SUBMISSION BY THE

Housing Industry Association

to the

Treasury

on the

Architecture of Australia's tax and transfer system

20 October 2008

CONTENTS

HIA ::
Chris Lamont
Housing Industry Association
79 Constitution Avenue
Campbell ACT 2612
Phone: 02 6245 1300
Email: c.lamont@hia.com.au

1 Introduction

The Housing Industry Association, Australia's largest building industry association, welcomes the opportunity to provide comment on the Australian Treasury paper; *Architecture of Australia's tax and transfer system*.

HIA notes that the primary subject of the review is Australia's tax transfer system. A number of concerns have been expressed by HIA in respect to the efficiency of this system and the consequential impact on the supply of housing and housing affordability.

It is understood that a more detailed consultation process will commence early next year focusing specifically on housing and development related tax issues. In light of this, and the ongoing nature of this review, HIA would like to provide at this point a brief response but looks forward to providing more detailed submission(s) at a later date.

HIA also looks forward to participating in planned consultations with the Australian Government and Treasury to ensure appropriate consideration and detail is afforded to issues concerning residential construction and housing taxation.

2 Government taxes & charges applicable to housing

There are various taxes and subsidies that have an impact on housing demand and house prices. Provided below is a brief summary of the federal taxes and allowances that apply to housing.

2.1 Federal government taxes and charges

2.1.1 Goods and Services Tax (GST)

The GST was introduced on 1 July 2000. GST does not apply to the sale of an established house but is levied on the sale of a newly constructed dwelling.

2.1.2 Capital Gains Tax (CGT)

The current CGT regime was introduced in September 1999, requiring all investors of property and stocks to include 50 per cent of the nominal capital gain in their assessable income. The current CGT regime has generally been considered to be a concessionary arrangement for investors compared to the previous one. However, as some have observed 'when the nominal gain is more than twice the real gain, the new CGT increases the tax liability'.

The effect of the CGT on housing demand and house prices is complex, mostly because property investors focus on the post-tax return of their investment that is determined by the conjunction of the CGT, allowable deductions and the marginal (personal income) tax rates.

2.1.3 Negative Gearing

Investors have been allowed full negative gearing rights throughout the period, except between August 1985 and September 1987 when negative gearing was quarantined and investors had to carry forward losses.

It was observed that rental investment declined in this period and there was consequent upward pressure on rents. As a result, the then government reinstated negative gearing after September 1987.

There has been considerable attention given to the supposed benefits of negative gearing to property investors and the suggested increase in house prices arising from negative gearing. Interestingly none of this attention has highlighted any empirical evidence to support such suggestions.

Draft research by HIA and ACIL Tasman has assessed the impact of negative gearing on house prices as statistically insignificant during the period 1995 – 2005. A far greater contribution to house prices was seen from the introduction of the GST, state and local government development taxes and charges and the halving of CGT on the sale of investment property.

2.1.4 First Home Owners Grant (FHOG)

In the 1970s the Australian government ran a number of grant schemes for first home owners. These schemes were phased out in the early 1980s. However, in July 2000 the then government reintroduced the first home owner's grant to compensate for the effects of GST on house prices.

While the FHOG was intended to offset the impact of the GST on the cost of housing, the GST does not apply to the sale of existing dwellings. By contrast, the net additional impact of the GST on the cost of a then average new house 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*."[1]

2.2 State government and council taxes and charges

Various taxes and charges levied at the State and local government levels can directly affect housing prices or indirectly through the cost of constructing a new dwelling or holding properties. Provided within Attachment 1 is a breakdown of

[1] Select Committee on Housing Affordability: *A Good House Is Hard To Find: Housing Affordability In Australia*, June 2008

these charges on entry level new house and land packages in a number of areas across Australia. In some instances these charges have increased by more than300 per cent over the last ten years.

2.2.1 Conveyancing duty

Conveyancing duty or 'stamp duty' is levied by state governments on the purchase of properties (house and land). Stamp duties are generally calculated as a percentage of house prices above a threshold level so they often increase with increases in house prices (despite adjustment of the threshold).

Stamp duties paid by land developers and home builders, such as on the purchase of raw land, are often incorporated into the final house price paid by the buyer. Stamp duties on the final house price are then paid directly to the government by the buyer, despite the stamp duty collected on earlier transactions in the supply chain.

The expense associated with the amount of stamp duty and GST collected on the sale of raw and developed land are incorporated into the final house and land or apartment price. HIA believes that an input tax credit system is required to eliminate the cascading effect of stamp duty on stamp duty and on other taxes and charges, such as GST, associated with the production of new housing.

2.2.2 State land taxes

State land taxes are paid by property owners based on the value of land held in a single ownership. Some states also levy land taxes on premium value owner-occupied property.

2.2.3 Infrastructure development charges & levies

Infrastructure development charges are levied by many state and local governments on residential development. Local government charges include development contributions for local and district open space, roads, drainage, library services and the like, required by councils, along with water and wastewater infrastructure charges required by water supply authorities. State government levies are intended to be allocated to major transport infrastructure and state and regional road network improvements.

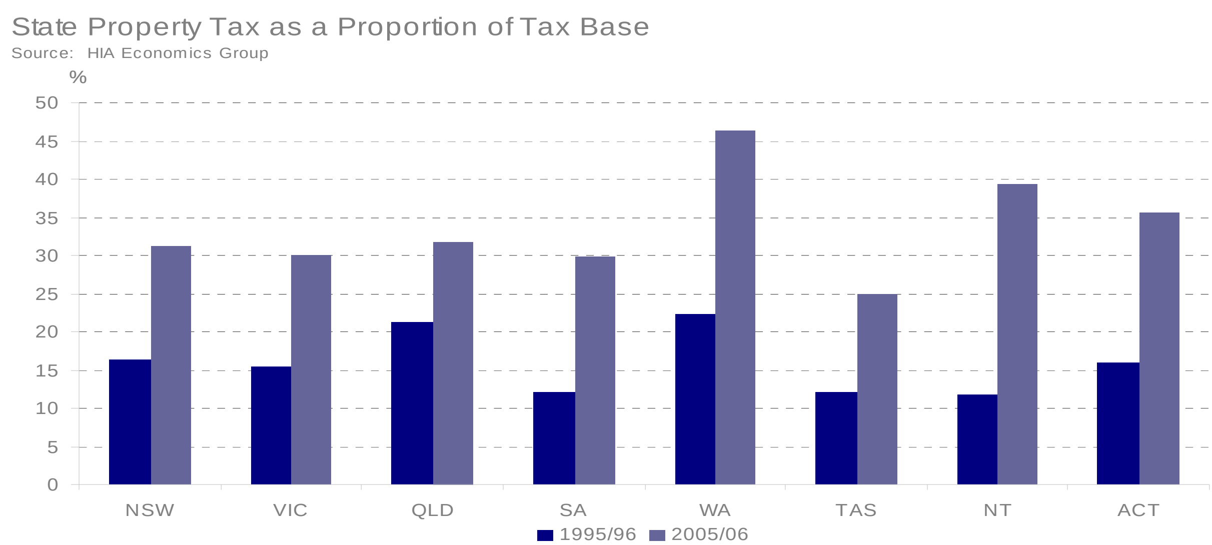
In NSW, for example, these levels of taxes are highest due to development levies introduced in 2002 in the form of a transport levy in four designated greenfield areas, leading to the introduction of a special infrastructure contribution within Sydney's growth centresgc at $33,000 per development lot and major centres of varying percentage rates, up to 3% of the development cost.

3 Growth in taxation on new housing

The most notable 'intervention' in housing markets over the past decade has been a substantial increase in the reliance of state and local governments on revenue from residential property. This has been most prevalent in respect to new residential development.

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. Attachment 1 sets out the total levies on land and housing in capital cities and regional areas within capital cities.

HIA estimates underlying demand to be in the vicinity of 190,000 new dwellings per annum and current supply in the order of 150,000. The consequential effect is what can only be described as 'price churn' for the existing housing stock.



The list of charges 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 that provides essential access and service provision and without which the development could not proceed. This infrastructure is considered to be core requirement for housing development and should be 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 and 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 state and local government funding overall 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 for the decline in housing affordability. However, due to the existence of what is now a chronic vertical fiscal imbalance, such a conclusion would be drawn from an assessment of the symptoms rather than the actual cause(s).

3.1 Impact of vertical fiscal imbalance

There are 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.

One option for reform involves the states and territories receiving direct, 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. The complicated distribution of GST revenues and Commonwealth Special Purpose Payments has resulted in considerable inequity and inefficiency among the three tiers of government.

A revised income tax distribution model would ensure that equity is restored to the allocation of tax revenue. Such a model may see income tax revenue apportioned on the basis of labour force participation, population and economic growth.

Current arrangements often involve financial supplementation in a range of areas with little and, in some instances, no measurement of performance or accountability for investment in infrastructure, 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 urban 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 house costs and stalling development in the residential construction sector.

3.2 Tax definitions for the Review

The review adopts the Australian Bureau of Statistics' ('ABS') definitions of '**tax**', which is '*compulsory, unrequited transfers to the general government sector*', and '**taxation revenue**', which is '*revenue arising from compulsory levies imposed by government*'[2]

In relation to user charges, where users are charged directly for a publicly provided good or service, it is intended to treat them differently '*because those who pay the charge receive a direct benefit that is proportionate to it. However, if the charge is in excess of the cost of providing the service, or unrelated to it, then some portion of it is a tax*'[3].

In respect to new housing construction, there is a need to review the classification of what are termed 'charges' in line with the above definitions. This is particularly the case for the construction of new housing as charges imposed on new developments are increasingly in excess of the cost of providing the service, unrelated to the development or provide a service that extends well beyond that area or section of the community from which the charge is collected. Furthermore, it should be noted that stamp duty and other related taxes are also levied on these charges.

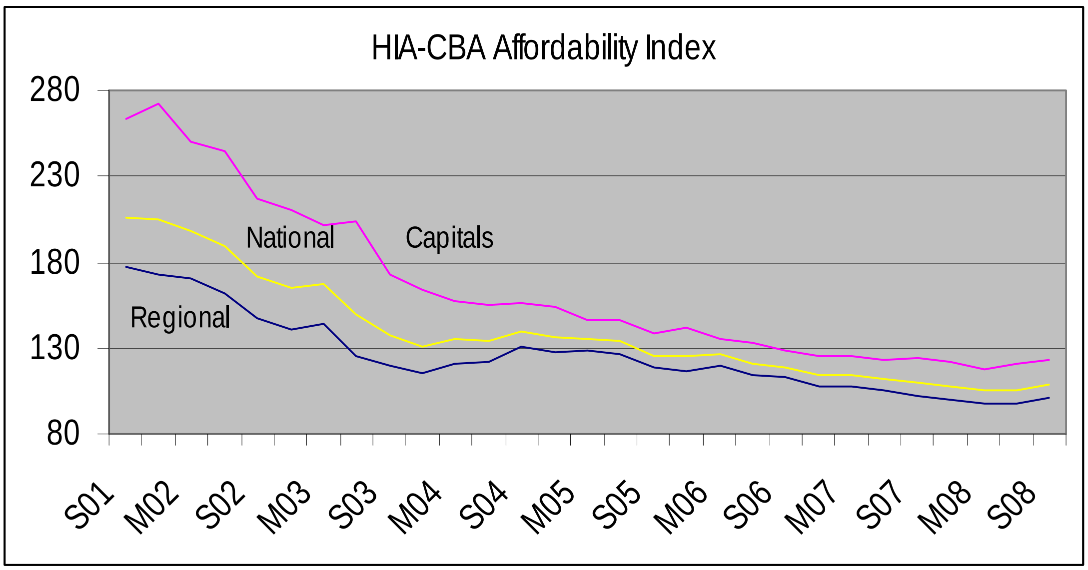
For the sake of uniformity across all jurisdictions, HIA recommends that the meaning of '**tax**' both at common law[4] and as extended by statute[5] should be adopted by the review.

[2] Discussion paper @ page 11.
[3] Ibid, @ page 296
[4] "a compulsory exaction of money by a public authority for public purposes, enforceable by law, and is not a payment for services": *Matthews v Chicory Marketing Board (Vic)* (1938) CLR 263, following *Lower Mainland Dairy Products Sales Adjustment Committee v Crystal Dairy Ltd* (1933) AC 168 @ 175
[5] For example, monetary contributions under s 94 of the Environmental Planning and Assessment Act 1979, *Baulkham Hills Shire Council v Wrights Road Pty Limited* [2007] NSWCA 152

4 Measuring housing affordability

Since 1984, HIA and the Commonwealth Bank have published a barometer of first home ownership affordability, called the Housing Affordability Index. The Housing Affordability Index uses average household income, interest rates and the cost of a typical first home to develop a time series index. At the base level of 100, the amount of household income is just equivalent to the required income. The index measures the impact of interest rate movements against incomes and house prices.

4.1 Yield on investment from private rental market



The Housing Affordability Index shows a significant reduction in housing in the early part of the decade.

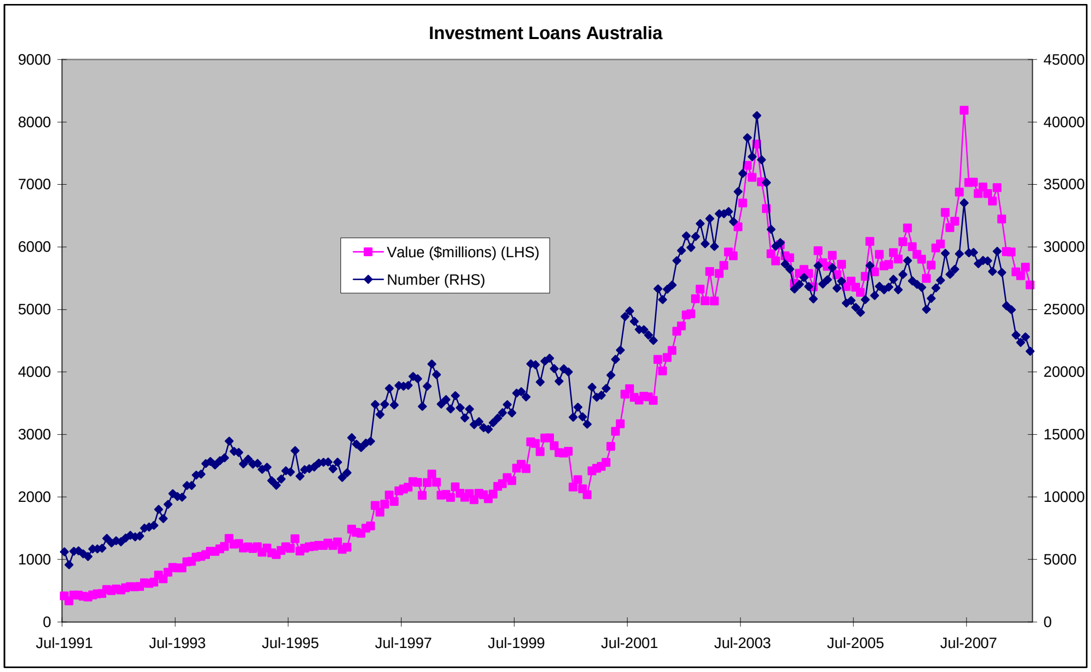
The HIA-Commonwealth Bank Housing Affordability Index for first home buyers improved by 3 per cent over the September quarter this year, but the series remains at near record lows. The index was 1.1 per cent lower when compared to the September 2007 quarter level.

The decline in housing affordability as measured by the index corresponds exactly with the more substantial increases in taxes and charges imposed by local and state governments and administrative and associated delays with the development of serviced land, both infill and greenfield.

4.2 Yield and volume of investment in private rental market

Australia's population is growing at historically high levels. Australia's resident population grew by 332,000 or 1.6 per cent in 2007. Much of the increase in Australia's population was due to record immigration levels, with Australia's net overseas migration intake increasing to 184,000. This number will increase in 2008/09 as the Commonwealth has announced the intention to boost the migration program, announcing a further 37,500 in the permanent immigration program.

Despite a growing population and national vacancy rates n the private residential market in less than 1.5 per cent, investment has not increased in either dollar value or volume in recent times. Conversely, investment in residential sector has declined considerably as shown below.



Source: ABS Housing Finance and HIA estimate of loan numbers

HIA is of the view that the decline in investment has been on account of persistently high and increasing taxes on property and pessimistic expectations in regard to capital gain from this investment.

A measure of gross rental yield for both houses and units is provided below.

Gross Rental Yields: Units

	Mar-08	Dec-07	Mar-07	3 Months % change	12 Months % change
Sydney	5.0%	5.1%	4.9%	-1%	4%
Melbourne	4.7%	4.7%	4.8%	1%	-1%
Brisbane	4.7%	4.7%	4.8%	1%	-1%
Adelaide	5.0%	5.0%	4.9%	2%	2%
Canberra	6.0%	5.8%	6.4%	3%	-6%
Perth	4.5%	4.5%	4.1%	1%	10%
Darwin	5.9%	5.6%	5.1%	5%	14%
Hobart	4.6%	4.9%	5.1%	-6%	-9%
Newcastle	4.5%	4.3%	3.9%	3%	14%
Gold Coast	5.0%	5.0%	4.9%	0%	0%
Sunshine Coast	4.4%	4.4%	4.5%	0%	-2%

Source: Australian Property Monitors

Gross Rental Yields: Houses

	Mar-08	Dec-07	Mar-07	3 Months % change	12 Months % change
Sydney	4.1%	4.1%	4.0%	1%	3%
Melbourne	3.9%	4.1%	4.2%	-3%	-7%
Brisbane	4.5%	4.6%	4.8%	-1%	-5%
Adelaide	4.4%	4.5%	4.7%	-2%	-7%
Canberra	4.7%	4.7%	4.9%	1%	-2%
Perth	3.7%	3.6%	3.2%	4%	16%
Darwin	4.9%	4.7%	5.1%	3%	-4%
Hobart	4.9%	4.9%	5.1%	0%	-3%
Newcastle	4.8%	4.7%	4.5%	3%	7%
Gold Coast	4.3%	4.5%	4.5%	-3%	-3%
Sunshine Coast	4.1%	4.1%	4.1%	1%	2%

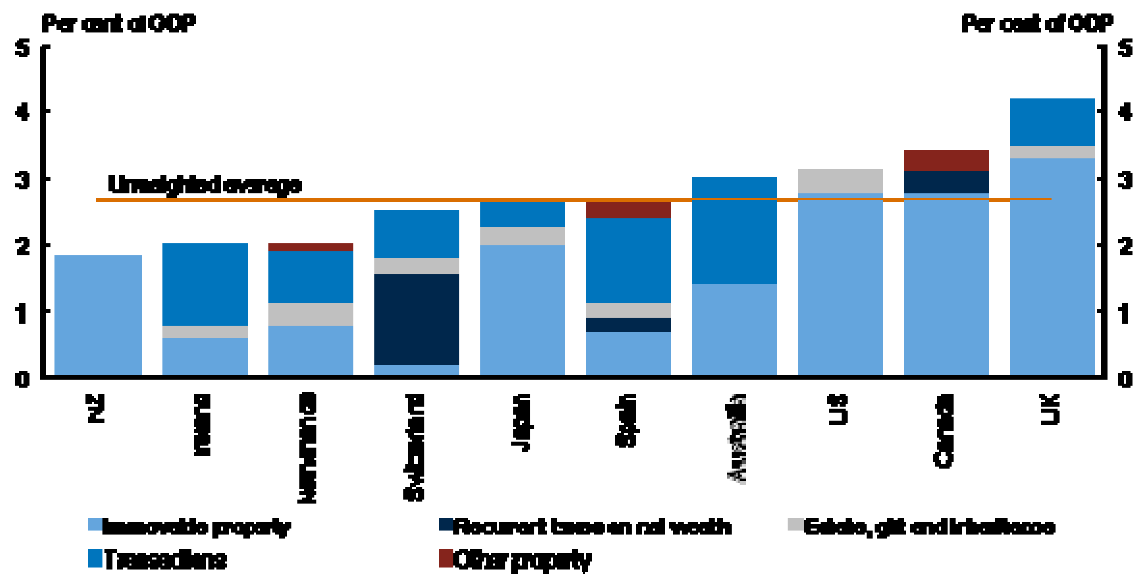
Source: Australian Property Monitors

5 International tax comparison

The disproportionate reliance on tax revenue from property has been identified in a number of previous reviews, most of these, however, have seriously underestimated or failed to examine at all the impact of local, state and federal government taxation on the construction of new housing in isolation.

As identified in the report International Comparison of Australia's Taxes[6] Australia has a comparatively high reliance on property and transaction taxes (3.0 per cent of GDP) and is eighth highest of the OECD-30. In terms of the OECD-10, Australia's overall tax burden in this category is much closer to the unweighted average. Australia is fourth highest in terms of tax burden of the OECD-10 measured as a percentage of GDP (see chart below).

Taxation revenue as a proportion of GDP, ordered by tax burden



Source: OECD *Revenue Statistics*, 2005.

There was no attempt to quantify in this or any other international comparative study to compare the taxes imposed on new residential construction across the OECD. HIA considers that this is something that should be considered by the this review and would be happy to provide further assistance to complete this assessment.

[6] Dick Warburton and Peter Hendy, April 2006

The impact In respect to new housing, the various and ranging taxes applied to the production of new housing stock, whether for owner-occupiers, private or institutional investors, has been a major deterrent for investment providing significant barriers for owner-occupiers and investors alike. The impact of these taxes HIA contends has resulted in house price inflation in Australia's existing housing stock. In addition the cost of adding to the supply of housing faces significant planning, regulatory and tax disincentives which have also added considerable cost pressures. The combination of the above has lead to a serious decline in housing affordability and a chronic shortage of housing in the private rental market.

6 Conclusion

As stated in the introduction HIA looks forward to participating in further consultations on this subject.

In particular, HIA welcomes the opportunity to provide further dialogue on any considerations concerning residential property, particularly as they impact on the supply and construction of new residential accommodation. HIA notes the references made to the proposed introduction of the Carbon Pollution Reduction Scheme (CPRS) HIA has undertaken some preliminary assessments on the impact of CPRS on new house prices and would be happy to discuss this further at the appropriate opportunity

ATTACHMENT 1

Land & Housing Total Costs

	SW Sydney 1	SW Sydney 2	NW Sydney 1	NW Sydney 2	Nth Melbourne	Nth Brisbane	Brisbane Eastside	Western Brisbane	Perth	Adelaide
Total Land Costs*	$312,444	$331,494	$376,850	$382,850	$173,444	$242,895	$260,108	$241,070	$266,376	$86,221
Total House Costs**	$198,150	$218,150	$276,150	$243,150	$170,302	$233,877	$247,615	$298,320	$176,683	$186,253
Total Commonwealth Taxes	$45,650	$45,650	$58,900	$58,900	$30,405	$48,129	$36,757	$44,334	$45,227	$23,190
Total State Taxes Charges	$50,150	$62,950	$60,400	$60,400	$10,966	$9,803	$10,920	$13,506	$9,031	$3,802
Total Council Taxes Charges	$35,600	$50,000	$35,600	$32,000	$9,120	$25,410	$15,000	$15,391	$18,648	$10,315
Total Government Charges	$131,400	$158,600	$154,900	$151,300	$50,491	$83,342	$62,677	$73,231	$72,906	$37,307
Total Move-In Costs	$510,594	$549,644	$653,000	$626,000	$343,746	$476,772	$507,723	$539,390	$443,059	$272,474

*Includes land acquisition, project management, govt. fees & levies, finance & holding costs, selling costs and mark-up

**Includes dwelling costs, govt. fees and levies, finance costs

Source: HIA