction on income losses, but would pay 30% tax rate on capital gains.

This same approach was outlined in the Henry Tax review. But to apply a 40% discount to savings and losses.

Business Tax

The 30% business tax is aligned with the top marginal tax rate of 30%. This helps reduce tax planning and tax distortions.

Family Home

Capital Gains on the family home would be taxed at the full marginal tax rate. With a maximum 30% tax rate, owners would still make a 70% profit.

Alternative options can found in the appendix including the $2M capital gains tax or a $25,000p.a. Tax free threshold in line with the age pension. This can be accumulated as a threshold.

Superannuation

Superannuation would become a delayed income, with removal of lower tax rates.

Superannuation contributions would be paid as after tax payments as this is a high contributor to a regressive tax system.

During the accumulation phase, earnings are not taxed.

In retirement, the tax free earnings component from the accumulation phase would be taxed at the marginal tax rate when drawn down. The first $45,000 would have an average tax rate of just 6.25%.

Discussion

My proposal of the tax system is to simply bring it back to its least distorted position. Horizontal equity is flat, with vertical equity retaining its progressivity whilst minimising taxes.

From this position, the system is likely to be the most efficient, fair, and least distortionary.

Incentives for saving more money for retirement or owning a tax free home ultimately result in distortions and erosion of a fair tax system.

For every incentive put in place, the top tax bracket of 30% increases, which goes against the objective of productive work taxed higher than unproductive assets.

Unfortunately, the paralysis created by our federal system means we can never achieve a better and fair tax system.

Appendix – Family Home Capital Gains Tax Alternatives

$2M Capital Gains Tax on the Family Home

An alternative that has been proposed is for a capital gains tax free threshold of $2M.

Implementation of this option would likely lead to distortions in the property market, as buyers would purchase properties well under the $2M and sell when they reach the $2M price. And then go back and buy a $1M house.

If information of this initiative is known before a start date, high value property owners would sell and re-purchase another property to avoid paying capital gains tax on their existing capital gains above the $2M threshold.

Tax Free Threshold of $25,000p.a. Accumulated (Equivalent to the Age Pension).

An alternative is a $25,000 capital gains tax free threshold that is accumulated each year for all owner occupiers. The threshold would be indexed each year. This roughly aligns with the age pension. Over 40 years this is $1Million in capital gains tax free.

The idea is that government wants home owners to accumulate at least the equivalent of the age pension in capital gains to be tax free. Beyond this rate, tax is payable at the marginal rate upon sale.

All owners get the same threshold, so are incentivised to retain their property as the tax free threshold can be accumulated.

Higher priced properties would pay more tax above the tax free threshold. So it's progressive. (See Table next page).

Implementation can occur at any time without retrospectivity to previous gains, and would simply be the portion of time the new tax has been in place as a percentage of the total time the family home is owned.

Example

A property purchased for $300,000 in 2001 is sold in 2025 for $1,500,000.

This is a capital gain of $1,200,000.

The capital gains tax is introduced in 2022. Hence 3 years of the 24 years of capital gain are used to calculate the taxable amount.

Hence {(3years / 24years) x $1.2M – (3 years x $25,000)} = $75,000.

Assuming the owner has an income of $45,000, the $75,000 is added to their taxable income. Hence the tax rate is 20% for all of the capital gain. This results in $15,000 tax.

Table of Comparison using the $25,000 p.a. Tax Free Threshold for Capital Gains Tax of the Family Home.

An example is shown with properties bought and sold over 10 years. Property prices increase by 100%. A $25,000 p.a. tax free threshold is applied.

The results show that the threshold creates a progressive scale.

For a homeowner who buys for $500,000 property and sells for $1M, the tax payable is $50,000. Or about a 10% tax rate. Removal of the threshold would result in $135,000 tax or a 27% tax rate.

Family Home Price Increase (~7% p.a.)	**Capital Gain**	**Accumulated Tax Free Threshold of $25,000 p.a.**	**Taxable Income**	**Tax Payable** **Wage of $50,000**	**Net Gain**
$100,000 to $200,000	$100,000	$250,000	$0	$0 (0% of Capital Gain)	$100,000
$500,000 to $1M	$500,000	$250,000	$250,000	$51,000 (10% of Capital Gain)	$450,000
$1M to $2M	$1M	$250,000	$750,000	$201,000 (20% of Capital Gain)	$800,000
$5M to $10M	$5M	$250,000	$4.75M	$1.4M (28% of Capital Gain)	$3.6M