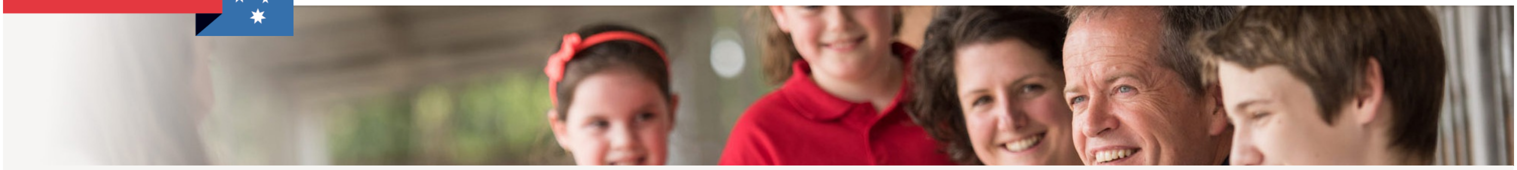


POSITIVE PLAN TO HELP HOUSING AFFORDABILITY

For most young families in Australia, the dream of purchasing and owning their own home is almost completely out of reach.

Working and middle class families are increasingly being priced out of the housing market. Ownership rates for young people aged 25-34 have spiralled downwards in recent years from 60% to 48%. Young people are being forced to take on levels of debt unimaginable just a few decades ago.

With first home buyers making up just 1 out of 7 of all home purchases, we have to do better. It's well and truly time someone did something about making housing more affordable in Australia. That's why Labor has announced a policy that will help level the playing field for first home buyers competing with investors.

Labor will reform negative gearing and the capital tax discount effective from 1 July 2017, a policy which will help put the Australian dream of home ownership back within the reach of middle and working class families.

The fiscal challenge

Australia is changing rapidly, and the Commonwealth Budget must change too. The Budget needs to promote growth and jobs into the future, not entrench subsidies of past decades.

This requires tough choices, and a line by line assessment of all calls on the Budget against the simple test: can a Budget designed to drive jobs and growth into the future, afford it?

Budgets are inherently a statement of priorities for any government – where they choose to raise revenue and how they spend and invest resources to achieve policy outcomes.

Budgets are also set against, and part of, a broader economic context that should guide the aggregate position (surplus/deficit) and the composition of budget settings.

Labor's approach to fiscal policy is therefore framed by our economic priorities to boost growth and create jobs. That is why we are investing in schools and higher education, reforming and boosting infrastructure spending, driving a clean energy future and a universal health care system.

To fund these priorities requires a strong Budget position. This requires an assessment of all budget items – both expenditure and revenue – to ensure that the budget is delivering on our priorities for the future within an aggregate position that is sustainable.

And it requires tough budget choices to align purpose and funding. Labor understands this, and that is why we have announced a number of measures to fund important investments, and contribute to Budget repair, including:

- making multinational companies pay their fair share of tax
- reducing superannuation tax concessions for millionaires
- increasing the changes to tobacco excise
- ceasing the Emissions Reduction Fund, and
- not proceeding with the Liberals' new Baby Bonus.

Labor will continue to scrutinise budget line items to fund important investments and contribute to Budget repair.

A fair tax system

Australia aspires to be a fair society and we expect our tax system to align with this aspiration.

For most Australians this is the case – their tax is withheld fortnightly on the basis of their wages. The more an employee earns, the greater the amount of tax they pay. This simple principle of progressive tax scales is a fundamental pillar of our tax system, and ensures that the burden of tax falls on those most able to bear it.

While this principle applies to fortnightly pay cheques, it does not apply to other aspects of the tax system. Significant tax subsidies are available for people that hold investments, establishing a significantly more favourable tax basis for holding capital, rather than earning income.

Higher income Australians are able to use these tax subsidies to reduce the income tax they pay, primarily through negatively gearing property and the capital gains discount. These subsides are concentrated in the highest income deciles, as low and middle income Australians are more likely to spend their income on consumption, whereas higher income Australians are able to accumulate capital and use tax benefits to reduce the amount of tax they pay on their income.

Ultimately, a dollar of tax avoided by high income Australians is an extra dollar of tax paid by all other Australians.

Labor is committed to ensuring that the tax system is fair for all Australians.

Leaky bucket

The Australian tax system includes a number of deductions and concessions that result in taxpayers reducing their tax bill. Many of these represent legitimate expenses like work related expenses, such deducting the cost of a uniform or tools, or incentives to drive policy outcomes – like research and development incentives.

Labor supports the existence of deductions and concessions where they drive positive policy outcomes and improve neutrality in the tax system. As a policy instrument, they provide a mechanism that allows Government to influence behaviour to achieve specific policy objectives. But these need to be done on the basis that they are a fair and effective use of resources, both in terms of the policy, and in the broader budget context.

It is important to recognise that deductions and concessions – essentially forgone revenue – represent significant costs to the Budget. To date, they haven't received the same level of scrutiny as the payments system.

This should start from proper recognition of what tax subsidies actually are: government spending through the tax system. The impacts of these items are reported annually in the tax *expenditure* statement released by Treasury.

This position is supported by Martin Feldstein, Professor of Economics, Harvard University, former Chair of President Reagan's Council of Economic Advisors, who noted that:

> *Reducing those [tax] subsidies, then, is really cutting government spending. The resulting deficit reductions show up on the revenue side of the budget, but the economic effect is to cut government spending. … Anyone opposed to government spending should favor removing these subsidies from the tax code.*

The payment system is highly targeted and progressive in nature, while tax concessions are beneficial to high income earners. Therefore any serious approach to budget repair requires these tax subsidies to undergo the same level of scrutiny as budget spending.

For example, superannuation earnings concessions are expected to grow by 33% over the next four years, more than twice the rate of growth in the age pension over the same period (14%). The fact that the top 10 per cent of Australians receive nearly 40 per cent of Australia's of superannuation tax subsidies whereas the age pension max rate starts tapering down for couples on incomes of $7,488 demonstrates why action is needed.

That is why Labor has already acted to reduce the generosity of tax concessions for high income superannuants – to moderate concessions for Australians with superannuation balances in excess of $1.5 million.

Proper scrutiny of tax subsidies is fiscally responsible and can remove unintended consequences of tax subsides. Labor will continue to strengthen the revenue base through removing unfairness, and ensuring that the tax system is designed to deliver our priorities.

No retrospective tax changes

Labor recognises that Australians make financial decisions in good faith on the tax arrangements in place at the time.

While making change to the tax system to improve fairness is a policy objective of Labor, it must be done without negative retrospective impacts on existing investments. This same approach was taken by Labor the announcement policy to curb generous and excessive tax concessions for high income superannuation accounts.

Jobs and Growth

Taxation has a significant impact on decisions made in the economy, incentivising some behaviour and curbing others.

Labor believes that the tax system should be designed to boost jobs and grow the economy.

The tax system acts a form of traffic lights in the economy, directing investment within the economy.

In setting tax policy, therefore, we should be designing a system that green lights investments on activities that boost economic activity, and underpin the efficient allocation of resources. Existing policy arrangements that direct resources to unproductive investments and speculative markets should be re-considered.

Research and Development tax incentives are an example of tax concessions that provide beneficial tax arrangements for companies that invest in R&D. The objective of the R&D tax incentive is to boost competitiveness and improve productivity across the Australian economy, while incentivising industries to conduct R&D work that may not otherwise have been conducted without the incentive.

Similarly, tax policy should provide disincentives/red lights to activities and investments that are not productive. Similarly, disincentives to curb harmful behaviours are effective as is the case with Labor's announced continuation of increases to the tobacco excise.

The importance of getting the settings right to improve the allocative efficiency of capital cannot be overstated.

The Financial Systems Inquiry (Murray Inquiry) pointed out that reducing tax concessions that create major distortions would improve the allocation of capital in the economy. This means that resources would flow to their highest value use, improving productivity and growth outcomes, while also improving the stability of the financial system. This would drive increased and more sustainable economic growth and jobs.

For Labor getting the tax system right has a very real impact for working Australians – it boosts jobs, and supports growth.

That is why reforming the tax system is so important to lifting living standards in Australia.

The problem

Tax subsidies are unsustainable, and unaffordable

Several tax subsidies are growing at a rate that is unsustainable.

Quite simply the Budget position today, and over the medium term cannot afford both these generous subsidies and the necessary investments required to boost growth and jobs. It is appropriate that every budget line item that is growing rapidly undergo close scrutiny to ensure that the spending/tax subsidy is achieving its stated objectives and that the quantum is appropriate when evaluated against competing policies.

Two specific tax deductions – negative gearing and capital gains subsidies – are both significant calls on the budget and are growing at a rapid rate.

Negative gearing

Negative gearing refers to the situation where investors make an investment (mostly in property) that loses money in the short term (e.g. loan and related costs are greater than rental income), in the expectation of making capital gains in the future.

The investor can deduct any losses associated with the investment from their salary and wage income.

For example:

James buys a unit as investment property, and his expenses for the property are greater than rental income, resulting in a $10,000 loss. James can use that $10,000 loss to reduce his $130,000 income to $120,000, providing a $3,700 tax subsidy to James.

Capital gains tax discount

When an individual sells an asset for a profit, they make a capital gain equal to the amount of profit on the asset. They would then pay tax on that gain at their marginal tax rate.

Individuals, trusts are entitled to a 50% discount on the capital gain amount providing they have held the asset for more than one year.

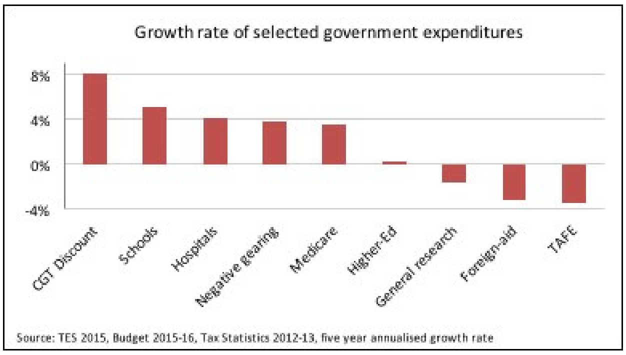
For example:

Jane sells a property that she's owned for 5 years, and makes a $150,000 capital gain over that period. Her annual salary is $190,000 in the year of sale. Applying the capital gains tax discount would see the capital gain reduced to $75,000, which takes her effective marginal rate on the capital gain from 47 cents in the dollar (top marginal rate) to 23.5 cents in the dollar, which is lower than the marginal rate of an average income earner.

Negative gearing and the capital gains discount have not achieved their aim to boost housing supply and encourage the building of more new houses. This year, they will cost the budget over $10 billion. That's more than that the government spends on higher education or child care.

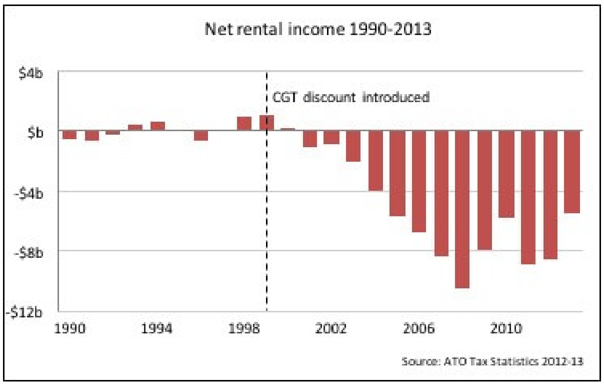
For example, the capital gains tax discount subsidy is growing rapidly, with revenue foregone doubling from $4.2 billion in 2013-14 to $8.6b by 2018-19.

The capital gains discount cost is growing, on average, at 8% per annum over the forward estimates. This rate of growth is greater than funding on research, universities, VET and schools.



These tax subsidies are unaffordable, and to continue them will crowd out funding for important investments in that are required to grow our economy and jobs.

Furthermore, these tax subsidies have an interaction effect as investors can get tax subsidy from losses over the course of ownership, and then access a significant tax subsidy at the point of sale. As shown below, the introduction of the CGT discount in 1999 accelerated claims significantly.



Tax subsidies benefit the wealthiest Australians

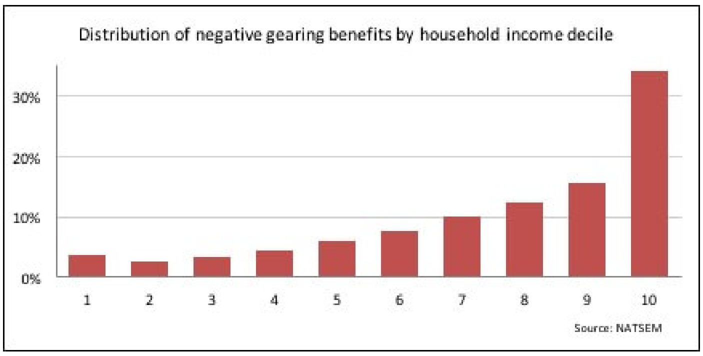
Tax subsidies are skewed to high income earners. Australians benefits from the Commonwealth through either the payments or the tax system. The OECD and the Henry Tax Review has recognised that payments are highly targeted in Australia, and overwhelmingly support low income Australians. However tax subsidies are highly inequitable, with the vast majority of benefit to high income earners.

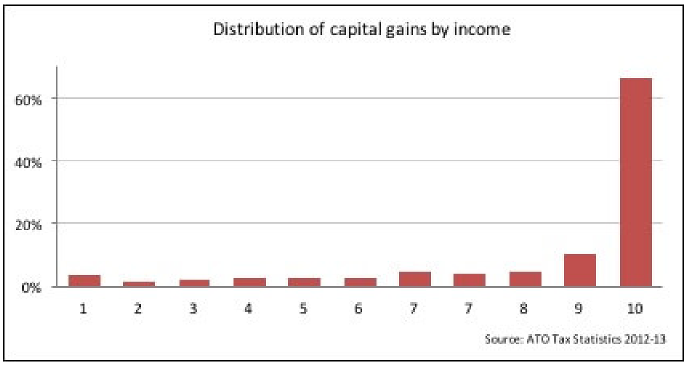
For negative gearing, the top 20% of income earners receiving around half of the negative gearing benefits, according to NATSEM. The top 10% capture more benefit that the bottom 60%.

Claims by the Government that the benefits overwhelming go to low and middle income earners are incorrect. The Government uses income data after tax deductions have been applied. More reliable data which uses gross income shows that the benefits overwhelmingly to higher incomes earners.

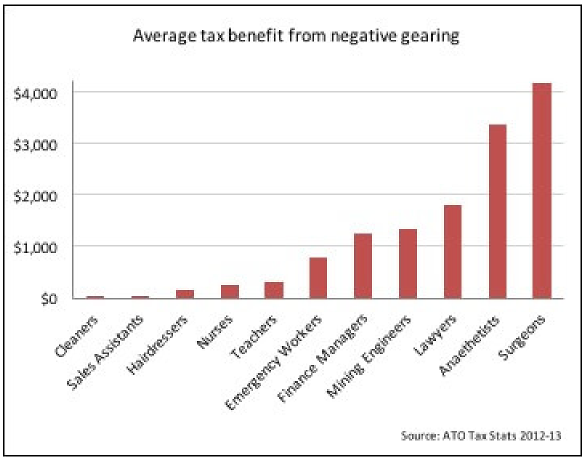
The benefits for the capital gains tax discount is even more inequitable, with the top ten receiving nearly 70% of the total subsidy.

These investment subsidies come at a significant cost to the budget, which means that other taxpayers have to pay higher tax rates or accept lower quality services in order to pay for these subsidies.





Despite spurious claims being made about the benefits of negative being overwhelmingly claimed by nurses and policemen, the evidence from analysis by the Grattan Institute shows that in fact it is finance managers and anaesthetists that benefit from these investment subsidies.



Any argument that nurses, teachers or hairdressers losing out in the future is also false. All existing properties are fully grandfathered – and therefore unaffected - while the reforms simply change the direction of investment to new assets. That is, tax concessions for negative gearing will continue to be available to people of all career types and income levels.

It is also worth noting that as these tax concessions continue into the future, that the biggest risk to family budgets is the Liberal Government.

Malcolm Turnbull's Liberal Government is cutting up to $5,000 from family budgets per year through their unfair cuts – cuts that will hit the families of teachers, policemen and cleaners.

For example, under the Turnbull Liberal Government, 1.5 million families will lose their end of year supplements of $700 per child – around 500,000 of these families are on household incomes of less than $50,000 a year.

Not supporting productive investment in new housing

Tax subsidies can play a positive role when they support productive investment that in turn supports economic growth and new jobs.

Rather than leading to productive investment, the combination of the capital gains tax discount and negative gearing has led to over-investment in loss making on existing property.

The most recent Australian Bureau of Statistics data shows that 93 per cent of new investment loans go to people purchasing existing housing stock.

This means that the vast bulk of investment does not increase supply or boost jobs. All it does is increase demand and the price of the existing homes, allowing investors to use tax subsidies to outbid owner occupiers and first home buyers from existing properties.

This problem has been identified by a large number of reviews and policy experts such as the Henry Review, the Government's own Financial System Review and the Grattan Institute.

> *"The tax treatment of investor housing, in particular, tends to encourage leveraged and speculative investment in housing" and "Reducing these concessions would lead to a more efficient allocation of funding in the economy"* **Financial System Review, Box 3: Major Tax distortions, page 22 of Overview**

Economist Saul Eslake, one of the leading thinkers on housing affordability in Australia has noted that:

> *"after the Howard Government's 1999 decision to tax capital gains at half the rate applicable to other income (instead of taxing inflation-adjusted capital gains at a taxpayer's full marginal rate), 'negative gearing' became a vehicle for permanently reducing, as well as deferring, personal tax liabilities"* **Saul Eslake, 50 years of housing failure**

Housing affordability

The capital gains tax discount and negative gearing have also given investors an unfair advantage over first home buyers. In 2015 investors outnumbered owner-occupiers in new housing loans for the first time.

Australia also has some of the most generous taxation concessions for housing investments amongst all advanced economies. In recent years this helped fuel an investor driven property boom, leaving more and more young people and first home buyers unable to purchase a home. The interaction of negative gearing and the capital gains tax discount has also encouraged speculative behaviour exposing the economy to unnecessary levels of financial risk.

The Grattan Institute:

> *"The combination of capital gains tax rule changes in 1999 and negative gearing has strongly increased the demand for investment properties. Investors compete directly with potential homebuyers, particularly for established houses. This makes it harder for first home buyers to secure a property."* **Grattan Institute, Renovating Housing policy, page 13**

Labor's Proposal

Labor will reform negative gearing and the capital gains tax discount to ensure that our tax system is fair, sustainable and targets jobs and growth.

Negative gearing

Labor will limit negative gearing to new housing from 1 July 2017. All investments made before this date will not be affected by this change and will be fully grandfathered.

This will mean that taxpayers will continue to be able to deduct net rental losses against their wage income, providing the losses come from newly constructed housing.

From 1 July 2017 losses from new investments in shares and existing properties can still be used to offset investment income tax liabilities. These losses can also continue to be carried forward to offset the final capital gain on the investment.

Capital gains tax

Labor will halve the capital gains discount for all assets purchased after 1 July 2017. This will reduce the capital gains tax discount for assets that are held longer than 12 months from the current 50 per cent to 25 per cent.

All investments made before this date will not be affected by this change and will be fully grandfathered.

This policy change will also not affect investments made by superannuation funds. The CGT discount will not change for small business assets. This will ensure that no small businesses are worse off under these changes.

Labor will consult with industry, relevant stakeholders and State governments on further design and implementation details ahead of the start date for both these proposals.

Benefits of Labor's tax reform package

Sustainable budget to fund our priorities

Australia is changing rapidly, and the Commonwealth Budget must change too.

The Budget needs to promote growth and jobs into the future, not entrench priorities of the past decades. That is why Labor has been acting to put the budget on a sustainable footing and provide the confidence that Labor can fund its important investments.

Labor does not believe in the context of competing priorities – schools, hospitals, science and research – that the budget can afford to continue these concessions as they currently stand.

The truth is, without curbing to poorly targeted subsidies, Australia won't have the money to invest in the future.

This tax reform package will improve the budget bottom line by $32.1 billion over ten years. When combined with Labor's previously announced revenue and savings measures this leads to an improvement of $100b over ten years.

Furthermore, it is better economic policy. As the Murray Inquiry recommended, reducing these distortionary tax settings will lead a more efficient allocation of funding in the economy.

Allocating capital more efficiently will lead to more productive investment decisions in the economy, delivering more jobs and higher incomes in the future.

Make Australia's tax system fairer

Labor is working to make the tax system in Australian fairer. It is patently unfair when first home owners in Australia get no tax breaks to buy their first home, but get significant subsidies to buy their second, third and fourth homes.

These subsidies - negative gearing and the capital gains tax discount –overwhelmingly provide benefit to the wealthiest Australians.

Limiting these subsidies will strengthen the budget, and create space to invest in schools and hospitals that all Australians need.

Furthermore, these changes will promote productive investment rather than debt-fuelled speculation in existing property, Labor's plan makes Australia's tax system fairer.

While the Turnbull/Abbott governments have sought to cut essential services that all Australians need, Labor's plan means ensuring that where we have subsidies in our system that they are fit for purpose and are not excessively generous to those who don't need them.

New houses will lead to growth in jobs and increase housing affordability

Housing Affordability is of increasing concern across Australia. Particularly in some of our major cities, house prices have skyrocketed beyond the reach of many. First home buyers now make up less than 15 per cent of all home purchases, which is well below the historic average of 20 per cent.

In part this is because Australian housing construction has not kept up with population growth since the early 1990s. Labor's reform of negative gearing tax subsidies is aimed at shifting the incentive to the construction of new housing. Independent modelling by the Parliamentary Budget Office assumes that following the changes, negatively geared investment in new dwellings will almost double.

Two-and-a-half years into the Abbott-Turnbull Government there have been many promises, but little action on housing affordability.

In contrast, Labor has been working and acting. In March 2015 Labor held a Housing Affordability Roundtable. The roundtable brought together policy think-tanks, industry bodies, academics and consumer representatives.

Labor also invited submissions on its Housing Affordability Strategy from these participants, as well as other interested organisations and everyday Australians.

Whether it was policy think tanks, would be new home buyers, or parents concerned about whether their children will ever be able to enter the property market, one theme was overwhelming. The interaction of negative gearing and the capital gains tax discount, was making it harder – not easier – for Australians wanting to own their own home.

Labor understands that housing affordability is a complex problem. Record low interest rates and underlying supply dynamics, particularly at the state level, are significant factors affecting housing affordability. It's why Labor will have much more to say about housing affordability before the next election.

But reforming taxation arrangements on housing is the first big step in tilting the balance back towards first home buyers.

This policy will see a boost in new housing and will provide young families with the chance to find a home, and will take pressure off inner city housing markets that are predominantly made up of existing dwellings.

This will also lead to new jobs for construction industry, with independent analysis from the McKell Institute estimating that these policy settings would result in an additional 25,000 jobs.

Financial implications

The independent Parliamentary Budget Office has costed the impact of this policy as improving the budget by $565 million over the forward estimates, and $32.1 billion over the decade.

Tax reform – *Better targeting negative gearing* and *Reducing the Capital Gains Tax Discount from 50% to 25%*	
2015-16	0.0
2016-17	0.0
2017-18	-15.0
2018-19	580.0
Total	565.0

amounts in millions

This reform adds to existing Labor proposals to improve to Budget, including making multinational companies pay their fair share of tax reforms to the taxation of multinational entities, reducing superannuation tax concessions for millionaires, increasing the changes to tobacco excise, ceasing the Emissions Reduction Fund, and not proceeding with the Liberals' new Baby Bonus.