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Submission to Australia's Future Tax System 2009

Name Withheld

This submission applies to Consultation question10.3: Recognising the influence that some taxes and transfers have on the use of housing and residential land, what changes, if any, should be made to ensure the housing stock and residential land are used efficiently?

Recommendation: To more effectively use housing stock and residential land, I recommend that limits be placed on the ability of investors to claim Negative Gearing and a full review of Capital Gains Tax discount on property sale be undertaken with a view to re-instate full CGT on sale of existing property.

In regard to negative gearing, Point 4.57 of the 2008 Senate Housing Affordability report said it best "Millionaires and billionaires should not be able to access it, and you should not be able to access it on your 20th investment property. There should be limits to it."

Summary:

1. Reinstate full Capital Gains Tax (100%) on sale of existing investment property (phase in over say 3 years)
2. Maintain current discount CGT arrangements of 50% discount for sale of investment property that was new construction (this discount continues to apply to shares)
3. Tax deductions (mainly loan interest) on investment property is only to be claimed against income derived from the investment itself (phase out the current arrangement over say 3 years)
4. Remove FHB Grant for existing homes – as recommended by 2008 Senate report Housing Affordability.

The purpose of these measures is to increase productivity within the economy and at the same time reduce unproductive debt in trade of existing assets (housing stock and residential land).

Equity is declared to be central to Treasury's mission and policy advice and benefits the wider community. Equity should exist in practice and not just theory.

Housing represents a large segment of credit in Australia. "Total credit in Australia today is $1.9 trillion. Nearly one trillion of that is housing." (1)

The intrinsic value of a home is its provision of shelter for stable family life – a cornerstone of a long term viability of community and nation.

However, housing over the last decade has degenerated into a colourless speculative industry. This was highlighted in 1999 by a former Treasurer, who stated: "Work for a living and we'll tax you at close to 50 cents in the dollar; speculate and we'll only take 25 cents. Not only that but, as a special deal - while stocks last - we'll pay half your speculating costs." (2)

This speculative mentality is still encouraged by a tax system to this day. The result is has been an unsustainable private debt binge at the cost of productivity and substantial tax revenue losses. One estimate cited in the 2008 Senate Housing Affordability report was in the order of $50 billion per year combined total of capital gains tax arrangements, land tax exemption and negative gearing arrangements.

It is time that something was done about open-ended claims for negative gearing and counter-productive CGT discount on existing property. The ability to claim tax deductions against other than income generated by the investment itself is not conducive to a healthy social economy. Negative gearing and reduced CGT in its current format are a major assault on the equity and fairness of Australia's income tax system.

Taxpayers with higher incomes can extract a larger tax break because they have a higher 'other income'. Also, it does not matter how large the loss is on the passive investment, the whole loss can be used against other income, for example salary. Extrapolate this kind of behaviour onto every taxpayer in the economy and the system would melt down in short order.

As pointed out by the 2008 Senate report Housing Affordability: "the average house price in the capital cities is now equivalent to over seven years of average earnings; up from three in the 1950s to the early 1980s." The report makes it obvious that housing unaffordability is no accident and is, in large part, a function of poorly designed tax rulings.

As an aside, other factors do impact on housing costs, such as irresponsible bank lending, land banking, other taxes and artificially high rate of migration. However, it is the tax treatment of property that is the most obvious elements of the tax system that can be easily amended via tax review.

Australia's tax transfer system does not appropriately deal with property across sectors of the community. Investors and home buyers are treated so differently it is hard to imagine how the word equity can apply.

However, a number of simple changes could be made to the tax system to ensure housing stock and residential land are used efficiently.

Negative gearing gives excessive tax advantage to investors. About ninety percent of investors claim tax concessions associated with negative gearing to not build anything. This neither creates employment in the building industry nor assists in addressing the recent above CPI rent rises. Investors, encouraged into greater debts via embedded advantage in the tax system, must necessarily demand greater rents.

Many countries already *quarantine* negative gearing so that losses in property can only be offset against income derived from that property.

Such a quarantining would encourage growth in the economy and not the present setup where most investment debt sits in existing homes creating nothing. This is a 'fairer' approach than disallowing it altogether, eliminates the temptation to use negative gearing to avoid paying personal income tax, and builds in the expectation of making a profit at some stage from the property, not running at a loss forever in the hope of speculative capital gains outrunning inflation.

Currently, most investors use their ‘extra buying’ power to effectively outbid genuine home buyers at sales and auctions of existing homes. This is what undermines any claim that access to housing is equitable across sectors of the home buying market. Given the recent events associated with debt deleveraging and the Global Financial Crisis it would seem logical to not encourage debt at the expense of productive activity.

Treasury should know by now that negative gearing is widely viewed as little more than a legislated rort. It needs to be quarantined. This has effectively been the recommendation of the last two housing affordability inquiries (2004 Productivity Commission First Home Ownership report and 2008 Senate Housing Affordability report). It is impossible to understand how well resourced Inquiries can clearly point this out, and still nothing is done to address the problem. My hope is that this time around, policy makers can act to close down inequitable facets of the tax system once and for all.

As mentioned earlier, equity is central Treasury's mission and policy advice and benefits the wider community and should exist in practice and not just theory.

One possible set of solutions to address tax leakage for unproductive debt in the housing sector of the economy is listed below:

1. Reinstating full Capital Gains Tax (100%) on sale of existing investment property (phase in over say 3 years)
2. Maintain current discount CGT arrangements of 50% discount for sale of investment property that was new construction (this discount continues to apply to shares)

3. Loan interest on investment property is only to be claimed against income derived from the investment itself (phase out the current arrangement over say 3 years)
4. Remove FHB Grant for existing homes – as recommended by 2008 Senate report Housing Affordability.

Note: I include the removal of FHB Grant for existing homes as it is proven to only encourage greater levels of debt for the borrower. Some claim it should really have been called a Vendor's Grant, and others jokingly refer to it as FHB Bribe, which it is.

The above list forms the basis of my submission. Thank you for your attention, it must at times be difficult to wade through another's thought process. Enjoy yourself a break.

Further Thoughts:

For those who think that the phase out of negative gearing would be the end of real estate as we know it then please consider the following findings of a recent study by Australian Housing and Urban Research Institute 'Understanding what motivates households to become and remain investors in the private rental market.' (Report 130 April 2009)

"Overall the study found that only a small number of investors will be affected by any change to negative gearing rulings."

Cautionary Thoughts:

What is more likely to spell the end of real estate as an investment is the irresponsible lending practices of banks. This could be remedied by a more prudent or strident regulatory oversight by government.

The following excerpt of an essay was written by Martin Armstrong:
'Is It Time To Turn Out The Lights?' (3)

The essay highlights the need for government to get this right and quickly.

The End of Real Estate (excerpt)

The two contracting factors that are conspiring against real estate are (1) the Debt Crisis cutting off available capital to keep the bubble expanding, and more importantly, (2) the collapse in state revenues. The states and municipal districts rely upon property taxes. The greater the mortgage crisis, the greater the foreclosures, and that suspends the tax revenues as well. This causes the collapse in state and local revenues forcing states to raise taxes even higher and this is precisely the combination of a debt crisis that ends societies and has been the destroyer of civilization. When it goes to extremes as it did in Byzantium, it even destroyed capitalism reducing the average worker into a peasant who was forced to sell himself, his family, and future children into servitude just to survive. (end excerpt)

I hope, in regard to above potential situation, that affirmative action can be taken now by government regulation of bank credit issuance - but that is another story. I have just included here because the issues of tax rulings and irresponsible credit issuance are to be treated in conjunction with each other if any lasting solution is to hold.

Thank you on behalf of Name Withheld.

Resources:
1. http://www.pm.gov.au/media/Speech/2009/speech_0762.cfm
2. How tax system egged on property speculation http://smh.com.au/articles/2004/06/28/1088392603764.html
3. Is it time to turn the lights out – Martin Armstrong http://www.contrahour.com/contrahour/2009/03/martin-armstrong-is-it-time-to-turn-out-the-lights.html

Open Convection 24Apr09
http://www.abc.net.au/unleashed/stories/s2551064.htm

Tax Attacks 14Apr09
http://www.abc.net.au/unleashed/stories/s2532177.htm

Australian Housing and Urban Research Institute ‘Understanding what motivates households to become and remain investors in the private rental market.’ (Report 130 April 2009)

2008 Senate report ‘Housing Affordability’ Chapter 4 - Factors influencing the demand for housing
(http://www.aph.gov.au/SEnate/committee/hsa.../report/c04.htm

Productivity Commission First Home Ownership 2004
http://www.pc.gov.au/projects/inquiry/housing