

## SUBMISSION TO AUSTRALIA'S FUTURE TAX SYSTEM REVIEW 2008

Policy making, based on the principal of fairness and equity, is the major challenge facing us all. Australia is not exempt.

This submission is limited to highlighting a number of elements of tax policy that have encouraged a trend of speculation and blinkered acquisitiveness within the community. These discriminatory aspects of tax policy have resulted in private debt to income level of 160 percent. One result has been a lack of equitable access to home ownership. The long term fallout is significant for the viability of the community.

The Epilogue of this paper covers the crucial element of fairness.

Specifically, this paper focuses on tax treatment of Loan Interest deductions on residential property debt where a complete lack of horizontal equity between home buyers and investors appears.

Peripheral and connected to tax equity in housing are related elements:

1. negative impact of negative gearing and interest only loan,
2. high tax impost on savings,
3. personal tax threshold atrophy at base level,
4. IG2: planned blunder or the revenue versus costs fantasy.

NB. This paper centres on residential property. Two distinct groups of residential property buyers exist: Home buyers and Investors.

The argument that investors who buy investment properties should be treated differently to home buyers can be put to rest at this point.

Residential property is made up of two sub groups:

1. residential – non income generating, aka a home, and,
2. residential – income generating, aka residential investment.

Housing unaffordability in Australia is no accident. It is the result of deliberate discrimination against home buyers with systemic tax advantage skewed heavily towards investors. Housing will not become affordable until the issue of tax discrimination is addressed.

### Summary

Tax treatment of mortgage loan interest on residential property debt depends on the status of the person or entity taking on the debt. This discrimination flies in the face of Horizontal Equity – a supposed cornerstone of our tax system. Differential tax treatment between home buyers and investors has a profound influence on ease of purchase and debt repayment. The lack of equity of accessibility to Item 20Q – Loan Interest Deduction on mortgage debt, is a prime example of discriminatory tax policy that requires urgent attention.

Bank savings are severely taxed at 50-80% compared to superannuation at minus 100-140% (depends on which report one reads). Surely, the evidence is now in that a savings mentality should be encouraged, not penalised.

Negative gearing and interest only loans have been instrumental in encouraging speculative behaviour associated with the current property bubble. Both are toxic to home ownership, drawn down on Treasury coffers and thereby cut funding of essential infrastructure. Both tax elements have helped turned Australia into a basket-case of debt.

Personal base tax threshold atrophy: Rarely is the base tax threshold increased in line with cpi. This is evidence of a regressive policy

mentality.

Intergenerational Report (IG2) is cost compromised and closer to a fantasy than solution in terms of stabilising Australia's future. Artificial demand created by accelerating migration is both juvenile in conception (pyramidal expansion of spending and credit demands via pyramidal increase of population) and flawed in forward cost benefit estimates. Accelerating migration has been used to deliberately skew housing affordability and rents in favour of those who already have equity.

#### Context

In 1999 the government changed CGT with the stated reasoning that it would 'promote investment in innovative and high growth companies'. However, rather than create business that actually produced something, there was the invasion of the residential property market by investors.

The carrot of tax relief, now about \$450k (\$350k in loan interest deductions alone) per \$300k of loan debt, is all too tempting for investors.

Q: What have investors done with generous tax concessions?

A: About 1 in 12 have invested in new dwellings. The rest of the investors have used systemic tax advantage to outbid genuine home buyers at sales and auctions, effectively disenfranchising the next generation from the prospect of owning a home.

This is a gross injustice and diminishes us as a society. It says we place no value on fairness or the facilitation of a stable family life. Increasing the size of rental portfolios seems to be the preoccupation of government (both Liberal and Labor).

It appears as if new entrants to home ownership are not welcome. Lip service programs such as NRAS, Housing Affordability Scheme and a minimalist special Savings Account are sham solutions rather than application of tax fairness.

Example (1), the NRAS gives institutional investors \$6,000 tax credit plus \$2,000 cash or equivalent incentive per year for 10 years (both indexed to the cpi) to build new dwellings. NRAS assists investors to build bigger rental portfolios. Why was a similar scheme not offered to home buyers to build new properties instead?

Example (2), the \$512M Housing Affordability Scheme, which aims to take \$20,000 off the cost of new homes and ramp up supply, has what chance of success? Has government identified which investors, waiting in the wings, are going to stand back and let genuine home buyers just waltz in and buy a home? Highly subsidizing investors guarantees failure.

None of the above solutions will remove the underlying tax advantage given investors. The tax system screams discrimination against home buyers but it seems policy makers are either numb and blind with self interest or oblivious to this fact.

#### Lack of Horizontal Equity 1: Access to Loan Interest deductions

The tax treatment of loan interest on residential property debt depends on the status of the person or entity taking on the debt. This differential tax treatment between home buyers and investors has a profound influence on ease of purchase and debt repayment.

Investor advantage is built into the tax system and forms a major hurdle for home ownership despite Treasury website stating that: "Taxation measures should . . . be consistent with the principles of economic efficiency, horizontal and vertical equity"

Investors can claim all Loan Interest on mortgage debt. Consumers, that is, home buyers, can claim no Loan Interest deduction. This means that there is no "horizontal equity" between investors and home buyers.

In terms of equitable tax treatment, either both investors and home buyers are eligible for Loan Interest deduction, or neither. Allowing only investors this deduction is a prime example of a regressive tax regime.

#### Lack of Horizontal Equity 2: Capital Gains and Bank Savings

Some hold the logic of not discriminating between different types of income. That is, all capital gains should be taxed at the same rate as other income. However, in some countries, capital gains are regarded as 'unearned income' and are taxed at a higher rate than other income.

Also, the treatment of bank savings as opposed to superannuation or other investments is a good example of preferential tax discrimination/ lack of horizontal equity. With levels of debt to income at 160 percent, we have one of the lowest household savings rates in the world – ranking a lowly 23 out of an index of 24 countries in a recent OECD report. One solution is tax-free savings scheme.

France, Holland, Germany and the UK already have such schemes. The French tax incentivised savings account is a great example of a scheme which is simple to administer and available to all. French people can save up to 15,000 Euro or AUD 25,000 without paying tax on the interest earned in these accounts. In the UK, the Individual Savings Account (ISA) enables account holders to save up to 3,000 pounds sterling tax-free each year.

Introducing a tax-free savings schemes for all Australians would curb the nation's debt binge, tackle inflation and offer a buffer against market volatility.

#### Negative Gearing: Simply a legislated rort? Interest-only Loans: How toxic?

Only 1 in 12 dollars of investment loans goes into construction of new dwellings. The other 11 in 12 loan dollars are used by investors to outbid genuine home buyers at sales and auctions of existing properties. This fact alone should have rung alarm bells for government (Liberal and Labor). Investors are simply chasing tax breaks.

The ability to offset costs (mainly loan interest) against income, other than income generated from the associated property investment, has encouraged more debt than would have otherwise been possible. This is the curse of negative gearing and interest only loans. Both elements have brought Australia undone. We would have been relatively untouched by recent credit events if not for our massive debt levels.

The cost: slow disintegration of the social fabric of the community. What point this regressive tax regime or mentality? Will the government just leave the mechanics of social cohesion to myopic and blatantly self-interested investors?

Investors have thus far proven no inclination to pay their fair share of tax, increase the pool of housing or even keep a lid on rents, despite massive tax concessions.

## IG2: Economic Fantasy of Revenue versus Cost Benefit

The Intergenerational Report (IG2) is premised on the idea that the aging of the Australian workforce and its associated retirement costs to the tax system will be assisted by accelerating immigration.

Put simply, more workers, more spending, more revenue, balance budget. Liberals called it Go for Growth. However, some call it Go for Rental Portfolios Growth.

Sept 2008: Government released an Access Economics report that estimated the 2007-08 migration program will bring a net benefit of \$536M/year.

However, this net benefit in the report "Migrants Fiscal Impact Model: 2008 Update" is dwarfed by the real long-term costs (not factored into the net benefit as stated by the modelling):

- Model extends out for 20 years, it is not a 'life cycle' model of migrants. Retirement / pension phase and associated costs are not included in calculations.
- Impact on Budget from any children of the migrant group born after arrival in Australia is also not considered.
- Public goods and infrastructure funded by Commonwealth budget not included.

The cost of Federal projects (alone) this year is \$20B initial allocation of Building Australia Fund, mainly for roadworks and other infrastructure in major cities. Add to that, a forecast \$80B States infrastructure spending in the coming year and revenue from increasing immigration (\$536M) is farcical.

Of even more concern are Treasury projections related to this matter. See Chart 8, Projected Path of Net Debt (IG2):

[http://www.treasury.gov.au/documents/1239/HTML/docshell.asp?URL=01\\_Exec\\_summary.htm](http://www.treasury.gov.au/documents/1239/HTML/docshell.asp?URL=01_Exec_summary.htm)

Using Treasury projections, Australia will have 100% Debt to GDP by about 2070. It should be noted Australia Treasury is currently in surplus. Banana anyone?

## RECOMMENDATIONS

- All Home Buyers be given access to Loan Interest deduction
- Means testing of those who access Loan Interest deduction
- Phase out negative gearing and interest only loans
- Bank savings encouraged by tax incentivized accounts
- Base tax threshold (currently atrophied at \$6,000) be indexed to cpi
- Property prices to be included in cpi calculation

## Epilogue

It was only recently that an understanding of the full extent of the current discriminatory tax rulings and what, in essence, it signifies started to dawn. The underlying cause or mentality behind this kind of discrimination and its catastrophic potential came into focus after reading Barry Long's "Origins of Man and the Universe".

Following is a summary of the chapter titled Decline and Fall:

All civilizations are attempts at civilization.

All have failed due to an inherent flaw in the social conscience stemming from humanity's inability to grasp what civilization is for.

The means of destruction of a civilization must not be confused with the cause of destruction. Moral failure has been the cause of every civilization's downfall. Our moral failure, the worm in the western flower, was cultured by the drive among the privileged to have more while the many by comparison had little or nothing.

Ours is the first world civilization. In that we are unique and represent the end of a phase in man's development.

But its failure, and unfitness to endure as the permanently civilizing way of life, lies in the expediency of its shifting values. Our particular failure is intellectual duplicity, our double standards.

We have not possessed the moral strength to stand against the pressure of wealth and self-interest, to uphold in practice the worthy ideals we protested. (end)

Thanks to Barry Long for his love of humanity and his deep insights.

A dream who came to Life.

Thank you for your consideration of this submission.