SUBMISSION TO AUSTRALIA'S FUTURE TAX SYSTEM REVIEW PANEL:

Improving Opportunities and Equity in Home Ownership through the Tax System

1 We submit for your consideration the following proposals to change the taxation of owner-occupied housing (i) to assist with housing affordability for first home buyers and (ii) to discourage the occupation of expensive housing for the purpose of earning tax free capital gain. A tax concession for first home buyers (FHBs) in the form of a mortgage interest tax offset could be funded by tax revenue from capital gains tax (CGT) levied on about the top five per cent of owner-occupied homes. The overall proposal therefore has the major benefit of being roughly revenue neutral after four years.

2 The proposals are summarised below. More details, some variations on the proposals, comparisons with other measures, likely market reactions and estimates of the tax expenses and revenues can be found in the Appendix. The Appendix comprises extracts from our refereed paper to be published in the October 2008 issue of the Australian Tax Forum (the extracts are submitted with permission of the Publishing Manager of the Australian Tax Institute). The extracts are from Sections IV to VII of the paper. The paper does canvas other options not described in the extracts and refers to many other studies and sources of data. Sections II and III of the paper provide background on the taxation of housing and housing affordability in Australia.

3 The first proposal is that FHBs would be eligible for a mortgage interest tax offset of 31.5 per cent of their mortgage interest up to $20,000 per annum for the first five years of their borrowings.

4 The tax offset would be portable to other lenders and subsequent home purchases. A minimum period of prior residency or taxpaying status should be considered. A phase out period after five years might be needed to enable FHBs to adjust to the lowering of their disposable income.

5 The aim is to assist with housing affordability for those wishing to become owner-occupiers. The benefit is unlikely to flow through immediately to higher prices in housing markets dominated by FHBs because the offset would not be paid as a lump sum (by contrast, the First Home Owners Grant and reductions to Stamp Duty are lump sums that are arguably captured by sellers).

6 The second proposal is that owner-occupiers who purchase residential properties would be required to pay CGT on the positive difference between the resale proceeds (price, less selling costs) and the cost base, being the greater of:

(i) $1 million; or

(ii) the purchase price, plus buying costs; or

(iii) a professional valuation of the property at the date of introduction.

7 The gain would be treated in the same way as other capital gains, with an entitlement for personal tax-payers to a 50 per cent discount before adding the gain to other taxable income. This proposal would impose a tax on about 5 per cent of owner-occupied homes when they are sold at a capital gain. The threshold for the cost base could be revised upwards as average house prices rise.

8 The objectives of twinning these proposals are:

(i) to make the CGT on the highest value owner-occupied properties politically palatable;

(ii) to provide assistance to those aspiring to buy without diverting government funds from other housing priorities such as inexpensive rental homes; and

(iii) to contribute to a shift of wealth over the longer-term towards younger households from older, well established households.

9 It is believed that these tax changes would be reasonably simple to understand and administer. The FHB tax offset would be capped to provide most benefit to those most in need. The CGT would have relatively low costs of collection and limited potential for avoidance.

10 These proposals, although possibly controversial in some quarters, would align tax policy with much recent community, political and media concern about housing affordability.

11 The extracts from the attached paper, including the estimated tax expenses and revenues from these proposals, were prepared before the extent of the current global financial difficulties were evident and before the Federal Government's October package of measures to stimulate the Australian economy were announced. Whilst recent events and announcements might alter our calculations, they do not change their broad impact or their justification.

12. The proposals are put forward by the authors for consideration and do not represent the views of Curtin University.

16 October 2008

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APPENDIX

Extracts from a paper to appear in the October 2008 issue of Australian Tax Forum, Vol 23 (4).

"Improving Opportunities and Equity in Home Ownership through the Tax System"

Jeff Pope and Patrick Rowland

"IV A TAX OFFSET FOR FIRST TIME RESIDENTIAL HOME OWNERS

One policy option to alleviate the difficulties of housing affordability for first time (residential) home buyers (FHB) would be to introduce a tax offset or tax deduction for the interest paid on home loans. Government support (at the Commonwealth or State level) for house purchase through tax relief or subsidies for repayments at less-than-market interest rates existed in Australia in the 1970s and 1980s, but for relatively short-lived periods depending on the politics of the time (such as the First Home Owners Act 1983). There is little if any evidence as to the impact of these schemes; Hansard probably provides the best record of these earlier policies. Tax relief on mortgage interest for home owners is or has been available in other countries. The UK had non-targeted mortgage interest relief tax expenditure from 1983 until April 2000, but this was left to decline in real terms and eventually was abolished. Non-targeted mortgage interest tax relief is also available in other European countries, including the Netherlands, Sweden, Finland, Italy and Greece, and housing tax benefits are also available in the USA….

Three main reasons are suggested for limiting the mortgage tax relief in Australia to FHBs. First, a much greater portion of the tax expense would go to those currently unable to afford to become home owners than if all home owners were eligible. Secondly, targeting the tax relief would limit the tax expense and lessen the portion of the relief going to those not in need. The FBH mortgage interest relief, particularly if capped in the manner proposed below, would be more significant for lower and middle income households, purchasing modest homes, than for higher income families. Thirdly, such a policy would help improve inter-generational equity, albeit marginally over the longer-term, and perhaps more importantly signal a change in Government policy in this regard.

In order to properly consider mortgage tax relief, the primary issues are (i) the limits on the amount; (ii) whether it is available as a tax deduction or tax offset; (iii) the criteria for qualifying for such relief; (iv) the length of time it would be available; (v) the need for a phasing-out period of such relief; (vi) the cost (revenue loss or tax expenditure) of such a scheme, (vii) its administrative and compliance costs (i.e. operating costs) and (viii) some preliminary consideration of the effects upon the housing market.

The proposal is for a tax benefit that is designed to help those FHB who would find it difficult to meet loan payments on the purchase of a typical first home. The average size of home loan to FHB in Australia in March 2008 was $230,000. Loan payments on a 25 year monthly amortising loan of $230,000 would be $23,162 at an interest rate of nine per cent per annum, with interest in the first year of $20,596. It is therefore suggested that the tax benefit should be limited to $20,000 per annum of interest (although this would need to be adjusted in future years). However, a sensitivity analysis using maximums of $10,000 pa and $30,000 pa is presented below.

…. The authors' preferred alternative is a tax offset, which has commonly been favoured in Australia as it helps lower income FHB more than those on higher incomes. The proposed tax offset would be calculated at 31.5 per cent of interest paid on a mortgage to FHB up to the maximum amount of loan interest. The proposal is that every dollar of loan interest up to $20,000 per annum for eligible FHB would give a tax offset of 31.5 cents, at current tax rates.

The eligibility rules for the proposed FHB scheme are potentially contentious and involve economic, political and legal judgment…. The authors favour either a minimum residence period in Australia, perhaps three years out of the last five years or limiting the benefit to Australian citizens.

No restrictions on the value or location of the properties, or of the age or family composition of the recipient, are proposed. No annual indexation of the benefit is recommended but obviously occasional reviews of the maximum benefit would be required. The length of time such a FHB tax offset would be available is critical….

The principal factor which should decide the time limit for the offset is the increase in disposable incomes over the years and the point at which FHB can be "expected to stand on their own two feet". To illustrate by way of an example, FBH with loans of the recent average of $230,000 at an interest rate of nine per cent (costing $23,162 pa in loan repayments over 25 years) would be eligible for a tax offset based on the maximum claim of $20,000 pa, giving them a subsidy of $6,300 per annum (or around $121 per week). Using a gross income for households of $75,000 per annum, the loan repayment would reflect 31 per cent of the gross income without a FHB offset but 22.5 per cent with the repayment reduced by $6,300 per annum. There are several measures of "mortgage stress" but loan payments of more than 25 per cent of gross income is adopted here to illustrate the effect of the offset and for how long it is available. Table 1 shows how growing gross income would make the offset significantly less important to FHB after five years. This table assumes that the loan interest rate remains unchanged and gross income grows at five per cent per annum in nominal terms. Although the average FHB will be required to pay more of their gross incomes in Year 6 (without the offset) than in Year 1 (with the offset), the percentage of gross income would have declined to loan payments of less than 25 per cent (i.e. below the mortgage stress level). Thus, depending on the assumptions made, it is reasonable to argue that at least a five year period is needed.

Table 1: Average FHB Loan Payments as a Percentage of Gross Income

Year	Gross Income (GI)	% of GI **with** FHB offset	% of GI **without** FHB offset
1	$74,816	22.5	31.0
2	$78,556	21.5	29.5
3	$82,484	20.4	28.1
4	$86,608	19.5	26.7
5	$90,939	18.5	25.5
6	$95,486	17.7	24.3

Note: The assumptions on which this table is based are explained in the text but include a constant interest rate, the current average FHB loan and growing average income.

The size of the FHB offset and the number of years for which it is available partly determine whether a phase-out period is needed and if so for how long. Essentially, the larger the FHB offset (and therefore the more help it is to FHB to enter the housing market) and the shorter the period for which it is available, the more likely a phase out period would be required. For example, such a phase out period could be over a one year period (i.e. 50 per cent of full concession in Year 6 if it is available for five years) or over three years (i.e. 75 per cent in Year 6, 50 per cent in Year 7 and 25 per cent in Year 8). The critical calculation is to ensure that a high percentage of FHB beneficiaries do not return to a position of mortgage stress because the offset has run out, either with or without a phase-out period.

The estimated costs of a FHB mortgage interest tax offset depends on a range of assumptions including the maximum offset, the numbers of years for which it is available and prevailing mortgage interest rates. A preliminary estimate of the tax expense for a five year tax offset (with no phase out period) for up to $20,000 per annum of loan interest, in 2008 dollars, but after the scheme has been running for five years, is $3.17 billion per annum, as shown in Table 2. The estimates are based on a constant number of 120,000 FHB loan per annum. This assumes that the average claim would be 83.8 per cent of the maximum of $6,300 at a nine per cent per annum interest rates.

The sensitivity of the costs of the FHB offset to different maximum eligible interest payments and different interest rates is shown in Table 2. Apart from these two variables, the other assumptions are as explained above. The figures suggest that, even if a $30,000 mortgage interest deduction was allowed and interest rates were a relatively high 11 per cent, the cost of this tax expenditure would be around $4.2 billion – far less than the arguably conservatively estimated subsidies on owner-occupied housing, excluding the CGT exemption, of $16.5 billion and $6.0 billion for private rental housing (2004 figures).[1]

Table 2: Aggregate Annual Estimated Costs of Five Years Mortgage Interest Relief for First Home Buyers in $Billion (in current prices, after fully established)

Maximum eligible interest pa	Average % of maximum offset at 9% interest	Loan interest rates		
		7%	9%	11%
$10,000	**100.0%**	**$1.89**	**$1.89**	**$1.89**
$15,000	**91.9%**	**$2.54**	**$2.61**	**$2.65**
$20,000	***83.8%***	***$2.99***	***$3.17***	***$3.29***
$25,000	**75.7%**	**$3.25**	**$3.58**	**$3.79**
$30,000	**67.6%**	**$3.31**	**$3.83**	**$4.17**

Note: Subject to various assumptions as discussed in the text. The authors' core proposal is italicised.

The impact of this proposal on housing markets should be thoroughly debated and modelled; the following are only preliminary comments. Some measures to improve housing affordability for FHB are likely to push up prices for what are typically first homes by most of the initial benefit. It has been suggested that the FHOG and reductions in stamp duty for FHB have done this. This effect is likely to be because of the immediate saving to the buyer and the inelasticity of housing supply in the short term. The availability of a FHB tax offset may bring more buyers into the market but it does not immediately increase their deposit. It would however increase their buying power, provided that most lenders continue to calculate borrowing capacity based upon a maximum portion of disposable income. The effect would be similar to a drop in interest rates but restricted to the targeted group of buyers. Therefore, one would expect there to be some upward pressure on house prices, unless there are also measures to increase the supply of first homes or sites for first homes. It must be emphasised, therefore, that the FHB tax offset should be considered as part of a package of measures to improve affordability to avoid much of the benefit being swallowed up by higher house prices.

V CAPITAL GAINS TAX APPLIED TO HIGH VALUED OWNER-OCCUPIED HOUSING

….The proposal discussed here is to levy CGT on the gain in value of the principal residence above a specified high-value cost base or threshold….

As well as raising additional tax revenue from the realisation of hitherto exempt owner-occupied housing assets from those most able to pay, this proposal would help to reduce what many believe to be an over-investment in non-productive owner-occupied housing assets, particularly so-called luxury houses. The reason for twinning this proposal with a FHB tax offset is that their combined effect would be to reduce the increasing gap between the older wealth owning generation and younger working generation that have comparatively little wealth….

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[1]Abelson and Joyeux, (2007), 'Price and efficiency impacts of taxes and subsidies for Australian housing', *Economic Papers*, Vol. 26 (2) 147-169.

The great political sensitivity of levying CGT on the family home, even if it is limited to the highest price brackets, is recognised. Nonetheless, there is a great deal of current political and media coverage concerning housing affordability without any real debate as to the corollary that, in some way, those with the greatest wealth in housing assets would be expected to contribute the most to helping those who aspire to own their own house. This paper seeks to address this imbalance by analysing one housing policy taxation option, whilst continuing to stress the importance of greater supply of new housing into the market through a range of other policies that are outside the scope of this paper.

This CGT proposal, although simple in its intention, has several complex issues in its implementation, particularly any transitional arrangements. The following suggested criteria are proposed for debate and are used for preliminary estimates of the potential tax revenue.

The proposal is for owner-occupiers to pay CGT on half of the positive difference (the gain) between the resale proceeds (price, less selling costs) and the cost base, being the greater of:

(i) $1 million; or

(ii) the purchase price, plus buying costs; or

(iii) an independent valuation of the property at the date of introduction.

This would not permit any "grandfathering" rights for those who purchased their homes prior to the introduction of this tax. However, the objective is to avoid any taxation of gains in value prior to the introduction (or perhaps the announcement) of the legislation; the need for independent valuations is a compliance cost that is necessary to avoid any retrospective taxation. Valuations would only be required for those properties that were purchased before the date of introduction for less than $1 million and are sold for more than $1 million. The threshold figure of $1 million is roughly double that of the typical median house price of around $500,000 in various parts of Australia.

This proposal would initially affect about five per cent of owner-occupiers, based upon the portion of sales for more than $1 million in 2007. This ignores the variations in the composition of housing sales as a sample of all homes. The number and percentage of sales in different price brackets in recent years is set out in Table 3, indicating the growing number and portion of sales for more than $1 million. Table 4 provides a more detailed breakdown of the number and portion of sales in price brackets starting at $200,000. Most of the sales for less than $200,000 are likely to be sales to related parties and other sales which are not at arm's length and they have therefore been excluded.

Table 3: Australian House and Unit Sales from 2000-01 to 2006-07 and calendar year 2007 at prices of $1 million or more

Year	Number of sales =>$1million	Number of sales => $200,000	% of sales =>$1million
2000/01	5,091	195,554	2.6
2001/02	8,117	296,494	2.7
2002/03	10,176	337,622	3.0
2003/04	12,574	362,658	3.5
2004/05	12,119	344,131	3.5
2005/06	14,836	387,206	3.8
2006/07	20,214	423,089	4.8
2007	21,455	417,420	5.1

Source: RP Data

This data has been used to estimate the tax revenues from the proposed CGT on high value, principal residences. No estimate of revenue from CGT in the future is possible without several assumptions. The most significant and problematic is the projected growth in house values. In this case, it has been assumed that house and unit values grow at a *nominal* eight per cent per annum, after allowance for transfer costs. This is consistent with the increase in the ABS Established House Price Index between December 1997 and 2007 of 9.8 per cent per annum before transfer costs. There is some evidence that higher priced properties in Australia grow at a faster rate than others but this has been ignored in the modelling.

Table 4: Australian House and Unit Sales 2000-01, 2003-04,2006-07 and calendar year 2007 by Range of Value

	Year			
Price range	**2000/01**	**2003/04**	**2006/07**	**2007**
$200k to $499k	166,532 *(85.2%)*	288,333 *(79.5%)*	318,260 *(75.2%)*	305,248 *(73.1%)*
$500k to $999k	23,931 *(12.2%)*	61,751 *(17.0%)*	84,615 *(20.0%)*	90,717 *(21.7%)*
$1m to $1.49m	2,804 *(1.4%)*	7,334 *(2.0%)*	11,444 *(2.7%)*	12,133 *(2.9%)*
$1.5m to $1.99m	1,050 *(0.5%)*	2,580 *(0.7%)*	4,196 *(1.0%)*	4,483 *(1.1%)*
$2m to $2.49m	441 *(0.2%)*	1,022 *(0.3%)*	1,776 *(0.4%)*	1,802 *(0.4%)*
$2.5m to $2.99m	245 *(0.1%)*	534 *(0.1%)*	997 *(0.2%)*	1,027 *(0.2%)*
$3m or more	551 *(0.3%)*	1,104 *(0.3%)*	1,801 *(0.4%)*	2,010 *(0.5%)*
Total	195,554 *(100%)*	362,658 *(100%)*	423,089 *(100%)*	417,420 *(100%)*

Source: RP Data

…. For a conservative assessment of revenue growth, a 10 per cent per annum increase in the volume of sales in each of the price brackets over $1 million has been adopted. In the first year, the volume of sales in the taxable brackets is assumed to be half a full year's volume.

Another key assumption is that 70 per cent of all sales are to owner-occupiers, rather than to investors, and this is treated as constant across the price brackets and over time. Because this tax will only apply to high value homes, it is assumed that all the discounted CGT will be paid at the maximum marginal tax rate of 46.5 per cent. The average CGT has been calculated on values and prices at the mid-point in each price bracket (and on a value or price of $4 million in the bracket for sales at $3 million or more) and using the midpoint of the year (for example, the third year's gain is based on 2.5 years of growth at eight per cent per annum). The revenue for the first five years after introduction is modelled in Table 5, assuming that the tax was introduced on 1 July 2008 and that all taxpayers have held their properties for one year or more (and hence are entitled to discount the gain by half before adding it to other taxable income). The tax revenues in Table 5 are in nominal terms.

The following example explains the calculations in Table 5. In the second year (2009-10), the selling price of a property bought for $1,250,000 on 1 July 2008 is estimated to be $1,402,961, being eight per cent per annum compound growth for 1.5 years. This gain of $152,961 would be halved (the 50 per cent discount for personal taxpayers CGT) and taxed at 46.5 per cent per annum, resulting in tax of $35,563. It is estimated that there would be 10,277 sales of properties that were in the $1 to $1.5 million price bracket, based upon 70 per cent to owner-occupiers of the 12,133 sales in the bracket in 2007 (see Table 4), increased by 10 per cent per annum for two years. These 10,277 sales paying average CGT of $35,563 would generate revenue of $0.365 billion. The total revenue for all the price brackets for each of the first five years is shown in Table 5. As many owners hold their properties for more than five years, the revenue would continue to increase in later years.

These estimates are based on permitted "bracket creep" and, at some stage, the threshold of $1 million would need to be increased unless there is a decision in the future to make the incidence of CGT on principal residences more widespread.

….The administrative costs, compliance costs, start-up costs and deadweight losses are recognised but ignored in these calculations. If the CGT threshold is set at $1 million purchase price for an owner-occupied home then around five per cent of principal residences would be subject to CGT, as shown in Table 3. This would have affected a little over 15,000 owner-occupied homes in 2007 based on 70 per cent of the 21,455 sales. The revenue per assessment is relatively high, making the tax reasonably cheap to levy.

Table 5: Estimated Revenue from the First Five Years of applying Capital Gains Tax to Owner-Occupied Homes above a Threshold of $1 million (in nominal prices)

Price bracket	$1m to $1.49m	$1.5m to $1.99m	$2m to $2.49m	$2.5m to $2.99m	$3m+
Year 1					
Average sale	$1,299,038	$1,818,653	$2,338,269	$2,857,884	$4,156,922
Tax on ½ gain	$11,401	$15,962	$20,522	$25,083	$36,484
No of sales	4,671	1,726	694	395	774
Revenue (billions)	$0.053	$0.028	$0.014	$0.010	$0.028
Year 1 revenue					**$0.133bill**
Year 2					
Average sale	$1,402,961	$1,964,146	$2,525,330	$3,086,515	$4,489,476
Tax on ½ gain	$35,563	$49,789	$64,014	$78,240	$113,803
No of sales	10,277	3,797	1,526	870	1,702
Revenue (billions)	$0.365	$0.189	$0.098	$0.068	$0.194
Year 2 revenue					**$0.914bill**
Year 3					
Average sale	$1,515,198	$2,121,277	$2,727,356	$3,333,436	$4,848,634
Tax on ½ gain	$61,659	$86,322	$110,985	$135,649	$197,307
No of sales	11,304	4,177	1,679	957	1,873
Revenue (billions)	$0.697	$0.361	$0.186	$0.130	$0.370
Year 3 revenue					**$1.743bill**
Year 4					
Average sale	$1,636,414	$2,290,979	$2,945,545	$3,600,111	$5,236,524
Tax on ½ gain	$89,841	$125,778	$161,714	$197,651	$287,492
No of sales	12,435	4,594	1,847	1,053	2,060
Revenue (billions)	$1.117	$0.578	$0.299	$0.208	$0.592
Year 4 revenue					**$2.794bill**
Year 5					
Average sale	$1,767,327	$2,474,258	$3,181,189	$3,888,119	$5,655,446
Tax on ½ gain	$120,279	$168,390	$216,501	$264,613	$384,891
No of sales	13,678	5,054	2,031	1,158	2,266
Revenue (billions)	$1.645	$0.851	$0.440	$0.306	$0.872
Year 5 revenue					**$4.115bill**

Note: Subject to various assumptions as explained in the text.

No allowance has been made for any lowering in the growth in values of properties worth more than $1 million caused by the introduction of the CGT (although a slowing to half of the volume of sales in the first year has been factored in)….

Whilst the threshold might appear to be an arbitrary figure, it has been set at a level that might be politically acceptable in a climate in which the difficulties of FHB are widely recognised and the costs of assisting them could be largely met from this additional CGT revenue….

Based on the assumptions above, it is estimated that CGT from owner-occupied housing would be around $4.1 billion per annum in nominal terms after five years, as shown in Table 5 (or $3.5 billion in current dollars; see below). However, into the longer term, maintaining the threshold at $1 million would lead to a considerable year on year increase in revenue.

VI NET TAX IMPLICATIONS OF THESE PROPOSALS

It is worth re-iterating that estimated tax expenditure and revenue from these proposals is based on many assumptions, some of them problematical…. That said, it is now appropriate to make some comparison of the likely costs of the proposed FHB mortgage interest deduction and the revenue that would be raised from applying CGT to higher valued residential housing.

To better reflect the implications of the phase in of both taxes, the aggregate costs and revenues from Tables 2 and 5 respectively have been adjusted as follows. The aggregate cost that was based on an additional 120,000 FHB loans per annum to eligible borrowers in the first year has been adjusted to allow for an extra 10,000 FHB loans in each subsequent year. The expense has been calculated in current dollars. To make the CGT revenues consistent with the FHB expense, the revenue for the first five years has been deflated to current dollars (using inflation rates of four per cent for the first two years and three per cent for subsequent years). The annual cost and revenue estimates are displayed in Table 6.

Table 6: A Comparison of the Estimated Costs of the FHB Tax Offset and Revenue from CGT on Higher Value Owner-Occupied Homes in $Billion (in current prices)

	FBH Tax Expense	CGTax revenue	Net effect
Year 1	$0.63	$0.13	-$0.51
Year 2	$1.32	$0.85	-$0.48
Year 3	$2.01	$1.56	-$0.44
Year 4	$2.69	$2.43	-$0.26
Year 5	$3.38	$3.48	$0.10

Note: Subject to various assumptions as discussed in the text.

Table 6 is calculated as follows. For the FHB Tax Expense, the estimated expense in the first year of operation at a nine per cent per annum interest rate with $20,000 maximum eligible interest payments and an assumed average claim of 83.8 per cent of the maximum (as explained in Section IV) is $0.63 billion, being 120,000 buyers multiplied by 83.8 per cent of $6,300. In the second year, a further 130,000 FHB are assumed to claim the same amount (in current prices), making a total of 250,000 FHB claiming 83.8 per cent of $6,300, totalling $1.32 billion. For the third, fourth and fifth years, the number of FHB claiming is estimated to increase to 380,000, 510,000 and 640,000 respectively. For the CGTax Revenue, the Year 1 to 5 totals from Table 5 are deflated to current prices. For example, the Year 2 revenue of $0.914 billion is deflated by $(1.04)^2$ to estimate the revenue in current prices of $0.85 billion; the Year 3 revenue of $1.743 billion is deflated by $(1.04)^2$ and then by 1.03 to estimate the revenue in current prices of $1.56 billion.

In current dollars, our analysis suggests that after five years the costs of the FHB tax offsets reach their highest because this is the first year in which there will be five years of FHB claiming the offset. By this year, the CGT revenue will be stabilising but it is anticipated that it would still increase slowly in subsequent years. By Year 5, the combined proposals would be approximately revenue neutral. As shown in Table 6, the preliminary estimates suggest that the net cost in current dollars over the first five years would be around $1.58 billion and thereafter the revenue should more than match the expense, subject to adjustments to the thresholds for each proposal.

The net costs of these proposals may be compared with other tax expenditures. By comparison to other housing tax expenditures and indeed tax expenditures and income tax deductions overall, the net figure of around $0.5 billion per annum in the early years is a modest sum….compared with recent owner-occupied housing subsidies (including imputed costs and the CGT exemption for owner-occupiers) of $5.9 billion….Comparing each proposal separately suggests that taxation of owner-occupied housing, after five years but in current dollars, would increase to around $21.3 billion and subsidies to around $27.1 billion, from $17.8 billion and $23.7 billion respectively.[2]

For further comparisons, …the 50 per cent CGT concession [cost] $5.0 billion (2005-06 figures);[3] the income tax deduction for work-related expenses, a major factor in the debate on personal income tax reform, costs around $13 billion pa (in 2005-06 figures).[4] Over a longer time horizon, with both proposals continued unamended, the FHB tax expenditure and CGT housing revenue would be in balance and then move into a net surplus for the government.

This paper should be seen as initial, exploratory research. If these proposals or similar ones were to be considered further by policy makers then full econometric modelling of the economic and social effects would need to be undertaken over the long-term. This would include distributional effects of both income and wealth between family income groups, owner-occupiers and those in private rented accommodation and different generations (age groups).

VII CHALLENGES IN IMPLEMENTATION

….The economic arguments against either of these two proposals lie in their further distortion of an already distorted market. As earlier figures have shown, the government currently effectively subsidies owner-occupied housing around $6 billion per annum. The effect of the FHB proposal could be increased house prices particularly below the median unless there is a commensurate increase in land supply, a key factor emphasised earlier in this paper. However, given greater land supply, the effect of the FHB proposal is likely to be far greater opportunities to purchase a house for younger, lower income households. The eligibility rules become critical in this regard….

Turning to the upper end of the scale, subjecting owner-occupied houses over $1 million to CGT may or may not affect sales depending on hard-to-predict behavioural responses in terms of holding periods for such houses. One likely behavioural response would be tax avoidance. This may take the form of high income and wealth families placing their principal residence in the names of family-owned companies, company structures or trusts although this is not obviously advantageous, given the 50 per cent CGT discount for personal taxpayers….

To ensure that only changes in value from the date of introduction are taxed, there will be occasions when property valuations at the date of introduction will be necessary, as outlined in Section V. Property valuations are relatively costly and, particularly for high value residential properties, valuations may contain a subjective element, exposing the valuers to pressures to lean towards the higher end of the range of possible values. There seems to be no alternative to such uncertainty and compliance costs if the CGT is to be introduced without retrospective tax."

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[2] Abelson P. and Joyeux, R. (2007), above note 1 in Table 3 at 154.

[3] Freebairn, J. (2007), 'A package of less special deductions and exemptions and low tax rates', *Australian Tax Forum*, Vol 22 (2), Table 3 (drawn from the Tax Expenditure Statement 2006, Treasury, Canberra) at 73.

[4] *Taxation Statistics 2005-06* (2008), Australian Taxation Office, Canberra, at 14.