Federal tax concessions and the housing crisis

We will challenge values which emphasise acquisitiveness and greed…….

Uniting Church, Statement to the Nation, 1977

What this resource is and who it is for

This resource has been developed for Uniting Church congregations and their communities. It examines the impact of some Federal taxation policies, negative gearing and the capital gains tax discount, on housing in this country.

These may seem like quite dry issues, but they have an impact on very important matters such as the availability of affordable housing, the overall fairness and equality of our society and what funds government have available to pay for services for the whole community.

This resource invites Uniting Church members to asses these Federal taxation concessions in the light of principles drawn from theological reflection, as well as assessment from policy analysts, economists and other commentators. The material suggests that, when scrutinised from the perspective of the common good, these tax concessions are shown to be neither effective nor fair. Many groups, including the Uniting Church through UnitingJustice Australia, are calling for these policies to be substantially revised.

We hope this material will aid Uniting Church members as they think through these issues for themselves. It will help members evaluate the position of candidates in the upcoming Federal election in regards to these tax breaks and their impacts. We encourage you to use the material to prompt discussion and debate within your congregations and communities, and especially to ask questions of those who are seeking your vote.

Why housing matters

Having access to decent, secure and affordable housing is a basic human need and right. It provides the stable foundation we need to raise our children, connect with friends and neighbours and make the most of opportunities in education and employment. In short, we need secure and affordable housing to flourish as human beings.

Currently Australia is experiencing a crisis in secure and affordable housing:

- *Home ownership*: Rising prices means owning your own home is becoming more difficult. Younger people and those on lower and middle incomes are being squeezed out of home ownership. [1-3]
- *Private rental*: More people are renting than ever before, including more families with children. Nationally, there is a shortage of 539,000 rental properties for low income households.[4,5] While pressures are greatest in capital cities, housing stress extends to all areas.

Difficulties in housing are even more acute for those on waiting lists for social and affordable housing and for the more than 100,000 people experiencing homelessness in any given year.[6]

Many factors impact on housing

Housing is a complex area. There are many factors that impact on both the supply of, and demand for housing. Some areas, such as zoning laws and release of land are the responsibility of state and local governments; some are more the concern of our Federal government. Both negative gearing and the capital gains tax discount are Federal tax concessions. While many factors influence the availability and affordability of housing, commentators agree these concessions have a significant impact on demand for housing and the price of housing. It makes sense, in a Federal election year, to examine these policies and their effects and consider if they need changing.

Values and principles that inform a Christian view of taxation

At its inauguration in 1977 the Uniting Church included this statement:

We will challenge values which emphasise acquisitiveness and greed in disregard of the needs of others and which encourage a higher standard of living for the privileged in the face of the daily widening gap between rich and poor.

In its thinking about taxation the Uniting Church, through the work of UnitingJustice Australia and other parties, has identified a number of principles that shape a Christian view of wealth and taxation: [7,8]

- The world and the abundance it provides is God's generous gift for the wellbeing of all. As recipients of this gift, human beings have a responsibility to ensure that all have a share in the wealth it provides.
- In a democracy such as Australia, taxation provides a primary tool for the equitable distribution of wealth and the provision of resources for the common good.
- The design of our taxation system determines the ability of our governments to fulfil their responsibility to provide services so that all people may have a decent life and the opportunity to share in the wellbeing of the community.
- As Christians we must respond particularly to God's call to care for the most vulnerable in our society, and taxation is one means by which resources are provided for this care.

- When people are debating taxation they are actually talking about the level of responsibility we accept for each other.
- Taxation should not be seen primarily as a burden to be endured, but as an appropriate response to God's generous provision to us.

In line with these principles a taxation system should generally be:[7]

- Progressive: People should contribute according to their means. Those with more should contribute a greater proportion than those with less.
- Equitable: There will be inequalities in income across different groups and across generations, but gross inequality undermines community wellbeing and is inconsistent with the biblical vision. It is one role of the taxation system to reduce these inequalities and enable a fairer sharing of resources.
- Redistributive: In addition to providing services for all, such as health, transport and education, taxation should assist those who are most vulnerable and in need of support to have a decent life.

The Uniting Church believes that the taxation system is our primary means for ensuring the equitable distribution of wealth and the raising of public money, our 'common wealth', in order that we may ensure that the basic needs of people in society are met.[8]

Negative gearing and capital gains tax discount – how do they work?

Negative gearing

Negative gearing allows investors to deduct the cost of an investment property against all their other income, thus lowering their tax bill.

Negative gearing was originally introduced in the 1980s to stimulate the building of new dwellings, with the aim of boosting the economy and increasing the supply of housing at the same time.

Negative gearing allows tax payers to subtract losses they make on investments from their taxable wage income. It works in the following way. An investor borrows money to buy a residential property and rents it out. If the rent they receive is less than the money they spend on the property, including interest on loan repayments, then this loss can be deducted from their other taxable income. Australia is one of only three OECD nations (Japan and New Zealand are the others) that allows this kind of deduction. There is no limit on the deductions that can be claimed for investment expenses from rental properties.

It's important to remember that although the investor may be making a loss in terms of rent received, the property is increasing in value. When they sell the property they expect (or hope) it will be worth more than when it was purchased. This increased value is called the capital gain. When housing prices increase rapidly investors can make very substantial capital gains.

Capital gains tax discount

The capital gains tax discount (CGT discount) means investors only pay tax on half the increased price when a property is sold. (Note: owner occupiers pay no capital gains tax)

Capital gains are subject to capital gains tax (CGT). This tax is paid when an asset is sold for more than it cost. In 1999 the Australian government introduced a 50% discount on the CGT, if you have held the asset for more than one year. This means only half the capital gain on an investment property is subject to tax. For example, if a property was purchased for $500, 000 and sold for $700, 000 the capital gain is $200, 000. But the owner would only pay tax on one half, or $100,000, of the capital gain.

It is the combination of a capital gains tax discount, together with negative gearing, that has so encouraged speculative investment in the property market in Australia.

What are costs of these tax breaks?

Work by the Australia Institute estimates the cost of both tax concessions is about $7.7 billion a year.[1] This is made up of $3.7 billion for negative gearing and $4 billion for capital gains tax discount. Both these concessions represent a loss of taxation revenue for the community as a whole.

Other groups have made estimates of the cost of these tax concessions. For example, estimates on the cost of negative gearing ranged from $2.4 to $4.6 billion. While estimates vary, there is agreement they represent a very significant amount of forgone income.[9-12]

Moody's analysts Glenn Levine and Fred Gibson say economists have criticised negative gearing as an unfair and unproductive distortion that cost the Federal Government around $4 billion a year.[9]

Who benefits from these tax breaks?

Around 1.2 million Australians use negative gearing to invest in residential property. A proportion of these are on modest incomes. Figures show about 40% of people who use negative gearing earn around or less than the median (middle) income of $52,052 a year. [13] But the bulk of users are on higher incomes and the vast majority of the financial benefit of both tax concessions goes to the already better off.

Work by the National Centre for Social and Economic Modelling and commissioned by the Australia Institute analysed the benefit of the tax concessions by income. [1]They found:

- 34% of the benefit of negative gearing goes to the top 10% of income earners
- 73% of the benefit of capital gains tax goes to the top 10% of income earners.

When the benefits of both tax concessions are combined, 56% goes to the top 10% of income earning households and 67% of the benefit flows to the top 20% of households.

By contrast only 13% of the benefit goes to the bottom half of income earning households.

The impacts of negative gearing and capital gains discount

In recent years a growing number of commentators have questioned the value of these tax concessions and raised concerns about them in terms of their effectiveness, their fairness and other unintended impacts. These voices represent a broad range of interests from economists, those in the financial industry, think tanks, social policy experts and peak community sector organisations. Below is a summary of some of the negative effects of negative gearing and the capital gains tax discount they have identified. While the tax breaks are not solely responsible for these issues, they have a substantial influence.

They increase speculative investment and property market volatility

The tax breaks of negative gearing and CGT discount combine to encourage speculative investment in residential property. Between 2000 to 2013 lending for investment housing rose by 230% compared to 165% for finance for owner occupiers. [14] Figures from the Australian Bureau of Statistics show investment loans now account for more than 50% of all new home loans.[15] The Reserve Bank of Australia warned in 2014 that investment in housing, "bears close monitoring for signs of speculative excess." [16, p3]

This high demand, combined with limited supply has the effect of inflating property prices, but it also contributes to market volatility. The 2014 Murray Inquiry into the financial system noted that the tax treatment of housing is a potential source of financial system instability.[17] Similarly, reports by the Australia Institute and the Australian Council of Social Service (ACOSS) state that speculative property investment has distorted the residential property market making it more volatile and susceptible to 'bubbles'. It also makes the economy more difficult to manage as the Reserve Bank will be cautious about lowering interest rates when the overall economy is weak, in case this pushes up already inflated house prices. [1, 14]

> *Negative gearing is not alone in creating housing market distortions but it is a key reason why investor activity continues to skyrocket."* Callum Pickering, Business Spectator [18]
>
> *It is the combination of the taxation of capital gains at half the normal tax rate when the property is sold, and the ability to claim unlimited deductions for 'losses' in the meantime that drives investors to negatively gear. The tax system encourages people to borrow more than they normally would otherwise in order to speculate on property values.*
> ACOSS [14]
>
> *The nation would benefit from a debate about the favourable tax treatment for investing in property and a better understanding of the risks involved.*
> ANZ Chief Executive Phil Chronican, quoted in the *Sydney Morning Herald* [19]

They fail to boost housing supply

One reason negative gearing was introduced was to increase the supply of housing, particularly rental housing, by stimulating construction of new dwellings. Unfortunately this has simply not occurred as hoped. Many commentators have pointed out that the vast majority of property investment (most estimates range between 90-95%) goes to the purchase of existing properties, and therefore does little to boost new housing supply [10-12,20] Nor does it lead to the economic benefits associated with construction (e.g. employment).[18]

Economist Saul Eslake argues that there is no evidence to support the claim of those who advocate for the retention of negative gearing, that it results in more rental housing being available than would be the case if it was abolished. He points out that most other 'advanced economies' do not allow negative gearing, but have higher rental vacancy rates that Australia. [21] ACOSS have also noted that current arrangements favour small investors with one or two properties, when what is needed is more investment by institutions such as super funds to stabilise the rental property market and give tenants more secure tenure. [14]

> *It's hard to think of any worthwhile public policy purpose which is served by it* [negative gearing]. *It certainly does nothing to increase the supply of housing, since the vast majority of landlords buy established properties: 92% of all borrowing by residential property investors over the past decade has been for the purchase of established dwellings.* Saul Eslake [21]

> *Its original purpose was to boost housing supply by encouraging greater investment into housing construction. By that metric it has been an unmitigated disaster.*
> Callam Pickering, *Business Spectator* [18]

> *Some claim that negative gearing allows more homes to be built. If so, it is a very inefficient way to do it. Only 5% of negatively geared properties are new homes; the rest are existing properties. Because negative gearing increases the price of homes it may encourage a little more building. But the big restraint on new building is not the profitability in housing, but the availability of land and the vagaries of our planning systems.* John Daley and Danielle Wood, Grattan Institute [20]

They inflate house prices

One of the most significant impacts of these tax concessions is their effect on house prices, which in turn has an effect on housing affordability.

The combination of increasing speculative investment in existing dwellings (fuelled by easy credit and low interest rates) and the lack of new supply, contributes to increasing house prices.[22] In 2014, Moody's Analytics estimated that negative gearing alone had added an average 9% to house prices nationally. [9] Australia has now the second highest house-price-to-income ratio among advanced economies.[21] ACOSS notes that, from 2002-12, average prices rose by 92% for houses and 40% for flats, while average rents rose by 76% for houses and 92% for flats – well above the Consumer Price Index.[14] In this environment of rapidly increasing prices, first home buyers and those on lower or moderate incomes simply cannot compete with cashed up investors. Consequently, more people from these groups will be excluded from home ownership and forced to become long-term renters. But high rents also means an increasing proportion of tenants are living in a situation of housing stress - that is, paying too high a proportion of income on rent, with less money available for other essentials. [23,24]

> *The more people negatively gear in order to get ahead, the more prices climb. The further they climb, the harder houses become to buy. And the harder they become to buy, the more the Australian dream recedes.* Peter Martin, Economics Editor, *The Australian.*

The high cost of housing means less money is available for other essentials. People go without meals or must limit use of electricity to get by. Others are unable to buy necessary household items such as a fridge. The cost of frequent moving increases financial hardship. (Impacts on Uniting [previously Burnside] clients living in rental stress) [24]

They reduce home ownership

The percentage of the population who own their own homes is decreasing, people are holding on to mortgages for longer and the numbers who rent are increasing. This is most evident among younger Australians and those on moderate to low incomes. [2,22,25] It is these groups who are particularly disadvantaged by current taxation arrangements. Home ownership for those aged 25-34 has declined from 45.1% in 2000 to 34.0% in 2011, and in the same period ownership among 35-44 years old has declined from 69.7% to 60.0%. [2]

While the percentage of high income earners with property loans is increasing, fewer low and middle income groups are holding mortgages and more are having to rent as buying becomes increasing unaffordable. The rate of low and middle income earners who are now renting is rising, and they are remaining renters for longer.[22] For example, rental rates increased by 13% among low-income earners between 2001 and 2012 and by 19% among middle income earners over the same period. [1]

Higher rents also impact on home ownership. As rent takes up a greater proportion of available income, it makes it increasingly difficult to save for a deposit.

The most important argument against negative gearing is that it drives up house prices because it increases the after-tax returns to housing investors, and so prices are higher than they would be otherwise. This helps existing home-owners but accelerates falling rates of home ownership among younger groups.
John Daley and Danielle Wood, Grattan institute [20]

Lower and middle income earners appear to be the most affected by increasing house prices with many being locked out of the property market as a result.
The Great Australian Lockout [22]

This means a high proportion of the younger generation will be renters all their lives, including in retirement. Ross Gittins, Economic Editor, *Sydney Morning Herald*

They increase inequality and social division

Current tax concessions for residential property reinforce inequality in different ways. The bulk of the benefit of both negative gearing and capital gains tax discount go to the already wealthy. As we have seen, 56% of the combined benefit goes to the top 10% of income earners. [1] The tax concessions cost the government, and thereby the whole community, about $7.7 billion a year. As one well known economist noted, "This is a pretty large subsidy from those who are working and saving to people who are borrowing and speculating."[21] Others have wondered why income from speculating and investing should be treated more favourably (taxed more lightly) than income from wages.[1]

Because these tax breaks involve a huge amount of foregone Federal income that could be spent for the benefit of the whole community, (more than $7 billion a year)[1], they represent a redistribution of wealth from the whole community to the already affluent. [18]

But tax concessions reinforce inequality in other ways. A report by the Grattan Institute illustrates how tax breaks on residential property overwhelmingly benefit current home owners and investors. Because a greater proportion of personal wealth is now tied up in homes, this deepens the divide between owners and investors on the one hand, and renters on the other. And because home ownership among the young is decreasing, the risk is this divide will be entrenched and deepened among future generations. [5]

> *Like most tax concessions on investment, negative gearing is biased to the wealthy. Most people with negatively geared investments are in the top 40 per cent of income earners. The top 2 per cent of income earners claim half of all capital gains.*
> John Daley and Danielle Wood, Grattan Institute [20]

> *This means a high proportion of the younger generation will be renters all their lives, including in retirement. And that means they'll get screwed by the system which, in the name of encouraging home ownership, has always been loaded against renters.*
> Ross Gittins, Economic Editor, *Sydney Morning Herald*

> *The Uniting Church believes that taxation is a profoundly moral matter. It is the primary means for ensuring the equitable distribution of wealth and the raising of public money, our 'common wealth', in order that we may ensure that the basic needs of people are met.* [26]

Objections to changing existing arrangements

While a range of commentators support changes to negative gearing and the capital gains tax discount there are also groups who oppose such changes. Some of the common objections and their counter arguments are presented below.

Rents will increase

Some who oppose change to negative gearing argue that it will worsen the existing shortage of affordable housing and thus push up rents. They state this is what occurred when the Hawke government abolished negative gearing in 1986. They claim this led to a surge in rents which prompted the reintroduction of negative gearing in 1988.

This claim has been assessed by ABC Fact Check and others, and found to be wanting.[21, 27] Rents did increase steeply in Sydney and Perth, but this was the result of very low vacancy rates in both cities. In other capital cities rents remained much the same or, in the case of Melbourne, went down.[11, 14,]

Others argue more generally that changes to tax concessions, making them less attractive to investors, will create a shortage of rental dwellings as investors sell their properties. But any such sell-off will make housing more affordable. Some people will buy these properties from the landlords and so move from being renters to being home owners. So any drop in supply of rental properties will be balanced out by less demand, with more people enjoying the benefits of home ownership. [18, 21]

Some advocates for reform suggest any changes should be brought in gradually to reduce any disadvantage to existing investors and lessen the risk of a sharp drop in prices. Others argue that changes should be grandfathered, e.g. only apply to new investors and that existing investors should be able to claim deductions until that asset is sold. [18, 20, 21]

Housing construction will fall

The property sector has claimed that removing negative gearing will reduce housing construction, worsening the housing shortage and increasing house prices. For example a Housing Industry Association spokesperson, Mr Grahame Wolfe, has been quoted as saying that new housing construction has been leading the economy and reducing investment would cut supply and drive up prices. [28]

In counter to this argument a wide variety of observers, from ACOSS to the Reserve Bank of Australia, note that the vast majority of housing investment goes towards purchasing existing properties rather than the construction of new dwellings. [14, 29] Australian Bureau of Statistics figures for 2014 show that 94% of investor loans were for existing stock. [1] Other quoted estimates range between 90% and 95% of loans being for established dwellings. [10-12, 18, 20] In other words, negative gearing is doing very little to increase housing supply. A very small proportion of speculative investment, some 5%-10%, is contributing to the construction of new dwellings.

Modest income earning 'Mum and Dad' investors will be the main losers

In February 17, 2016 the Treasurer, Scott Morrison told the National Press Club: "In terms of… my attitude toward negative gearing. I have always understood that for the vast majority of Australians who use negative gearing they are modest income earning Australians, nurses, teachers, police."[1] He also stated that "Two thirds of those who use negative gearing have a taxable income of $80,000 or less."[13]

These statements were assessed by the ABC Fact Check team on March 3, 2016.[13] They found Mr Morrison's claim that two thirds of those who use negative gearing have an income of less than $80,000 per annum was backed up by figures from the Australian Tax Office. But they pointed out that this was not surprising as the vast majority (82%) of taxpayers have a taxable income below $80,000. Put another way, 18% of taxpayers with an income over $80, 000 make use of negative gearing, while only 8% of those with incomes under $80,000 use it. It has also been pointed out that people who use negative gearing are able to reduce their taxable income, so those who claim a taxable income of $80,000 would have had a substantially higher income before deductions for negative gearing were made.

The term "modest income" was not defined. Average male full-time earnings are about $82,000, but the majority of people earn significantly less than this. The median (middle) income is more likely to represent a modest wage. Recent data shows the median earnings for all workers whether male or female, full or part time, is $52,052. This group makes up 59% of taxpayers and 40% of people who use negative gearing. In total, only 4% of this group use negative gearing.[13] On these figures, most people who use negative gearing have more than a "modest income".

In addition, while a significant minority of people on modest incomes use negative gearing in some way, it is true that a disproportionate amount of the financial benefit goes to higher income earners. The top 20% of income earners gain 49.8% of the financial benefit of negative gearing and the top 30% receive 62.2% of it. By contrast, the middle 40% of income earners receive only 28.1%, and the bottom 30% only 9.7% of the financial benefit.[1]

Conclusion

As ACOSS has noted, there are many influences on housing affordability. Federal tax reform is only one part of the solution, but it is an important part.

The majority of commentators consider that the current arrangements for negative gearing and capital gains tax exemption are neither effective nor fair. Together they distort the housing market by encouraging speculative investment and pushing up prices. Because the demand is for established dwellings, the current arrangements do very little to increase the supply of housing. The vast majority of the financial benefits from these tax breaks go to better-off households. Increasingly, younger people and those on moderate and low incomes are locked out of the housing market.

A consensus is emerging that major changes are required to both negative gearing and capital gains tax exemption. In an election year we need to sound the call for such change.

What changes should we call for?

Different groups have somewhat different prescriptions for the changes that should be made to negative gearing and capital gains tax exemption. For some examples, see our table *What are the experts saying…? What are the major political parties saying…?*

Suggestions range from no change at all to the abolition of both concessions. Between those poles there are a range of options arguing that the concessions should be limited to varying degrees, have their focus changed, or both. As a significant minority of the population currently benefit from the tax breaks, some proposals are concerned that existing investors not be unduly disadvantaged. One response involves 'grandfathering' any changes - that is, only applying changes to new investors after a certain date.[11, 18, 21] This would allow time for house prices to adjust and would limit exposure of current investors to sudden changes in the market. Others argue grandfathering simply helps maintain the inequality that already exists. An alternative is to allow a transition period so that the benefits of current concessions are progressively withdrawn over a few years. [20]

What is the Uniting Church calling for?

While each person has responsibility to make up their own mind, many church members will want to take account of the corporate wisdom of the church on these issues.

The Uniting Church, through UnitingJustice Australia has called for the following reforms:

- Capital gains tax discount: Replace the current capital gains tax discount on property with an indexation discount. This means investors would pay tax on the whole capital gain at their marginal tax rate, less a discount for inflation.
- Negative gearing: Interest (and other expenses) on investment would only be deductible in any given year up to the amount of investment income earned, not against any income (as is allowable now). If the costs (interest plus other expenses) exceed investment income in any given year these could be carried forward to reduce the ultimate capital gains tax liability.
- An exception to these rules should apply for investment in property as part of an approved affordable housing scheme to assist low income earners into housing. Such schemes should be designed to encourage new housing stock.

You can take action in at least two ways:

1. Let your local member know what you think about these issues:
Contact your local Federal Member of Parliament and let them know if you think these tax concessions need to be made fairer and more effective. To find your local Federal member, please see the information below.

Why not organise a letter writing (or email sending) gathering within your congregation or other community group? You could use some of the material provided here as background and then provide time for people to write their own letters. Having contact details of local Federal members will help. Provide some food to make it a social occasion as well.

It doesn't matter if your local member is someone you will vote for or not. Just let them know what your concerns are and how you think these policies should be changed.

If you write a letter or email please let us know at: socialjustice@uniting.org

2. Ask questions of the candidates in your Federal electorate:
During the campaign period prior to the election, ask questions of candidates as they doorknock, appear at public places (railway stations, shopping centres), or speak at community gatherings and political debates.

Ask candidates about their personal or party's position on the tax breaks of negative gearing and capital gains tax discussion. Let them know why you think these tax breaks should be reformed and what changes are needed. Share any experience you have of the difficulties faced by people trying to find secure and affordable housing.

Why not ask your church or community group to hold a forum of candidates in your electorate to speak to these and other issues, or gather a friend or two and organise a forum yourself?

To find your Federal electorate or Local Member

You can find out what Federal electorate you're in, and follow links to its MP and contacts, by entering your postcode at this site: www.openaustralia.org.au/

Federal Members of the House of Representatives (MHRs) - listed by name, electorate or party, with their contact details - can be found online here:
www.aph.gov.au/Senators_and_Members/Members

Once an election is called and nominations closed, you can find a list of the registered candidates for your electorate, and other useful information about voting, at the Australian Electoral Commission: www.aec.gov.au/

You could also contact the political parties – search online for "Australia political party contacts" – and ask for contacts for their candidate in your electorate.

These resources were prepared by members of the Social Justice Forum team, Uniting Church Synod of NSW and the ACT, March 2016.

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