

Zhong Jianying  
VIC

7 October 2003

Inquiry into first home ownership  
Productivity Commission  
LB2 Collins Street East  
Melbourne VIC 8003

**copy to:** The Treasurer

Sir,

### **Concessional tax treatment of owner-occupied housing**

Your issues paper raises taxation as a matter for consideration. It points out, amongst others, that:

- (a) a taxpayer's main residence is exempt from Capital Gains Tax ("CGT"); and
- (b) the implicit value of rental services provided by owner-occupied housing does not form part of the taxpayer's taxable income and is tax free.

#### **1 The government's concern should be to make affordable housing available, whether owner-occupied or not**

These concessional tax treatment of owner-occupied housing, relative to other assets, has two separate effects:

- (a) It encourages taxpayers to invest in owner-occupied housing. This increases the demand for residential housing generally, and contributes to rises in the price of residential housing.
- (b) It also discriminates against residential housing that is not owner-occupied, thus increasing the cost of rental housing. This in turn increases the demand for owner-occupied housing, and contributes to rises in the price of residential housing that tends to be owner-occupied.'

The government's concern should be to make affordable housing available, whether owner-occupied or not. Owner-occupiers tend to be wealthier than those who have to rent. Thus the concessional tax treatment of owner-occupier housing tends to contribute to the inflation of house prices, while making housing less affordable to those who are not owner-occupiers.

Broadly speaking, residential property with land tends to be owner-occupied. Strata title property tends to be rental-occupied.

The preferred course of action is to abolish concessional treatment for owner-occupied housing.

## **2 If concessional tax treatment is retained, it should be extended to rental housing**

If the concessional tax treatment of owner-occupied housing is retained, the concessional treatment should be extended to rental-housing. There are two alternative ways of doing this:

- (a) Rents paid on property occupied by the taxpayer should be deductible against taxable income; or
- (b) The concessional tax treatment for investment in residential property should not depend on whether the property is owner-occupied or not. A taxpayer should be able to nominate a single residential property for concessional tax treatment, even if that taxpayer is not currently occupying that property. This means that:
  - (i) rental income from that single residential property should not be included in taxable income; and
  - (ii) capital gains in respect of that single residential property should not be subject to CGT.

The tax concession should apply to only one residential property owned by the taxpayer at any time. Any other residential properties should be subject to the usual rules that apply to investments in other asset.

## **3 Owner occupation is a costly form of housing**

Unless concessional tax treatment of owner-occupied housing is abolished, the preferred alternative is to allow rental deductions against taxable income.

- (a) This would help make housing more affordable to those who do not own their own homes, and who may never own their own homes.
- (b) Rental yields on residential investment property would rise, encouraging investment in residential housing and thus making more rental housing available.
- (c) On the other hand, demand for owner-occupied housing would be reduced, thus making such housing more affordable to those who aspire to owner-occupied housing.

The overall effect is to reduce the level of owner-occupied housing. However this is not a matter of concern. The underlying concern for the government is affordable housing, whether owner-occupied or not. Owner-occupation is a more costly form of housing than rental housing:

- (d) **It requires a person to invest a substantial proportion of his or her wealth in a single asset, thus losing the benefits of diversification.** The individual's wealth is over-exposed not just to the residential property market, but to a particular asset within that market.

(e) **It leads to excessive turnover in residential properties.** Individuals typically live in more than one property over the course of their lives. To retain concessional tax treatment in respect of owner-occupied property, individuals have to "sell and buy" whenever they move to another property. However sale and purchase transactions are costly - e.g., agent's fees, advertising costs, government taxes. These costs can be avoided if individuals are able to retain concessional tax treatment when they move to a property that they do not own.

(f) **It discourages individuals from moving.** An individual's choice of location to reside at usually changes over time, often for work related reasons. If moving is costly (because of the loss tax concessions, or because of sale and purchase transaction costs), individuals may decide not move, even if this means foregoing job opportunities.

#### **4 The rules restricting concessional tax treatment to residential housing that is both owned and occupied by the taxpayer make it difficult for those who are less well-off to eventually own a home**

If concessional tax treatment for owner-occupied housing is retained and rental payments continue not to be deductible against taxable income, then at the very least the concessional tax rules should be revised to assist individuals who have to rent while saving to purchase a residential property, or who are unable to immediately move into a residential property.

I bought a residential property 6 years ago, with a view to eventually occupying that property. However during the past 6 years, I have been sharing accommodation with others in another property, while renting out the property I bought. This is because I could not afford to move into the residential property straight away. I had to rent that property out to help pay my mortgage on that property.

For the past 6 years, I have had to pay income tax on the rental income on that residential property, while not being able to claim a tax deduction in respect of rents I paid to my landlord.

I am now contemplating selling the residential property that I originally intended to move into, as I would like to live in another area. I have to pay CGT on that sale.

The CGT exemption in respect of a taxpayer's main residence allows that taxpayer to rent out that property for up to 6 years, and still enjoy CGT exemption in respect of that period of 6 years. If I had occupied the residential property I originally bought 6 years ago, and then rented it out, the CGT exemption would have applied to that property. However, as I did not move into the property when I first bought it (not realising then that that was how the CGT exemption rules work), I have to pay CGT for the entire period that I owned the property.

The rules that restrict concessional tax treatment to residential housing that is both owned and occupied by the taxpayer have made it difficult for me to own a home. Today, I still do not live in a home that I own.

#### **5 Recommendation**

The Commonwealth government should:

(f)

- (a) abolish the concessional tax-treatment for owner-occupied housing;
- (b) failing (a), allow taxpayers to deduct rental expense from taxable income;
- (c) failing (b), allow taxpayers to nominate a single residential property in respect of which concessional tax treatment would apply regardless of whether the property is occupied by the taxpayer.

In respect of (b) or (c), it may be sensible to limit the concessional tax treatment so that it applies only in respect of property of a certain value (indexed for inflation). However the restriction should apply equally to owner-occupied properties. This way, the tax concessions will be better targeted at those who are less able to afford housing.

Yours faithfully,

Zhong Jianying  
VIC

7 October 2003

The Treasurer  
Room MG47  
Parliament House  
CANBERRA ACT

**copy to:** Inquiry into first home ownership  
The Productivity Commission

Sir,

## **Inquiry into first home ownership**

You requested the Productivity Commission to undertake an inquiry to evaluate the affordability and availability of housing for first home buyers. You asked the Inquiry to identify and examine mechanisms available to improve the ability of households, particularly low income households, to benefit from owner-occupied housing.

### **1 The Inquiry's terms of reference may be too narrow**

I commend your request for the Productivity Commission to undertake this inquiry. However, I am concerned that the Inquiry's terms of reference precludes the Commission from recommending measures to make housing affordable, whether owner-occupied or not. In particular, I am concerned that the Commission is precluded from recommending any of the following:

(a) abolishing the concessional tax-treatment for owner-occupied housing; (b) allowing taxpayers to deduct rental expense from taxable income; (c) allowing taxpayers to nominate a single residential property in respect of which concessional tax treatment would apply regardless of whether the property is occupied by the taxpayer.

### **2 Please clarify the Inquiry's terms of reference**

Could you please clarify whether the Inquiry's terms of reference does allow the Commission to recommend measures to make housing affordable, whether owneroccupied or not.

### **3 If the Inquiry's terms of reference precludes the Commission from recommending measures to make housing affordable, whether owner occupied or not, please change the terms of reference**

If the Inquiry's terms of reference does not allow the Commission to recommend measures to make housing affordable, whether owner-occupied or not, could you please

amend the Inquiry's terms of reference so that it does allow the Commission to recommend measures to make housing affordable, whether owner-occupied or not.

I submit that owner-occupied housing is a more costly form of housing than rentalhousing. Please see my submission to the Inquiry (a copy of which is attached) where I explain why this is the case.

If you choose not to allow the Commission to recommend measures to make housing affordable (regardless of ownership), could you please explain why?

I would be grateful for your written reply to this letter. Could you please send a copy of your reply to the Productivity Commission's Inquiry into first home ownership?

Yours faithfully,