



SUBMISSION BY THE
Housing Industry Association

Tax Forum

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Housing Industry Association Ltd

HIA is the leading industry association in the Australian residential building sector, supporting the businesses and interests of over 43,000 builders, contractors, manufacturers, suppliers, building professionals and business partners.

HIA members include businesses of all sizes, ranging from individuals working as independent contractors and home based small businesses, to large publicly listed companies. 85% of all new home building work in Australia is performed by HIA members.



1. Executive summary

Housing is a staple of life, providing both shelter and a base from which Australians can participate in education, the workforce, and society more broadly. Australians of all means therefore require (and deserve) access to appropriate and affordable housing, and such access in turn ensures that a higher rate of productivity growth can be achieved.

The Tax Forum has the capacity to form the starting platform for driving a process of reform of Australia's Federalism model to: remove inefficient (largely state) taxes; reduce the total number of taxes; and boost Australia's productivity. The successful creation of this platform includes a requirement to examine how taxes at the Commonwealth level can compound taxes levied at the state and local government level.

A successful Tax Forum is, in the HIA's view, a forum that succeeds in commencing a substantial reform process of Australia's taxation system, a process which is almost universally seen as necessary. Such success would, by definition, create the starting point for the delivery of more equitable and efficient access to affordable housing in Australia, which as noted at the outset is an important contributing factor to generating a much-needed boost to Australia's productivity growth.

To ensure the successful commencement of the reform process, HIA identifies six key reform areas within the framework of the Tax Forum. The Commonwealth Government needs to commit to driving a process involving all tiers of government aimed at:

- reducing the large and inequitable taxation burden placed on the new home sector;
- working closely with the states and territories, and with local government, to this same end, with an initial focus on removing stamp duties on new homes;
- working with the states and territories, and local governments, to move away from the increasing reliance on a 'user pays' system for funding residential infrastructure;
- simplifying the current taxation arrangements falling on the new home sector to reduce a taxation compliance burden which falls disproportionately on small business;
- rationalising and reducing the large number of ad-hoc taxes, fees, and charges levied on new housing; and
- reducing the supply-side barriers which prevent a sufficient number and range of new residential dwellings from being provided each year in order to meet the demands of a growing and ageing population.

The Tax Forum Discussion Paper (TFDP) notes recommendations from Australia's Future Tax System Review (AFTS, widely known as 'The Henry Review') surrounding the need to fix Australia's housing supply being a pre-requisite to taxation changes. Recognition of the importance of these recommendations forms the focus of the HIA's point above regarding supply-side barriers. The evidence of the need for substantial policy reform to reduce these supply side barriers in order to boost Australia's housing supply is compelling.

HIA is of the view that a renewed commitment to housing supply reform is a key prerequisite to ensuring a successful Tax Forum. This view reflects the empirical evidence outlined in HIA's submission that a significant element of the inherent inefficiency and inequity of the current taxation system resides within the new housing sector. Therefore, underpinning the successful utilisation of the Tax Forum to begin a process of considerable taxation reform is a requirement for concrete policy decisions to be taken in order to reduce Australia's critical shortage of housing, which is especially evident in New South Wales and Queensland.

Returning to the need for overall reform of the taxation system, the new home sector is one of the most heavily taxed sectors of the Australian economy. All tiers of government place a large array of taxes on housing, on top of which cascade the final GST and stamp duty payments, escalating the total taxation burden falling on a new home.

Many of the taxes levied on new housing are highly inefficient and there is considerable inequity due to new housing being more heavily taxed than existing housing. The numerous taxes on new housing not only distort the housing market itself, constraining housing supply, but often also act to constrain labour mobility. Consequently, some of the current taxes effectively act as a brake on the aggregate Australian economy and as a result there is a strong productivity rationale for reforming taxes as they apply to new housing.

2. The Government's stated criteria for tax reform

The introduction to the TFDP notes that ideas for reform are required in the context of ensuring that '...the Government's strict fiscal discipline' is not compromised and that 'Proposals need to be affordable and fully funded'. The 'Looking forward' section of the introduction establishes four criteria around the 'national tax reform discussion':

- The Government's commitment to fiscal discipline (which essentially means that ideas that have a budget cost need to be funded);
- The impact that the tax and transfer system has on labour force participation, saving and investment decisions;
- That shifting the tax burden or tax mix from one base to another needs broad community consensus; and
- The key economic, social, demographic and environmental challenges and opportunities facing Australia.

The Tax Forum framework, which is heavily based on the AFTS, also includes four over-arching principles which encompassed its broad vision for Australia's tax and transfer system.' HIA supports these four principles:-

- Revenue raising should be concentrated on four robust and efficient, broad-based taxes:
 - Personal income;
 - Business income;
 - Rents, including rents from natural resources; and
 - Consumption.
- Narrow-based taxes should only be used where they improve social outcomes or market efficiency through better price signals.
- The transfer system should remain structurally separate from the tax system and remain highly targeted.
- Administration of the tax system needs to be more transparent and responsive to problems experienced by taxpayers.

With respect to these suggested criteria and principles, HIA notes that:

- Short-term fiscal discipline should not be used as a constraining influence on serious taxation reform that will pay substantial longer-term productivity and revenue dividends;
- Labour force participation is an important element to consider when reforming tax and the high transaction costs imposed on housing act as a constraint on labour mobility which in turn inhibits labour force participation;
- Taxes on housing are in general narrowly-based and improve neither social outcomes nor market efficiency;
- With regard to administration, there is an ongoing need to reduce taxation compliance costs for small business;
- Many of the taxes on housing fail the test of the axioms of good taxation policy including simplicity, equity, efficiency, neutrality, and certainty; and
- The tax system has major impacts on housing supply, housing affordability and hence the ability of the community to access shelter. The tax burden on new housing has grown substantially over the past decade and there exists an inequitable treatment of new housing compared to existing housing.

There is no denying that the tax burden on new housing must be reduced. However, prioritising the reform of any existing tax burden and evaluating alternative compositions for the taxation base is primarily a matter for the Government. It may well involve the need for tough political decisions, and most certainly extends beyond contemporary fiscal constraints of both an economic and political nature.



HIA outlines below five general points with regard to financing a reduction in inefficient taxes:-

1. sensible tax reform will itself pay dividends through higher productivity, efficiency gains, higher future economic growth, and hence increased future revenue streams;
2. a criteria of short-term “fiscal neutrality” constrains the ability of the Government to undertake the reforms necessary to improve Australia’s taxation system;
3. the Government has a large number of programs that could be examined closely for savings to offset a reduction in inefficient taxes;
4. the potential for efficiency gains, and savings, from reform of the current Federal-State fiscal arrangements is large; and
5. without consideration of the GST (in terms of its base, its rate, and its distribution among the jurisdictions), any taxation reform in Australia cannot be considered comprehensive.

While the onus of appropriately prioritising the raising of taxation revenue from different tax bases falls on the Government, two examples from the independent Centre for International Economics (CIE) report commissioned by HIA highlight the potential benefits of reducing the inefficient taxes on housing¹:

- Replacing the most inefficient taxes on housing with broader-based taxes (for example a broadening of the GST base) would stimulate annual economic growth by almost 2 per cent and would increase annual dwelling supply by 14 per cent; and
- In proportional terms, a \$500 million cut in stamp duty is estimated to infer a \$738 million benefit to home buyers and up to \$27 million to producers (builders). This example highlights the extent of inefficiency that arises from the levying of stamp duties (and conversely gives an indication of the kind of economic gains that may be had from the reduction or removal of these duties).

All six sessions of the Tax Forum are important and it is crucial for the Forum to make a start on policy reform regarding all six areas that have been identified. HIA’s primary focus in this submission rests with Session 4: State taxes, and with Session 1: Personal tax and Session 2: Transfer payments, although all six sessions are considered. Prior to addressing individual Tax Forum sessions, the HIA Submission outlines the tax burden borne by the residential building industry, particularly as it relates to new housing.

3. The new housing sector bears a large, inefficient and inequitable taxation burden

The Australian housing sector is heavily taxed in absolute terms

The Australian housing sector contributes between \$36 billion and \$40 billion in taxation revenue each year to federal, state and local governments in Australia. This equates to 11 to 12 per cent of the total revenue collected by all tiers of government and makes housing the second largest taxation contributor of all sectors in the Australian economy.

In terms of new housing, the GST is the largest tax, with around \$5.7 billion collected in 2008-09. The GST applies to new housing, but not to existing dwellings. This factor alone results in an inequitable treatment between new and existing housing stock.

Other large imposts on new housing include income taxes on construction and stamp duties, which together total around \$1 billion per annum.

Existing housing, although not as heavily taxed as new housing in a relative sense, also pays more than its fair share in taxation with stamp duties being the largest category by quite a margin.

The housing sector is heavily taxed in relative terms

In the ABS Input-Output tables there are 111 sectors of the Australian economy. When the total tax burden as a percentage of production costs is averaged across all these sectors the proportional tax burden is 24.4 per cent.

¹ The HIA commissioned a report from the Centre of International Economics (CIE): *Taxation of the New Housing Sector*. CIE collated information on all the taxes that eventually contribute to the final price of a new home, with figures then verified with a large number of residential building businesses. A computable general equilibrium model was then used to analyse the overall tax burden by industry sector and to also examine a number of tax scenarios.

There are a few sectors, including alcohol and tobacco, which are highly taxed due to the large negative externalities that may arise from their consumption. Even including the heavy taxation of these sectors, new housing is the 11th most heavily taxed of the 111 economic sectors. When considering the tax burden as a percentage of the production cost of commodities and services with a value added higher than \$10 billion, new housing is the second most heavily taxed of the 27 sectors that meet this criterion.

New housing contributes 1.2 per cent of the nation's value added but pays 2.8 per cent of tax. This compares with existing housing which contributes 7 per cent of value added but pays 8.4 per cent of tax. In proportional terms, new housing is considerably more heavily taxed than existing housing.

Many of the taxes levied on new housing are very inefficient

The AFTS notes that "many of the taxes applying to housing are inefficient". The analysis conducted by the CIE provides compelling evidence of this situation - more than half of the taxes falling on housing can be considered as inefficient (see Table 1 below).

These taxes primarily exist at the state government level, although there are clearly a high number of inefficient taxes at the local government level as well. Moreover, taxes such as the GST compound the impact of these inefficient taxes.

The most prominent inefficient or excessive² taxes on housing are: stamp duty; the excessive component of the land price; planning delays and uncertainties; and the excessive portion of infrastructure charges.

Table 1: Potential scale of inefficient or excessive tax on a dwelling

	<i>Sydney</i>	<i>Melbourne</i>	<i>Brisbane</i>
	A\$ per dwelling	A\$ per dwelling	A\$ per dwelling
Stamp duty	24 228	22 156	10 073
Land tax	1 457	1 117	909
Excessive land price	40 381	19 789	9 493
Planning delays and uncertainties ^a	38 094	22 609	23 297
Excessive portion of infrastructure charges	24 801	-	20 557
National Broadband Network	3 000	3 000	3 000
Building code excesses	9 583	10 926	11 609
Total — Greenfield	141 545	79 597	78 938
Stamp duty	23 718	16 248	10 194
Land tax	2 971	463	1 931
Excessive land price	11 087	7 174	9 391

The taxes on housing fall largely on the home buyer

The demand for housing is relatively inelastic. Housing is required as shelter, and where possible Australian households desire a home of their own, whether it is accessed through the rental market or by purchase. As the population grows so too does the number of households which increases the demand for dwellings. A range of factors underpin a robust underlying (or demographic) demand for housing in Australia which for many years now has considerably exceeded housing supply.

A number of constraints act on the supply side of the housing market. Many of these constraints (such as inefficient planning and approval processes) exemplify Australia's inefficient taxation system and cause

² Where charges or regulations are applied at a level above the economically efficient level, or above that necessary to fund provision of the good or service for which they are charged (as may occur in the case of infrastructure charging) then the charge or regulation is considered to be a tax as defined by the Productivity Commission.



housing supply to be less responsive than is desirable. However, in the longer term housing supply is expected to be more elastic than it is in the short run.

These demand and supply conditions combine to see much of the burden of any housing tax fall on the home buyer. The comprehensive general equilibrium modelling completed by the CIE suggests that more than 90 per cent of the welfare loss due to any tax (or in other words, the incidence of the tax) on housing falls on the buyer.

When direct, indirect and hidden taxes are included, the total tax on a new house can be as much as 44 per cent of its purchase price (in the case of Sydney) and repayments on these taxes alone make a call on 33 per cent of a young couple's income.

Conversely, when these taxes are reduced it can have a dramatic impact in terms of decreasing the cost (and hence the price) of a new home. CIE modelling shows how the cost of new dwellings falls as different categories of taxation are removed (see Table 2).

Table 2: Notional impact on cost from removal of taxes — Greenfield housing

Item	Sydney	Melbourne	Brisbane
	\$/dwelling	\$/dwelling	\$/dwelling
Current cost of house to home buyer	639 533	511 202	534 726
Scenario 1: less direct property specific taxes (stamp duty, GST, land tax)	-81 855	-68 521	-60 523
Scenario 2: less ambiguous taxes (excessive part of charges)	-118 637	-72 381	-90 835
Scenario 3: less hidden indirect taxes	-196 524	-114 579	-120 109
Scenario 4: less generic taxes	-267 916	-180 250	-189 159
Notional post-sale cost of dwelling	371 617	330 952	345 567

Data source: TheCIE 2011. Note, numbers may not match precisely with estimates in table 3.3 due to sequencing of taxes

Inefficient and excessive taxation of new housing therefore exerts a direct negative impact on housing affordability and causes significant losses which detract from overall national welfare.

4. Reform of Federalism/ state taxation

The states and territories rely too heavily on taxing property

It can be clearly demonstrated, as outlined in the previous section, that many state taxes (the topic of Session Four of the Tax Forum) are inefficient.

From a housing perspective, there is a range of measures available to the Commonwealth Government to address declining housing affordability. Fundamentally, however, sustainable and long-term restoration of housing affordability involves reform to Commonwealth-State financial relations. Despite the introduction of the GST, the states and territories, regrettably, continue to rely on a large number of narrowly-based and highly distorting taxes for their revenue collection. In particular, the states and territories rely too heavily on property taxes.

A heavy reliance from all three tiers of government on residential property for taxation has caused property taxes to grow rapidly. Local government revenue from levies on new developments and also from property rates have also escalated at a fast pace. Moreover, this substantial increase in the reliance of state and local governments on revenue from residential property has been most prevalent in respect of new residential development. Unfortunately, because taxes “down the line” (eg. the GST) cascade on top of these state and local government taxes, they are a primary cause of economic loss.

The state and territory taxes applied to housing generally fail badly on the key principles of good tax policy – simplicity, certainty, equity, neutrality, and efficiency. Part of the inefficiency of these taxes stems from the differing treatments which occur across state borders. The upside to this situation is that the removal of these taxes holds the promise of significant economic gains.

The complicated distribution of GST revenues and Commonwealth Special Purpose Payments has resulted in considerable inequity and inefficiency among the three tiers of government. Systematic reform would yield a more effective incentive system for a more efficient tax base across levels of government, including the level of government that necessarily resides at the heart of such reform, namely state governments.



One option for reform involves the states and territories receiving directly, a percentage of income tax revenue while forfeiting the complicated and at times less than transparent allocation of revenue through Commonwealth Special Purpose Payments.

It is a long-standing principle that the level of government providing a service or function should also have direct responsibility for the raising of tax revenues. A revised income tax distribution model would help ensure that equity is restored to the distribution of tax revenue. Such a model may see income tax revenue apportioned on the basis of labour force participation, population, and economic growth.

In addition to reform of the tax distribution among the states and territories, there is a seemingly never-ending list of state and territory taxes that need to be rationalised. In the first instance, targeting the largest and most inefficient (and hence the most distorting) taxes for removal would be a prudent approach.

Two prominent examples of inefficient or excessive taxes on new housing are stamp duty on residential conveyances and excessive infrastructure charges levied on new residential developments.

Stamp duty

It is well established within the economics literature that stamp duties represent one of the most inefficient of taxes. The AFTS reports that conveyancing stamp duties have a marginal welfare loss of around 35 cents for each additional dollar of revenue they raise. At a total residential stamp duty collection of around \$12 billion per annum, this means \$4.2 billion is lost annually due simply to inefficiency.

If this same amount (\$12 billion) were instead gathered via an increase in the GST then the welfare loss would shrink to less than \$1 billion, and if collected under a petroleum resource rent tax the loss would be close to zero. This means that almost \$200 per Australian per year could be enjoyed by replacing stamp duty with a broader-based tax – and over time this annual benefit would grow.

Turning to the practicalities of how to remove this particularly inefficient tax, there is no easy manner in which to replace stamp duties on property conveyances. It is likely that transitional costs would be incurred which reinforces the importance of reforming Federal-State relations (a point we cover in more detail below).

Despite the difficulties, the replacement, or at the very least substantial reduction, of stamp duty is a necessary reform of the Australian tax system. It will require a move to a considerably broader tax, which reinforces the necessity of incorporating consideration of the GST in any comprehensive taxation reform discussion and strategy. A reformed land tax could provide another example of a broad-based tax.

As a transactions cost on housing, stamp duties lock home owners into their existing residences rather than allowing them to, in a relatively costless way, sell their existing residence and purchase another property that is more attune to their needs as life circumstances change (eg. a bigger home as the family grows or a smaller home as the children leave the family home to live independently). In a similar manner, stamp duties act as a constraint on labour mobility. The large transaction costs on buying and selling a home act as a barrier to home owners moving elsewhere to seek better paid employment or, in some cases, moving to gain employment at all.

The OECD has noted that among the OECD nations, Australia has the fourth highest transaction costs on houses at just under 14 per cent of property value.³ The OECD also highlights the problems that high property transaction costs cause in terms of reduced residential and labour mobility, and has advised Australia in a number of reports to undertake reforms in this area.⁴

The existing tax system therefore creates disincentives for Australians to locate to the areas where their skills are most in demand. This is a key example of the current tax system constraining Australia's productivity growth.

Furthermore, stamp duties are not a small tax. Indeed, the states and territories rely heavily upon them as a revenue source. However, the smarter state governments have begun to understand the detrimental impacts stamp duties can have on the efficient use of the housing stock, housing affordability, housing supply, and labour mobility.

These states have undertaken reforms to cut stamp duty rates. For example, the Victorian State Government is already cutting stamp duty rates with an aim to, within four years, halve the rate of stamp duty applied to newly constructed homes purchased by first home buyers. Some other jurisdictions, while less ambitious

³ OECD 2011, Housing and the Economy Chapter in Going for Growth.

⁴ The OECD finds that Belgium has the highest proportional transaction costs at almost 15 per cent of property value while Denmark has the lowest at around three per cent of value.



when it comes to cutting stamp duties, do at least offer some stamp duty discount for first home buyers or for older Australians.

There are consequently examples of state governments that have moved to take some responsibility for taxation reform. However, given the size of remaining stamp duty collections and the large economic distortions and hence lost efficiency they cause, more needs to be done. State governments will, however, remain constrained in the degree of taxation reform they can engage in within the current vertical imbalances evident in Australia's taxation system, and stamp duty provides an example of this situation.

A significant reform to remove or make major reductions in the stamp duties applied to housing could be claimed by a reformist Commonwealth Government and will require a close working relationship between the Commonwealth Government and the states. Indeed, it will require the Commonwealth to assist the states and territories, including by funding any temporary revenue shortfalls, to replace their stamp duties on new homes with more efficient taxes.

Infrastructure charges

A further example of the inefficiency and inequity inherent in the current tax system, and of the requirement for substantial reform of Federal-State financial relations, is the taxation of residential infrastructure.

For new house and land packages, development charges/taxes in excess of \$60,000 are now charged by some local and state governments. These taxes, combined with GST, have added substantially to the cost of new housing and in many areas have stalled new development.

Current arrangements for investment in residential infrastructure often involve financial supplementation in a range of areas with little and, in some instances, no measurement of performance or accountability, or any obligation to improve service delivery.

There is clearly a need for the Federal Government to meet what is a growing requirement for community and economic residential infrastructure. Without this assistance, the reliance of state and local government on development taxes and other charges on residential property will continue. It is these taxes and charges, along with other regulatory inefficiencies, that are inflating new housing costs and stalling development in the new home building sector. These taxes therefore constrain the opportunity for Australians to build a home in a particular area and, as in the case of stamp duty, play a role in inhibiting labour mobility.

Although existing systems of residential infrastructure charging vary from state to state, in the main they are complex, potentially open to rorting, highly inefficient, and act as a considerable constraint on timely new residential development. The systems tend to be based on a quasi-user-pays system and are a leading cause of uncertainty, over-charging, gold-plating, delays, and ultimately additional housing costs.

There is also considerable inequity between the treatment of the cost of infrastructure for new developments (largely borne by the developer) and the treatment of the cost of replacing or refurbishing existing infrastructure (usually spread across the community). Furthermore, discussions over appropriate systems of infrastructure charging often overlook the fact that developers have long paid for, or provided in-kind, a considerable portion of infrastructure for new developments.

The list of charges that state and local governments levy on new homebuyers is extensive and continually expanding. While not an exhaustive list, new home buyers are now expected to pay direct infrastructure charges for water and sewerage 'head works' upgrades and reticulation, and for indirect infrastructure which includes: parkland and open space; the landscaping of streets; drainage systems; road and public transport facilities; pedestrian and cycle paths; libraries and museums; childcare facilities; public pools; and recreation and entertainment facilities.

HIA has no opposition to new developments paying for specific infrastructure which provides essential access and service provision and without which the development could not proceed. This infrastructure is considered to be a core requirement for housing development and should be (and is) legitimately provided by developers and home builders as part of the cost of development. To date, however, there has been little transparency in the calculation of development levies in most jurisdictions and there exists an insufficient nexus between the programmed investment, location of the investment, and the benefit derived by the broader community, relative to where and who this revenue is collected from.

The reliance on upfront development charges for infrastructure and services that used to be considered the normal responsibility of government appears to be a consequence of insufficient overall state and local government funding to meet these liabilities.

A crude assessment of the decline in housing affordability and growth in property taxes would simply look at the growth in these taxes and declare that state and local governments are the sole cause of the decline in



housing affordability. However, due to the existence of what is now a chronic vertical fiscal imbalance, HIA contends that such a conclusion would be drawn from an assessment of the symptoms rather than the actual cause.

A simple system of infrastructure charging whereby developers pay for listed infrastructure (eg road works within the new development) but do not pay for others (eg. water connections, the costs of which should be spread across all users) needs to be implemented across the nation.

Furthermore, development fees should be collected as needed for infrastructure provision rather than being paid up-front. Revenue raised from these charges needs to be hypothecated – i.e. revenue for infrastructure within a development should be spent on infrastructure in that same development.

A move towards simpler charging systems whereby much of the cost of new residential infrastructure, like the cost of refurbishing or replacing aging infrastructure, is spread across the entire community would overcome the problems inherent in the various charging systems that have long failed the nation. This would simplify charging, provide certainty, create neutrality between providing new and refurbishing/ replacing existing infrastructure, allow more responsive housing supply, and would appropriately recognise the public good characteristics of this vital infrastructure.

5. Personal income tax (Session 1)

The TFPD notes that an important aspect of Australia's personal tax system is how it rewards workforce participation, particularly when interactions with the transfer system are taken into account.

Housing policy reform is an integral part of boosting workforce participation

HIA recognises the obvious importance of this link and also agrees that improving participation is a key challenge for Australia's economy. In the previous section the HIA highlights the large, inhibiting constraint that the current tax treatment of housing imparts on labour mobility and hence workforce participation.

HIA contends that any successful reform implemented to enhance workforce participation through improving the nexus between Australia's personal income tax and transfer systems will require a complementary reform to the large and inefficient taxation of housing.

The aggregate effect of a range of taxes levied on housing, new housing in particular, significantly inhibits labour force mobility and therefore workforce participation. A failure to address this situation would considerably dilute the positive impact on workforce participation any improvement in the nexus between the personal income tax system and transfer payments could deliver in its own right.

Boosting housing supply is a pre-requisite for a more neutral taxation of savings choices

It was noted in the AFTS review, and repeated in the TFDP, that an important pre-condition to considering the prospect of a more neutral taxation of savings choices would require, in the case of housing, improvements to housing assistance and the efficiency of supply.

It is clear that Australia has failed over the last ten years to ensure an environment where real housing supply could have an opportunity to approach a level close to the average annual levels of new home building that underlying demographic (notional) demand imply are required.

It is well established that Australia has a large and growing dwelling shortage. The Federal Government's own National Housing Supply Council (NHSC) estimates a shortage of 205,000 dwellings as at June 2010, the Reserve Bank of Australia has estimated annual shortages of around 40,000 dwellings, and HIA's own research suggests a 220,000 dwelling shortfall as at June 2011. A range of industry analysis has produced estimates of Australia's housing shortages of a similar magnitude.⁵

Furthermore, with the annual underlying demand for housing continually outstripping yearly dwelling completions by figures in the tens of thousands, the cumulative housing shortage will continue to worsen. HIA's own research suggests that, in the absence of reforms to increase housing supply, Australia could face a dwelling shortage of half a million homes by 2020.

The nation's chronic housing shortage was one underlying driver of escalating dwelling prices and rents over much of the last decade. Notwithstanding small improvements in affordability in recent quarters (due largely to a modest softening of dwelling prices), over the longer term affordability has been trending downwards. It now takes approximately 1.8 times the average weekly ordinary time earnings for an adult working full time

⁵ See for example work by Goldman Sachs, Westpac, BIS Shrapnel and the ANZ Bank.



to affordably meet the mortgage repayments on a median priced home in Australia, which is up from 1.15 times in the late 1990s. Furthermore, it takes over 1.9 times the average weekly earnings in Australia's two largest cities.

There is a substantial amount of progress required to create a policy environment where new dwelling supply can sustainably approach the levels of annual underlying demographic demand. The AFTS review was correct to highlight that any move to a more neutral taxation of savings choices would require, in the case of housing, improvements to housing assistance and the efficiency of supply to occur first.

Negative gearing tax treatment is positive for housing supply

Attacks are routinely, and usually incorrectly, made on some current housing policies, primarily negative gearing, Capital Gains Tax (CGT), and the First Home Owner Grant (FHOG).

Negative gearing for residential property is an example of a policy that is often singled out as a tax reform target. Unfortunately, the importance that the current treatment has in terms of enhancing the supply of housing for the rental market, and also for bolstering the savings of middle Australia, is often overlooked.

The existing negative gearing provisions are an important feature required to underpin investment in housing. On a pure tax basis, rental income is assessable and it is entirely appropriate that rental outgoings are deductible. HIA welcomes the Government's commitments, as outlined in the TFDP, to retain the existing negative gearing arrangements for residential property and to also stand behind the importance of the principle residence to Australians.

In the period between August 1985 and September 1987 negative gearing was quarantined and investors had to carry forward losses. Rental investment declined in this period and there was a consequent upward pressure on rents. As a result, the then Federal government reinstated negative gearing after September 1987.

It is also important to note that it is not the wealthy that benefit from negative gearing – the vast majority of taxpayers accessing negative gearing deductions are middle income earners.

Both CGT and negative gearing cover the majority of asset classes, including property, and it is unfortunate that investment in housing is often singled out in criticism of negative gearing. Contrary to popular belief, and often misrepresented by analysts opposed to negative gearing, many other countries allow negative gearing. For example, full negative gearing is available in Canada, Japan, New Zealand, and Sweden, while partial negative gearing is allowed in France and Germany.

6. Transfer payments (Session 2)

Effective integration of the tax and transfer system

HIA supports the Government's strategy, outlined in the TFDP, to place a stronger emphasis on ensuring transfer payments are delivered with the right incentives, obligations and services to encourage Australians to develop skills to help them get a job and make sure their children are getting the best start in life.

It is also noted in the TFDP that it is important that the tax and transfer system remains relevant in the face of economic, demographic and social change.

Ensuring that affordable housing is readily accessible to all Australians is a vital ingredient in delivering an effective transfer payment system which complements and enhances the tax system.

One example relates to people earning income post-retirement. The TFDP notes that larger numbers of mature age people and people with a partial capacity to work might take advantage of growing opportunities for part-time and casual work if the system created incentives more suited to their circumstances.

One of the considerable barriers to employment for mature age people is, again, the disincentive to moving home that is created by the high stamp duty levied on residential property transactions. In other words, the labour mobility of mature age people is reduced. HIA concurs with the observation made in the TDFP that in the future there are likely to be more people earning some income post-retirement, and the tax and transfer system will need to take this into account. Ensuring people have a greater freedom of housing choice by removing inefficient transaction costs such as stamp duty on residential property conveyances is integral to ensuring the tax and transfer system does successfully accommodate this post-retirement future.

Boosting public and social housing supply

As outlined in the Discussion Paper, the AFTS review recommended that housing assistance be more integrated into the income support system. The review argued that greater integration would allow for a better direction of assistance to recipients based on their needs and means, and would encourage the provision of social housing that is of value to tenants. HIA concurs with this view.

The National Rental Affordability Scheme (NRAS) is an existing policy that provides incentive for an increased stock of affordable rental properties. The NRAS provides an existing policy framework that can boost the stock of social housing. As such this is a program that has the capacity to encourage the provision of social housing that is of value to tenants.

More generally, reducing the overall cost base for new housing would allow for a greater provision of social housing by the private sector, enhancing the efficiency of supply. In this regard the reduction or elimination of the range of inefficient taxes on new housing outlined in Section Four would allow for a larger, more efficient social housing stock.

As has previously been noted, reducing the large inefficiencies inherent in the taxation of new housing would also improve labour mobility and therefore workforce participation. This benefit would naturally extend to public and social housing as well as to the private housing market.

7. Business tax (Session 3) and Tax system governance (Session 6)

The compliance cost for small business is too high

Small business plays a vital role in the Australian economy.

The vast majority of businesses involved in the residential building industry are small businesses. One of the principal constraints facing small businesses within the residential building industry has been the considerable increase in compliance costs over the last decade in particular.

The residential building industry is inherently a dynamic, highly productive, and very efficient industry within the Australian economy. The effective and efficient performance of the industry is externally hindered by the inefficient taxation of new housing in particular, as outlined in Section Four above, and by the increasingly onerous compliance burden which adds excessive cost to small business operations.

The raising of revenue through taxation must be done as efficiently as possible, both in an economic and an administrative sense. The inefficient collection and administration of taxes distorts economic decision making. Furthermore, the increasing complexity and volume of Australia's taxation law represents an ongoing burden for all Australian businesses, including those in the residential building industry.

Resources devoted to compliance within an unnecessarily complex tax system could be employed much more productively. HIA supports measures that result in the minimisation by all levels of government of these costs. An essential component of this approach is a substantial rationalising of the large number of existing taxes, along with an overall movement towards simplifying the taxation legislation and compliance processes. Small businesses cannot take advantage of economies of scale which means that taxation complexity and its resulting compliance burden falls disproportionately upon them. In other words, as taxation complexity increases small businesses are increasingly disadvantaged relative to larger businesses.

The need for simplification also forms part of tax system governance (Session Six of the Tax Forum) reform.

HIA supports Government endeavours to make it easier for businesses to meet their obligations to governments through standardised business reporting (part of the Government's reform agenda outlined in Session Six of the TFDP). This section of the TFDP notes that technological advances may make it possible to provide individual Australians with a simpler picture about how the system affects them. Such technological advances for small business could obviously reduce compliance costs and therefore boost productivity.

Returning to Session Four, the HIA supports much of what the AFTS review favoured in terms of business taxation. Clearly the HIA supports, for example, a reconsideration of tax depreciation arrangements and some streamlining of depreciation for low value assets. This is especially the case for small business - it would be appropriate, for example, to allow the immediate write-off of assets of a value less than \$10,000 by small businesses, a recommendation of AFTS.



Overall, however, what is required to ensure the sustained success of small business operations is a simpler and more coherent tax system.

The removal of stamp duties on business conveyances is an obvious example of a reform that would reduce cost and boost small business efficiency.

The simplification of complicated tax rate scales to a single rate structure where possible would be another positive reform.

One vital component of the inherent efficiency of the residential construction industry is its reliance on sub-contract labour in the construction of new homes and renovation of existing dwellings. Recent moves by the Australian Taxation Office (ATO) to audit labour records of businesses within the new home building sector provides an example of an increased compliance burden which reduces the efficient operation of the sector.

The Taxation Treatment of Personal Services Income

As part of the GST package of Federal tax changes in 2000, new ‘Alienation of Personal Services Income’ (APSI) legislation was introduced. These new APSI rules were based on recommendations from the Ralph Review and stated that a contractor would be taxed as an employee unless the contractor could meet certain tests.

While the ATO considered these tests to be appropriate tests of running a separate business, the tests were widely felt by industry to be too restrictive. The Government of the day sat down with industry, including HIA, and came up with revised, workable APSI rules. As a result of considerable public pressure and in recognition of the flaws in the Ralph recommendations, changes were made in 2001 to recognise as a personal services business for tax purposes anyone who:

- worked to produce a result;
- provided all their own necessary tools and equipment; and
- were responsible to fix defects at their own expense.

This ‘results test’ was much more in line with the common law test of who is a contractor.

In a 2009 report the Board of Taxation found that the APSI rules had improved ‘integrity and equity’ in the taxation system, but was critical of the current system. The Board suggested dropping the ‘Results Test’ and returning to the recommendations of the Ralph Report, without recognising that it was as a result of the very unfavourable public reaction to the original test that saw a workable amendment constructed.

The Government referred the Board of Taxation Report to AFTS, which was critical of elements of the current rules, finding that:

- ‘Current rules limit, but do not eliminate, the scope for the alienation or assignment of an individual’s earned income to other people or legal entities. These rules are not fully effective, and are complex and uncertain.’⁶
- ‘A major failing with the current approach is that it attempts to distinguish between personal services income arising in employee-like cases and other personal services income, when in either case alienation or income splitting is inconsistent with the choice of the individual as the unit of taxation and with progressive income tax rates.’⁷

This second comment may be related to the fact that unions for many years have attempted to use a tax argument to bolster their attack on the use of small business contractors rather than unionised employees in the performance of work in many industries. There is no doubt that union claims of ‘sham contracting’ have muddied the waters in what should be a debate about taxation policy.

The AFTS Inquiry recommended that –

‘Consideration should be given to a revised regime to prevent the alienation of personal services income that would extend to all entities earning a significant proportion of their business income from the personal services of their owner-managers, whether in employee-like or non-employee-like cases. This regime may also apply an arm’s length rule to deductions arising from payments to associates to ensure deductions reflect the value of services provided.’⁸

⁶ Vol 2 p.51

⁷ Vol 2 p.52

⁸ *Ibid.*



HIA opposes this recommendation. HIA considers that the Report by the Board of Taxation, and the Recommendation by the AFTS, both took a big business' approach which represent a fundamental failure on their part to either understand or accept how individual contracting works.

Contracting has long been recognised as a perfectly legitimate method for undertaking work in the Australian economy as an alternative to using employees. The Independent Contractors Act 2006, which had bipartisan support in the Parliament, gave statutory recognition to this. Small business, and especially contracting, is the generator of most employment in the Australian economy and is the nursery of tomorrow's large successful enterprises.

Under this system, contractors provide their personal services to achieve work outcomes. They are small business persons who work for profit and value their independence. Their work ethic and flexibility means they are highly cost-effective and reliable. They do not cease to be a business merely because they do not derive most of their income from a business structure. They should not be prevented from paying a salary for services performed for that business, or prevented from accessing business tax deductions, merely because their business is not a large business.

Implementation of the Report's proposals would disadvantage the thousands of Australian individual tradespersons who work for themselves as subcontractors, particularly in the residential building industry. Housing critically depends on contracting to achieve current levels of affordability. Given that, on average, government taxes and charges already comprise over 40 per cent of the price of a new home, further changes to taxation that would reduce the use of contractors and increase effective tax rates for workers in the industry would not be helpful to housing affordability.

HIA considers that the current tax law in this area is working satisfactorily and the heavy-handed proposals to deny small business access to legitimate business tax deductions are unjustified and out of touch with the reality of life for hundreds of thousands of small business persons across Australia.

8. Environmental taxes (Session 5)

Carbon tax

The carbon tax would represent yet another tax on housing. If introduced, the carbon tax will be pervasive, will achieve little in the absence of a global agreement on carbon emission reductions, will cost jobs, and will decrease Australia's competitiveness and manufacturing capacity. Although compensation in the early stage of the carbon tax will ameliorate some of the impact there will be cost increases on the inputs to housing, not least of all many of the primary materials including brick, glass and ceramics. As the carbon tax compensation is phased out, and in the (likely) event that the carbon price rises, these impacts on the cost of a new home will become substantial.

In the first instance the Government should halt its plans to introduce a carbon tax until such time that a binding global agreement is reached on carbon emissions levels. However, should the Government successfully continue down its current path towards a carbon tax then the myriad of existing "direct" emissions-related measures, particularly those that have an impact on the cost of essentials such as housing, must be removed. This includes the removal of direct regulations such as minimum energy efficiency standards for housing, and for appliances, which when excessively applied (as is the existing case) constitute a tax.

Were there to be a system based on price signals implemented, then duplication through the existence of regulatory standards as well would unnecessarily distort markets, be highly inefficient, and cause increased housing construction costs. Under a carbon tax direct measures will be duplicative and will unnecessarily add complexity and cost.

For example, work done by the CIE in 2010 found that: the taxation component of moving beyond the economically efficient energy efficiency star rating can pose a substantial cost on a new home; and that current minimum energy efficiency requirements for new homes are likely to be at, or already past, the optimal level in most areas. Averaging the results for each housing type, movement above the optimal energy efficiency rating by one star poses an:

- average net cost of \$35.56 per square metre in Sydney;
- average net cost of \$43.22 per square metre in Melbourne; and
- average net cost of \$45.76 per square metre in Brisbane.



This means each additional star rating adds between \$9,500 and \$11,600 to the cost of a new home as per Table 3.

Table 3: Potential impact of moving above optimal star rating

	Units	Sydney	Melbourne	Brisbane
▪ Average floor area	▪ m2	▪ 270	▪ 253	▪ 254
▪ Cost related to energy efficiency standards	▪ \$/m2	▪ -35.56	▪ -43.22	▪ -45.76
	▪ A\$ per			
▪ Potential cost per new house	house	▪ -9 583	▪ -10 926	▪ -11 609

HIA is of the view that:

- the Government's current plans to introduce a carbon tax should be suspended until a binding global agreement on carbon emissions is reached; and
- if the Government does push ahead with a carbon tax then it must move quickly to remove direct measures, including minimum energy efficiency standards of buildings and appliances, which unnecessarily add to housing costs and which through duplication create avoidable inefficiencies.

Congestion tax and heavy vehicle road use charges

A congestion tax would contradict recent trends in urban planning strategies which appear to support increasing the dwelling density in city centres and along major transport corridors. It would make no sense to be increasing population density and then levying a congestion tax to try and undo the consequences of that congestion. Moreover, the price of car parking already acts as a pricing signal in heavily congested areas.

A congestion tax would:

- Add to construction costs in the areas where the congestion tax is levied, which will usually mean CBDs where there is a large amount of construction;
- Would simply represent yet another tax when an important goal of tax reform should be rationalising and removing existing taxes; and
- As noted in the TFDP, taxes can have unintended consequences. Accordingly, the levying of taxes should be aimed at raising revenue in the most efficient manner possible rather than being used to target other goals in specific areas, whether they be environmental or societal.

While there may be a purist economic argument to move existing road user charging towards being commensurate with the impact users have on the condition and upkeep of particular roads, the reality is such charges would add further complexity, add costs to the transport of goods (including building inputs) in a country where transport distances and resultant costs are already large, and would likely have a range of unintended consequences. Furthermore, all roads have strong public good characteristics and Australia should be moving away from a user-pays system on essential infrastructure. The HIA does not support a congestion tax or any increase in aggregate heavy vehicle road user charging.

Other taxes aimed at environmental impacts

Again, taxes are best used to collect revenue and the primary goal should be to do so in the most efficient manner available. Individual taxes which try to capture or modify certain behaviours by discrete sections of the community are generally poorly set, usually have unintended consequences, and merely add to complexity and the overall number of taxes. In the absence of a very compelling case, with substantial and demonstrated net economic benefit, these types of taxes should be avoided.

9. The FHOG should be reformed to create savings and to better target housing supply

In July 2000 the then government introduced the first home owners grant (FHOG) to compensate for the effects of the GST on house prices. Unfortunately the FHOG was applied to purchases of both new and existing dwellings, despite GST not applying to existing dwellings.

At the time of the introduction of the GST the net additional impact of the GST on the cost of an average new home was \$14,000. Today the impact is closer to \$30,000 on a median priced new house and land package.

The Senate Select Committee Report: *A Good House is Hard to Find: Housing Affordability in Australia* noted that there were solid grounds to consider amendments to the FHOG.

*“The FHOG would contribute more to improving housing affordability if it provided an incentive to increase the supply of houses rather than just increasing demand for them”.*⁹

Two reforms are essential in this area. Firstly, FHOG’s for existing properties should be reduced or removed. Secondly, in recognition that the current FHOG level of \$7,000 is inadequate, the grant to new home buyers should be lifted to \$15,000 in regional areas and \$21,000 in the capital cities.

There is no disputing that these grants for new housing work – and they have an important role to play in terms of helping first home buyers overcome the initial capital constraint they face in terms of trying to access the housing market. If targeted at new houses then a grant of decent size has the power to result in a marked increase in Australia’s housing stock, and, converse to claims the grant may simply push up prices, by boosting supply will actually take pressure off prices. HIA considers the use of grants for existing properties to be poor policy.

10. Large gains are possible from replacing inefficient housing taxes with a broad-based approach

CIE modelling indicates that, as an example, if the most inefficient taxes on housing, which include stamp duties and the excessive portion of infrastructure charges, were replaced by a broad-based tax such as an increase in the GST rate, then GDP growth could be increased by up to 1.6 per cent (or \$18.7 billion).

Needless to say removing current distortions and inefficiency in the pattern of production and consumption in the economy that is biased against housing would boost supply and consumption of new housing.

In proportional terms, a \$500 million cut in stamp duty and other taxes on capital in the residential construction sector is estimated to infer a \$738 million benefit to house buyers and up to \$51 million to producers (builders) – see Table 4. This is another example showing the extent of inefficiency that arises from the levying of stamp duties (and conversely gives an indication of the kind of economic gains that may be had from the reduction or removal of these duties).

Table 4: Benefits to consumers and producers from a \$500 million tax cut.

Simulation	Construction		Dwellings		Overall in housing	
	Gain to consumers	Gain to producers	Gain to consumers	Gain to producers	Gain to consumers	Gain to producers
	\$m	\$m	\$m	\$m	\$m	\$m
Stamp duty	531	37 ~ 51	207	95 ~ 167	738	37 ~ 51

Source: Estimates by TheCIE based on CIE-REGIONS simulations.

⁹ Select Committee on Housing Affordability: *A Good House is Hard to Find: Housing Affordability in Australia*, June 2008.