chp
council
to homeless
persons

CHP Submission to Re:think, the tax discussion paper

Introduction

Established in 1972, the Council to Homeless Persons (CHP) is the peak Victorian body representing organisations and individuals with an interest in and commitment to ending homelessness.

Homelessness occurs at the intersection of poverty, unaffordable housing and personal vulnerabilities. For this reason, adequate incomes, a dedicated supply of housing that is affordable and available to households on low incomes and appropriate support services are essential to preventing and ending homelessness. This submission focusses on the financial impact of various taxation measures on people at risk of or experiencing homelessness, and the way in which taxation affects the housing available to people experiencing or at risk of homelessness.

This submission is informed by discussions with members of the Peer Education and Support Program (PESP). These team members are volunteers of various ages and from a range of backgrounds who all have had a lived experience of homelessness

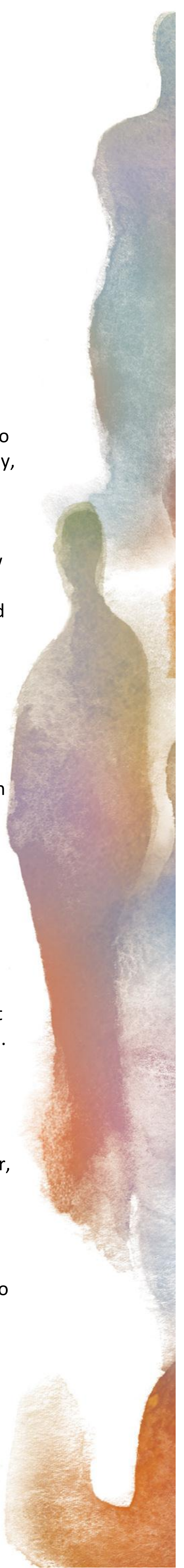
Tax and workforce participation

Low income households and those currently unemployed, have a far greater incentive to calculate the costs and financial benefits of work than most other households. On a low income the difference between a full dollar and 80 cents in income has a material impact on the individual's ability to meet basic needs. As such, interactions between the tax and transfer systems do affect people's decisions about entering into the workforce or increasing their hours.

In developing this submission, CHP conducted a consultation with our Peer Education and Support Program (PESP) for people with a lived experience of homelessness.

PESP team members were clear that the combined benefits of work, including increased income, pride and routine are strong motivating factors in people seeking employment. However they emphasized that the withdrawal of benefits and the interaction of the tax and transfer systems did influence their decision making about seeking paid employment. The ancillary benefits of a Health Care Card or Pension Concession card, such as utility and transport concessions, discounted prescriptions and other benefits were significant in calculations.

The financial insecurity inherent in casual work also poses problems. The process of reporting income to Centrelink leaves people in a precarious financial position, as income support payments are reduced before wages have been paid. Negative experiences of miscalculated



payments, resulting in under or over payment of benefits, discourage people from seeking employment. For households surviving on $290 to $390 a week, there is no capacity to save and hence little financial buffer to bridge the gap between reduced payments and wages being paid.

Similarly for people with mental illnesses continuing eligibility for the DSP is a concern due to the episodic nature of the condition. It became clear through the consultations that ironically, the fear of deeper poverty provides a disincentive to work.

Many of the issues identified as barriers to work could be overcome, not by changes to the tax rates, but changes to the transfer system. These issues were also identified in the review of the welfare system (Reference group on Welfare Reform 2015). This review proposed a “Passport to work” that allowed individuals to move in and out of the workforce for a period of time without losing concession benefits or payment eligibility. This could be an effective intervention for those moving in to work from unemployment.

Housing and taxation

As noted in the Re:think discussion paper, housing is the single biggest household asset. Home ownership serves a dual function of providing shelter and as a savings vehicle. As such housing wealth is lightly taxed in Australia, despite the fact that this may encourage over investment in housing. In particular the exemption of the primary place of residence from Capital Gains Tax is a significant taxation benefit.

While there are a number of factors that have contributed to increasing house prices in Australia, such as increased participation of women in the workforce, financial deregulation and current low interest rates, tax incentives have also played a significant role.

Within three years of the introduction of the Capital Gains Tax discount in 1999, the amount borrowed by housing investors had doubled and by 2013 it had tripled (RBA, Table D6 2015). While investment in housing is not a negative in itself, under ten per cent of housing investment was in newly constructed dwellings (RBA, Table D6 2015). The majority of investment lending is for existing dwellings and when investment is not contributing to new supply, increased investor borrowings simply serves to increase house prices. The recent Financial System Inquiry also noted that “The tax treatment of investor housing, in particular, tends to encourage leveraged and speculative investment…Housing is a potential source of systemic risk for the financial system and the economy” (The Australian Government The Treasury, 2014, P.278).

The combined tax breaks of negative gearing and capital gains tax discounts are estimated to cost the Federal Budget $7 billion a year (ACOSS 2015). This is more than the Federal Government spends on the National Partnership Agreement on Affordable Housing and Commonwealth Rent Assistance combined.

CHP is concerned with the impact of housing tax concessions to the extent that they distort the housing market, reduce government revenue for investment in social housing and crowd low income households out of the housing market.

Stamp Duty and land taxes

While stamp duty has been widely acknowledged as an inefficient state tax, it is one of the few direct taxes on housing wealth. It currently generates approximately $15 billion in revenue for state governments across the country (Australian Treasury, 2010).

The 2010 review of the Australian tax system (the Henry Review) proposed that stamp duty be phased out and replaced with a broad based land tax (Australian Treasury, 2010). This land tax would be levied at a rate dependent on the unimproved value of the land multiplied by the square metre value of land held. Each property would be assessed separately. Currently land tax only applies when the value of investment properties owned (cumulatively) reaches a certain threshold.

CHP supports this proposal as it would improve housing affordability in two ways. Levying the tax on the square metre value of the land would provide a financial incentive to be more efficient with that land, encouraging greater housing densities in high demand (and thus high value) locations. Secondly, levying the tax as an annual payment would require households and banks to include this payment in the calculation of ongoing costs. This would affect the amount that people are willing and able to borrow and spend, putting downward pressure on house prices.

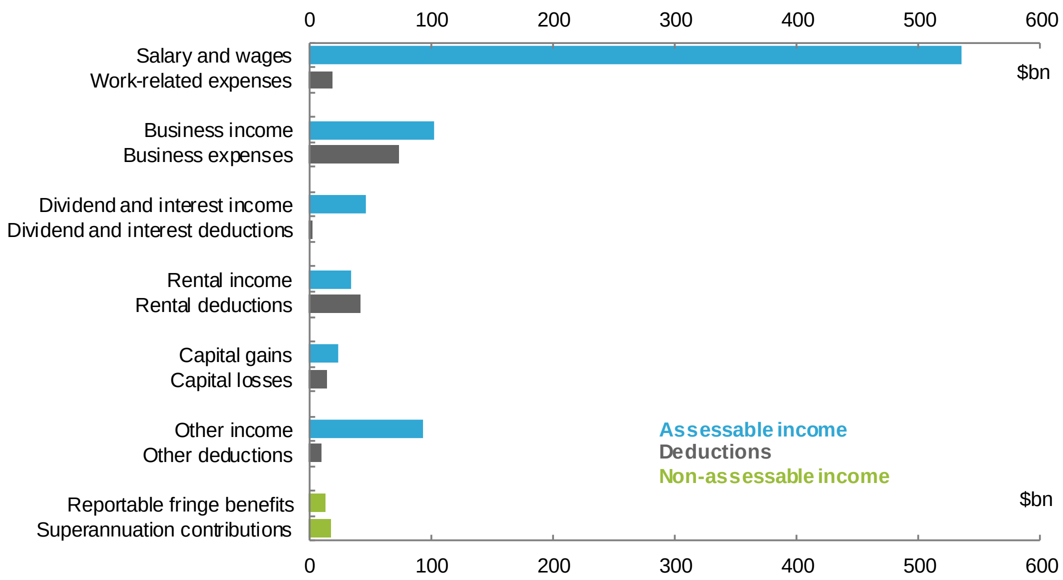
The Australian Capital Territory (ACT) has already commenced a 20 year transition to phase out stamp duties to be replaced by a broad based land tax. However, the ACT has some advantages in managing this transition as it already levies rates and has an immobile workforce in the Australian Public Service. In the rest of Australia the administrative arrangements for the collection of a land tax is more complex. CHP believes that the tax review should consider the ways in which the Federal Government can support State Governments to phase out stamp duties while replacing them with a broad based land tax. This could include securing agreement to consistent, nationwide rates and implementation timelines through COAG and by providing a financial incentive to cover transition costs.

Negative gearing and Capital Gains Tax Discounts for rental housing

As noted in the Discussion paper, it is the interaction between the capital gains tax discount and negative gearing which make negative gearing for property investment financially attractive. Any losses associated with the investment can be written off against an investor's income tax liability with the anticipation of profits made in capital gain, which is taxed at a discount.

While negative gearing applies to a range of investment products, the following table shows that rental housing is the only source of income where the deductions are higher than the income earned.

Major sources of income and deductions, 2011-12



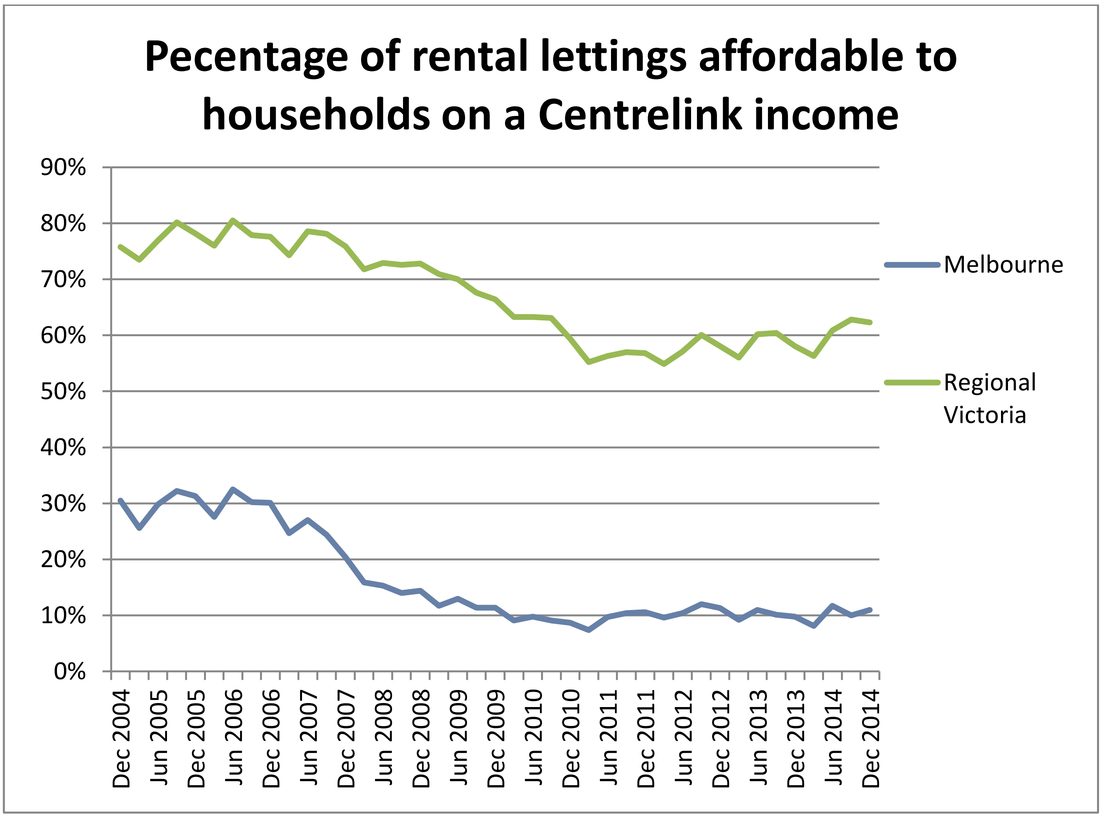
Source: Re:think discussion paper p.50

By allowing investors to claim losses on investments against all income rather than just income generated by the investment, negative gearing operates as a tax shelter for earned income. As noted by Stewart et al "More than 65 per cent of landlords have net losses that may be used to shelter other sources of income from tax" (2015).

Unlike other investments where negative gearing applies, such as shares, there are a range of deductions available to landlords against the costs of investing in housing. In the 2012 tax year, landlords generated over $33 billion in rent and claimed $41 billion in deductions against 19 scheduled items, including obvious expenses, such as interest on borrowings of $24 billion and agents fees of $2 billion. Other deductions, such as stationary, phone and postage costs totaling $59 million and 'sundry' expenses totaling $894 million, are less clearly related to the cost of providing rental housing (ATO, 2015).

While arguments about the financial impacts of negative gearing on the housing market are well worn, the structural impact of a large number of single investors is less often discussed. However with 73 per cent of people who claim a loss on rental property owning just one property and 91 per cent with two or less (ATO, 2013, p.14), the ability to secure housing supply in the private rental market is far from orderly. One study has estimated that one in four investors sell their property after 12 months (Wood and Ong 2010). This does little for the long term housing security of private renters, as 25 per cent of people have their housing sold out from under them. Taxation settings that encourage long term, institutional investment in rental housing would help improve housing stability for those in the rental market.

While it has been argued that negative gearing supports low rents, the number of affordable rental properties to low income households in Melbourne (and in other capital cities) has declined dramatically over the last decade (see figure 1 below). While the rental market has expanded, properties affordable to households in the lowest two income quintiles have declined, with a total shortage of affordable housing to those in the lowest income quintile (and not occupied by higher income households) is 271,000 dwellings nationally (Hulse et al, 2014). The private rental market, and the associated tax breaks are not assisting very low income households to secure or maintain rental housing.



Source: Department of Human Services, 2014

Alternative tax treatment for rental housing investment

The capital gains tax discount and negative gearing could be changed to encourage long term institutional investment in the rental housing sector, encourage investment in new housing supply, and reduce opportunities for tax avoidance.

Limiting the deduction of losses to rental income and reducing the scheduled items against which losses can claimed, would reduce the attractiveness of investment in rental housing, relative to other investment opportunities, and reduce the use of housing as a tax shelter. Similarly as recommended by the Henry tax review, an overall 40 per cent savings discount would align the benefits of different investments.

Only allowing tax deductibility for the purchase of newly constructed dwellings, could encourage the supply of new housing.

To prevent abrupt disruptions to the rental market, any changes should grandfather tax arrangements for current investors for a period of between 5 to 10 years.

Tax incentives for affordable housing

While the above changes to housing taxation would reduce the distortions in the housing market, they will not increase the supply of housing that is targeted to people on low incomes.

Many other comparable countries, such as the UK, Canada and the United States have a range of financial products to stimulate investment in affordable housing. These are supported by institutional structures and a range of financial intermediaries to package this finance together. In Australia the financial products available to low cost housing developers are limited to direct government grants and bank finance. The National Rental Affordability Scheme contributed to the range of products that could be used to finance affordable housing, however this has been discontinued.

Low Income Housing Tax Credit.

In the United States the Low Income Housing Tax Credit (LIHTC) has played a large role in financing affordable housing through the tax code. Since 1986 the LITHC as a helped finance more than 2.4 million dwellings (OCC 2014).

The Federal Government makes tax credits available to the states on a per capita basis. These tax credits are then issued to the low cost housing developer who sells them to generate equity for the housing development. In order to secure the credits either 20 per cent of the dwellings must be let to households on incomes of 50 per cent or less of the median area income at no more than 30% of that income or 40 per cent of dwellings let to households at 60 per cent of median area income.

The LIHTC is one part of a ‘split subsidy’ for low income households. The LIHTC reduces the cost of new construction or rehabilitation (JHCS, 2010). However for very low income households an additional income subsidy is needed to ensure that the rents remain affordable.

The majority of investors in these tax credits are large banks, due to the long investment horizon, the complex nature of the tax credit and the Community Reinvestment Act that requires banks to invest in the community.

Similar tax incentives should be considered to transform the affordable housing sector in Australia to play a greater role in the rental market.

It is important to note that the LIHTC took some time to attract investors, as they came to understand the affordable housing sector. The program was bolstered when it became a permanent part of the tax code, highlighting the importance of patience by government and certainty for investors.

Opportunities to channel investment in affordable housing

While the LIHTC is targeted to institutional investors in the United States, in Australia individual investors have clearly demonstrated an appetite for housing investment. Alternative tax concession mechanisms should be investigated to harness this investment appetite to secure rental housing that is targeted to households on a low income.

This could be done by limiting the losses claimed to the income earned from the rental investment, and providing a tax credit if the property is let at a rent that is affordable to a household in the bottom two income quintiles. The credit could be increased if the property is let to a household in the bottom income quintile.

Conclusion

Australia's housing taxation arrangements, by encouraging home ownership, disadvantage those households who will never own their own home. This includes those with the most urgent need for housing: people experiencing homelessness. The tax review provides the opportunity to refocus tax incentives for housing investment to ensure that the housing market is delivering for those most in need.

CHP recommends that:

- The Commonwealth Government support states to phase out stamp duties and replace them with broad based land taxes
- The deduction of losses for rental housing investment be quarantined to rental income
- That the savings be used to establish incentives for institutional investment in affordable housing
- Additional tax incentives be provided to housing investors that let properties to low income households at affordable rents be considered,

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