PROMOTING AFFORDABLE HOUSING

Submission to Re:think Tax Discussion Paper

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About Shelter WA

Shelter WA is the peak body for social and affordable housing in Western Australia. Shelter WA is also committed to the elimination of homelessness across the state. Shelter WA was founded in 1979 as an independent community based peak body committed to accessible, affordable and secure housing for Western Australians. It provides a link between government and the community through consultation, research, systemic advocacy, policy advice and community engagement. Our role is to provide an independent voice on housing rights and options in the state along the housing continuum, based on stakeholder engagement, consultation, and research of housing market and homelessness trends. Our work focuses on promoting the development of appropriate and affordable housing options for low to moderate income earners, and those who are otherwise disadvantaged in the housing market, and people experiencing homelessness.

Shelter WA promotes a diverse range of affordable housing options including social housing, affordable housing within the private rental market and affordable home ownership. Shelter WA also provides community education, disseminates information and undertakes housing and homelessness policy development. Our development of policy recommendations is based on sound research and consultation with housing consumers and organisations working on housing and related issues.

Introduction

Shelter WA welcomes the opportunity to engage in the national conversation on tax reform and to provide this initial comment on the *Re:think Tax Discussion Paper*. This submission responds to tax considerations highlighted in the discussion paper, particularly capital gains, negative gearing, stamp duties, and the treatment of not-for-profit entities, as they relate to the housing market and improving housing affordability. In developing this response, Shelter WA drew upon research relating to taxation and housing, engagement with stakeholders, and its Policy Platform, *Housing in WA: Sustainability and Affordability for the Future*. **Shelter WA will provide a more in-depth response, including analysis of alternative tax solutions related to housing, when the options (green) paper is released later this year.**

Our tax system has a significant impact on housing availability, choice and affordability. Tax policies such as negative gearing, capital gains discounts and stamp duties can have an inflationary effect on house prices and limit mobility in the housing market. Tax policies can also be effective tools to encourage investment in maintaining and increasing the current stock of affordable housing.

A thorough investigation is needed to examine how tax settings influence house prices, rents and savings patterns. Shelter WA encourages these issues to be examined as part of the White Paper on Reforming our Tax System, with the goal of minimising distortions in the market, better targeting of concessions and improving housing affordability, especially for people on low and moderate incomes.

Shelter WA Response

Commonwealth Tax Reform

The impact of capital gains tax discounts and negative gearing on housing affordability

Current tax treatment of housing creates market distortions and adds inflationary pressure to an already constrained housing system. In particular, Shelter WA is concerned about the impact of negative gearing, in combination with capital gains discounts, on house prices. There is confusion and misinformation in public debates about who benefits from negative gearing and capital gains discounts and by how much.

> Over 30% of individual taxpayers with geared rental housing investments earned over $500,000 in 2011.
>
> ACOSS (2015)

The Australian Council of Social Services (ACOSS) recently published a report, *Fuel on the fire: negative gearing, capital gains tax and housing affordability*. The report discredits the myth that the majority of households with negatively geared properties are middle income earners. The report found individuals appear to be middle income earners because the data often cited is based on adjusted income rather than total income. Adjusted income is reported after deductions (such as losses from negatively geared property) have been subtracted from total income. When total income is used, the report shows that in 2011 over half of taxpayers with negatively geared property were in the top 10% of tax payers and 30% earned over half a million dollars that year.[i]

Taxpayers carry the burden of tax concessions to upper income households. Capital gains tax concessions for investment assets, including, but not limited to, housing, amounted to $5.8 billion in 2013-2014 (Australian Government, 2015). The foregone revenue from tax concessions to upper income households could be better targeted and used to invest in social and affordable housing. Increasing the supply of social and affordable housing would help ease housing stress, diminish homelessness and reduce the need for government funded services.

> Over 90% of investor borrowing is for existing rental properties, not new ones, so investors are bidding up home prices without adding much to the supply of housing.
>
> ACOSS (2015)

While some argue that negative gearing and generous capital gains concessions are needed to encourage investment in the rental sector, very few property investors purchase new construction. Those that do invest in rental property tend to do so with an eye to capital gains, not more modest, long term income from rental yields. In their study of *Factors shaping the decision to become a landlord and retain rental investments*, Wood and Ong (2010) found that negatively-geared rental investors are more likely to terminate leases at any point in an investment spell. There is significant churn among investors, where they must refinance and sell properties in order to retain tax benefits, which contributes to an insecure environment for renters.[ii]

When considering changes to negative gearing, it is important to investigate the cost of renting and security of tenure for renters. It is often argued that when the Hawke Government temporarily removed negative gearing in 1985-1987, rental prices increased. However, only Sydney and Perth experienced rent increases during that time, both of which had been 'overheated' at the time that negative gearing was restricted. The rest of the country did not experience dramatic rent increases during that period.

Shelter WA suggests that any changes to tax for individual property investors must, at the same time, encourage institutional investment to increase the supply of affordable rentals and provide tenants with greater security of tenure. This could be done by utilising the additional tax revenue to re-instate the National Rental Affordability Scheme (NRAS) or an alternative mechanism. Institutional investment in the rental market is needed to accommodate the growing number of households remaining in the private rental system for extended periods of time.

With lending for investment properties rising by 150% in Sydney in the last three years, the Reserve Bank has warned that investment housing requires close monitoring for signs of speculative excess (ACOSS, 2015). Changes to negative gearing and capital gains may temper some of the speculative activity in those markets.

As part of the Tax Reform process, Shelter WA recommends that the Australian Government conduct a study on the influence of negative gearing and the capital gains tax discount on home purchase affordability and on the rental market, the effect of these arrangements on revenue, and their relationship to economic productivity. This recommendation is consistent with a recommendation made by the Senate Economics References Committee.

Senate Economics References Committee Recommendation on Investment Properties

In its final report, *Out of Reach? The Australian Housing Affordability Challenge*, the Senate Economics References Committee recommended that the Australian Government investigate the effect of the current taxation treatment of investment housing on home purchase affordability and consider if alternative approaches would help improve affordability. It recommended that the study examine these alternatives:

> (a) a housing-specific 'quarantine' approach, wherein losses for investment properties can only be deducted against rental income, with provision for losses in excess of rental income to be carried forward and deducted against future rental income and capital gains;
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> (b) a broader 'quarantine' approach, wherein interest expenses on all investments, including but not limited to housing assets, are only deductible in any given year up to the amount of investment income earned in that year, with provision for losses in excess of this amount to be carried forward and deducted against future investment income and capital gains;
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> (c) limiting the application of negative gearing arrangements to new housing stock, or designated new affordable housing stock;
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> (d) limiting the application of negative gearing to a certain number of properties (assessing options for various limits in this regard);
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> (e) options for phasing out negative gearing on investment housing;
>
> (f) applying the savings income discount recommended in the Henry Review to investment housing, with consideration given to the impact of this approach both with and without the implementation of the Henry Review's recommendations in relation to housing supply and housing assistance; and
>
> (g) reducing or removing the capital gains tax discount for investment properties, or reverting to the pre-1999 system of taxing real rather than nominal capital gains on investment assets.

Shelter WA recommends that the Australian Government explore these options to limit the impact of negative gearing and capital gains on house prices. Where appropriate, changes would need to be implemented gradually to protect people who made investment decisions under the existing rules. Shelter WA also recommends that any revenue raised from housing tax reform be directed to fund the growth of social and affordable housing stock.

Recommendation 1: Conduct a study of the influence of negative gearing and the capital gains tax discount on home purchase affordability and on the rental market, the effect of these arrangements on revenue and their relationship to economic productivity.

Recommendation 2: Apply part of the revenue gained from reforming negative gearing and capital gains discounts to strengthen tax incentives for investment in new affordable rentals (i.e. NRAS).

Ensuring adequate tax concessions for the not-for-profit sector

> As at 30 June 2014, 67,046 households were assisted with community housing in Australia.
>
> 80% of tenants reported being satisfied with the services provided by their community housing organisation.
>
> Productivity Commission (2015)

Community housing is housing provided by a not-for-profit community based organisation at below market rent for low to moderate income tenants. There are many types of community housing including: housing cooperatives, local government housing associations, specialist providers, broad service delivery organisations that provide housing and other welfare services, affordable housing developers, joint ventures and equity share rental housing, where community housing wholly owns the housing stock and leases it to tenants. In order to facilitate these diverse models and the growth of the community housing sector, community housing providers require certainty within the tax system.

Community housing providers currently have charitable tax status, which allows them to access a range of tax concessions including exemption from income tax and Goods and Services Tax (GST), access to the Fringe Benefits Tax and often local government concessions on rates and utility bills. These concessions lower construction, development and operating costs, which is essential to the viability of the community housing sector. However, access to these concessions is contingent on a community housing provider satisfying requirements that their organisation's purpose meets the criteria for charitable status (Community Housing Federation of Australia, 2014).

There have been some concerns in the sector that community housing providers' activities, such as the provision of affordable housing for low and moderate income households (in addition to their core activity of providing social housing for very low income households) could put their charitable status at risk. This is because 2013 legislation allows Australian Taxation Office (ATO) discretion to refuse tax exemption to a charity if it is not applying its assets 'solely' to its charitable purpose (ACOSS, CHFA,Homelessness Australia, National Shelter and Nato, 2015). Shelter WA supports the Senate Economics References Committee's (2015) Recommendation 38 that 'the Australian Government, through legislative recognition of charitable status, resolve any uncertainty over the effect that participation in NRAS or any similar scheme would have on the tax status of entities operating as charities, or public benevolent institutions'. Appropriate policies are needed to support community housing providers' access to charity tax status, ensuring the viability and growth of social and affordable housing.

Recommendation 3: Ensure consistency and certainty for community housing providers to maintain their charity tax status.

Another concern for the not-for-profit sector is the inability to secure public benevolent institutions (PBI) and designated gift recipient status (DGR) for organisations whose principal activity is advocacy, even when that advocacy is entirely dedicated to the relief of poverty, distress or disadvantage. This restriction makes advocacy organisations reliant on government funding, unable to raise sufficient funds from other sources. Shelter WA recommends the ATO review arrangements for DGR and PBI status to determine how organisations engaged in advocacy and policy development may be considered for PBI and DGR status, to enable the not-for-profit sector to deliver benefits to the community more efficiently and effectively.

Recommendation 4: Review arrangements for DGR and PBI status for organisations that provide advocacy and policy development.

State Tax Reform

Stamp duty and land tax

Stamp duties are widely recognised as inefficient taxes. Stamp duty on the purchase of housing prevents people from moving through the housing system, relocating for employment and downsizing as they age. Abolishing stamp duty while implementing a broad-based land tax would remove a significant cost to home buyers, help control house price inflation, and return equivalent revenue to State Governments over time. Notably, this recommendation has the potential to increase housing affordability for first time homebuyers, low and moderate income households and anyone wishing to move or downsize.

Replacing stamp duty with a broad-based land tax could contribute to the following (Wood, Ong, & Winter, 2012):

- downward pressure on house prices;
- faster development of old industrial sites;
- easier entry to home ownership for first home buyers;
- increased supply of private rental accommodation;
- a reduction in the number of taxes (by one); and
- removal of a barrier to labour mobility.

Shelter WA contributed to the Senate Inquiry into Affordable Housing and was pleased that the Committee recommended 'that state and territory governments phase out conveyancing stamp duties, and that as per the recommendations of the Henry Review, this be achieved through a transition to more efficient taxes, potentially including land taxation levied on a broader base than is currently the case' (Economics References Committee, 2015). Shelter WA strongly supports the recommendations made in the Henry Review and the Senate Inquiry into Affordable Housing to abolish stamp duty and introduce a broad-based land tax over a transitional period.

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ACOSS, National Shelter, the Community Housing Federation of Australia, Homelessness Australia, and the National Association of Tenants Organisation developed *An Affordable Housing Reform Agenda*, which describes some of the advantages of replacing stamp duty with a broad based land tax. The report explains that a broad based land tax 'discourages speculation in land and housing, encourages productive development, is simple to administer and difficult to avoid, and cannot be passed onto tenants' (2015, p. 14).

Changes to land tax are also required to stimulate large scale investment in the rental market. Currently, investors are charged land tax on their entire portfolio rather than the sum of the land tax that would apply to each individual property within a portfolio. Such high rates of land tax discourage institutional investment.

Importantly, any changes to stamp duty and land tax would require a transition period to avoid current home owners, who have already paid stump duty, having to pay an additional land tax. In order to ensure ongoing affordability, considerations will need to be made for low income households during both the transition period and in the ongoing implementation of a broad based land tax. This could be done by progressively structuring the land tax with exemptions for lower value properties, and/or basing concessions on household income. This will be particularly important for seniors who may live in an area with high value land, but do not have access to sufficient income to pay an annual land tax.

The ACT Government is phasing out stamp duties over the next twenty years, noting that this would support their agenda of making taxes 'fairer, simpler and more efficient' (ACT Government Treasury, 2014). It is unclear whether other states will follow.

Recommendation 5: Replace stamp duties with broad based land tax.

Conclusion

Shelter WA welcomes the opportunity to be a part of the national conversation on tax reform. Taxation settings are not the sole cause of the high cost of housing, but they exacerbate the conditions which have made housing unaffordable for many Australians, and contribute to growing rates of homelessness. Reforming the treatment of housing in our tax system will go some way to addressing housing affordability.

When people have access to safe, secure, affordable accommodation they are able to engage in employment, attend school and connect with the community, in a way that is difficult when living in housing stress, in insecure rental accommodation, and/or on the edge of homelessness.

In developing the options (green) paper, Shelter WA recommends the Tax White Paper Task Force:

- Conduct a study of the influence of negative gearing and the capital gains tax discount on home purchase affordability and on the rental market, the effect of these arrangements on revenue, and their relationship to economic productivity;
- Apply part of the revenue gained from reforming negative gearing and capital gains discounts to strengthen tax incentives for investment in new affordable rentals (i.e. NRAS);
- Ensure consistency and certainty for community housing providers to maintain their charity tax status;
- Review arrangements for DGR and PBI status for organisations that provide advocacy and policy development; and
- Replace stamp duties with broad based land tax.

Shelter WA encourages the Tax White Paper Task Force to include an examination of the tax treatment of housing in the options (green) paper, particularly tax concessions for investors, and their relationship to the cost of housing. All options should be considered, with decisions made based on strong evidence of the impact of tax concessions on investors, renters, homeowners and those seeking to enter the housing market. The focus of this examination should be to improve housing affordability overall, increase the supply of affordable housing, and improve security of tenure in the private rental market.

The not-for-profit sector providers play an important, and growing, role in our housing system. Charitable tax status is essential for community housing providers to provide housing and services to those in need. Consistency and certainty are required to allow community housing providers to structure their activities to comply with charity and tax laws, and continue to provide safe, secure, affordable accommodation for those with few alternatives.

State based taxes, such as stamp duties, contribute to the cost of housing and discourage mobility in the housing market. Reforming stamp duty must be considered as part of the broader tax reforms to ensure the State and Federal tax systems work together to deliver positive outcomes for housing affordability.

To discuss the issues raised in this submission in further detail, please contact Chantal Roberts, Executive Officer on (08) 9325 6660 or email eo@shelterwa.org.au.

References

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[i] Data from ACOSS report based on RBA, Submission to Senate Economics Committee on Affordable Housing, Financial stability review, Sept 2014.
[ii] Presentation by Rachel Ong, How our tax system affects housing affordability, Shelter WA Forum, 14 November 2011.