

OPINION: HANDS OFF HOUSING

1 March 2011

For Australia's housing industry, 2011 is shaping up to be a big year in terms of battles on the policy front, says HIA Senior Economist Andrew Harvey.

In 2011, the housing industry can expect to tackle issues relating to 'sham contracting', concerns over the lack of progress on government attempts to reform the supply side of the housing market, and worries over a Federal Government that does not have a dedicated housing ministry and has now begun to wind back important housing-related programs.

Unfortunately these programs include the National Rental Affordability Scheme and the Building Better Cities program, which was an election promise no less! And somewhere amongst the activity on these fronts, the Federal Government has promised to hold a Taxation Summit that could have dramatic consequences for our industry.

In a deal to secure the support of the independents, Rob Oakeshott and Tony Windsor, Labor promised that a tax summit would be held prior to June 2011 to consider all 138 recommendations of the Henry tax review. The Treasurer confirmed that all of the Henry recommendations would be up for discussion including those which the Government had explicitly ruled out in the past. A number of Henry's recommendations, if adopted, would alter markedly the incentives relating to both owner-occupier and investor housing, and also would impact on those operating in the building industry.

Among the Henry recommendations that could have major implications for the housing industry are changes to negative gearing and capital gains tax (CGT); recommendations relating to stamp duty and land tax; and potential changes to payroll tax. The risk for the housing industry is that we are often seen as the golden goose – with all levels of government tapping into housing as an easy revenue source. Unfortunately, the goose is ill and has had enough! It's time for the Government to recognize just how heavily new housing is taxed in Australia, from local council gouging of developer charges, through stamp duties levied by state and territory governments, to collection of the GST by the Commonwealth Government.

There's no doubting that tax reform is important to ensure that the Australian economy is flexible. Our growth relies on investment, productivity and participation, all of which are influenced strongly by tax settings. It is important that the Government acts to ensure that Australia has a tax system which helps foster an economy which is outward-looking, productive and efficient.

However, it is imperative that this time stakeholders, including Australia's residential building industry, are taken along as partners in the tax reform journey. It could be said this did not occur in the context of the Government's original response to the Henry Review.

Unfortunately, the hope that this might occur grows dimmer by the day. To date there has been a complete absence of information from the Government on the timing, potential invitees or the structure of the tax summit. Moreover, there is (quite understandably) real scepticism in many quarters over whether a government with such a tenuous grip on power can really implement serious taxation reform. And if it does implement major taxation changes, how compromised will they be?

The challenge for the housing industry will be to ensure that we do not have to endure any further taxation burden and, if the Government is serious about reform, that steps are taken to stop the unfair treatment of new housing relative to the treatment of existing property.

Perhaps it is the CGT and negative gearing changes recommended by Henry that could do most harm to our industry. Henry proposes that the current 50 per cent CGT discount be replaced with a 40 per cent savings discount for capital gains, meaning in essence that gains will be taxed more heavily. And when it comes to negative gearing, Henry suggests changes that in effect mean that only 40 per cent of the income on rental properties is taxed, but also only 40 per cent of the outgoings are allowable as deductions. This will severely disadvantage those 80 per cent or so of housing investors that have a negatively geared property (although it will aid positively-geared investors). For a heavily-geared property worth around \$500,000 this proposal alone could wipe as much as \$25,000 off the worth of an investment property in present value terms.

Because of the significant changes to incentives that would flow from the negative gearing and capital gains recommendations, these two proposals constitute very large risks for the housing industry. It should come as no surprise that these tax treatments remained untouched by the Rudd Government, particularly in an election year.

Looking back to 1985, Treasurer Paul Keating attempted to alter negative gearing arrangements by replacing the policy with a system that offset net losses against future profits. The result was a significant decline in investment in property, and with no introduction of new rental stock, rental rates shot upwards. Two years later that policy was wound back.

Further, with Australia being largely reliant on private investors to introduce new rental stock, the resulting reduction in new rental supply that would result from a downturn in investment would be fuel to the fire of an already undersupplied rental market. This point was not lost on the Henry Review authors who themselves noted the potential negative impact of the proposed changes on housing supply in the shorter term. Unfortunately, little of substance has been done post-Henry to remedy Australia's unresponsive housing supply.

Henry's recommendation that stamp duties should be removed and replaced by a broader-based tax (possibly land tax) is a sensible one. Studies show that the removal of stamp duty could increase annual housing turnover by as much as 40 per cent – that is, Australians would be freer to buy and sell property to suit their changing life circumstances.

Stamp duty is a very inefficient tax, a cost on transactions that stops the efficient use of our housing stock (including inhibiting churn in existing property thereby constraining new home building activity by trade-up buyers) and which acts to inhibit labour mobility. The OECD has recently found that Australia has the fourth highest transaction costs on real estate in the developed world – a situation that must change.

Removing stamp duties is a decision that any government, state or federal, will not make lightly considering that stamp duty makes up around one third of state government property taxes, which in turn comprise just under half of the entire state government revenue base. Given the potential funding shortfall in the short term (as land tax or some other revenue measure is put in place to offset the loss of revenue) and the political complexities, the Commonwealth Government cannot leave this issue to state and territory governments (as it tried to do in its original response to Henry).

The Commonwealth Government needs to provide a commitment to helping the states and territories to remove stamp duties, with removal of duties on new housing being the first port of call.

While there has been pressure from some quarters to include the GST among the items to be considered at the taxation summit, in January this year the Gillard Government ruled out any changes to the GST. In one sense this is unfortunate as serious Commonwealth-State relations reform can't really be undertaken without consideration of the GST. On the other hand, any hike to the GST rate (in the absence of very substantial trade-offs) would seriously harm the residential building industry (and potential new-home buyers) so perhaps its absence from the summit deliberations is not the end of the world.

Of course if the GST were included, the HIA would argue that as a staple of life, new housing should be made exempt as is currently the case for fresh food, some medical services and education. The fact that the GST is one of many taxes that put new housing at a considerable disadvantage to existing property would need to be a topic of considerable discussion.

A number of industry organisations voiced disappointment when the GST was excluded from the Henry Review and some continue to push for the present exemptions on certain goods and services to be ended so that all goods and services are subject to the tax. This approach often accompanies a call to increase the GST as a trade-off for lower personal tax rates and lower company rates. Comparisons have been made with New Zealand where the GST has risen from 10 to 12.5 per cent, and then to 15 per cent in October 2010. Elsewhere, on 4 January 2011, Britain lifted its GST (VAT) rate from 17.5 per cent to 20 per cent.

With Australia's GST serving to provide a stable and growing revenue source, no government (state or Federal) will have an appetite to cut the GST rate. Conversely, any hike in the rate would be politically untenable – particularly for a Government that has just endured a 'near-death experience' to reclaim the leadership reins, and which has stated that it 'has absolutely no plans to raise the GST.

Any attempt to change the GST regime is further complicated by the need for unanimous support from the jurisdictions, which is hard at the best of times, but near impossible given recent moves to Liberal governments in a number of jurisdictions. Minor changes in terms of GST coverage may be possible (particularly as state and territory agreement is not needed) – but on balance it is highly likely that the GST will remain off limits regardless of pressure from any particular quarter.

Due to the massive implications for our industry, the large taxation burden already imposed on housing, and the inequitable taxation treatment of new housing, HIA Economics is analysing the more important recommendations from the Henry Review to determine the potential impacts and what trade-offs, if any, might be acceptable from an industry point of view (noting that there will always be winners and losers).

HIA will continue to be strongly involved in the public debate over what changes to Australia's taxation regime may be sensible and warranted.

Andrew Harvey
Senior Economist
Housing Industry Association