

Economic Policy Centre

The University of Auckland Business School

Taxation of Housing: last chance saloon

**Pensions and Intergenerational
Equity Hub
Economic Policy Centre**

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Fair Economic Return FER

St John & Baucher: Fair Economic Return (FER) Restoring equity to the social fabric of New Zealand provides a different, yet principled, approach in the light of the failure over many years to implement a Capital Gains Tax (CGT) in New Zealand.



Can we agree about the problem?

- Endemic scary house boom/bust cycle
- Real resource misallocation problem
- High rents evictions homelessness despair and social dislocation
- Unsustainable inequality

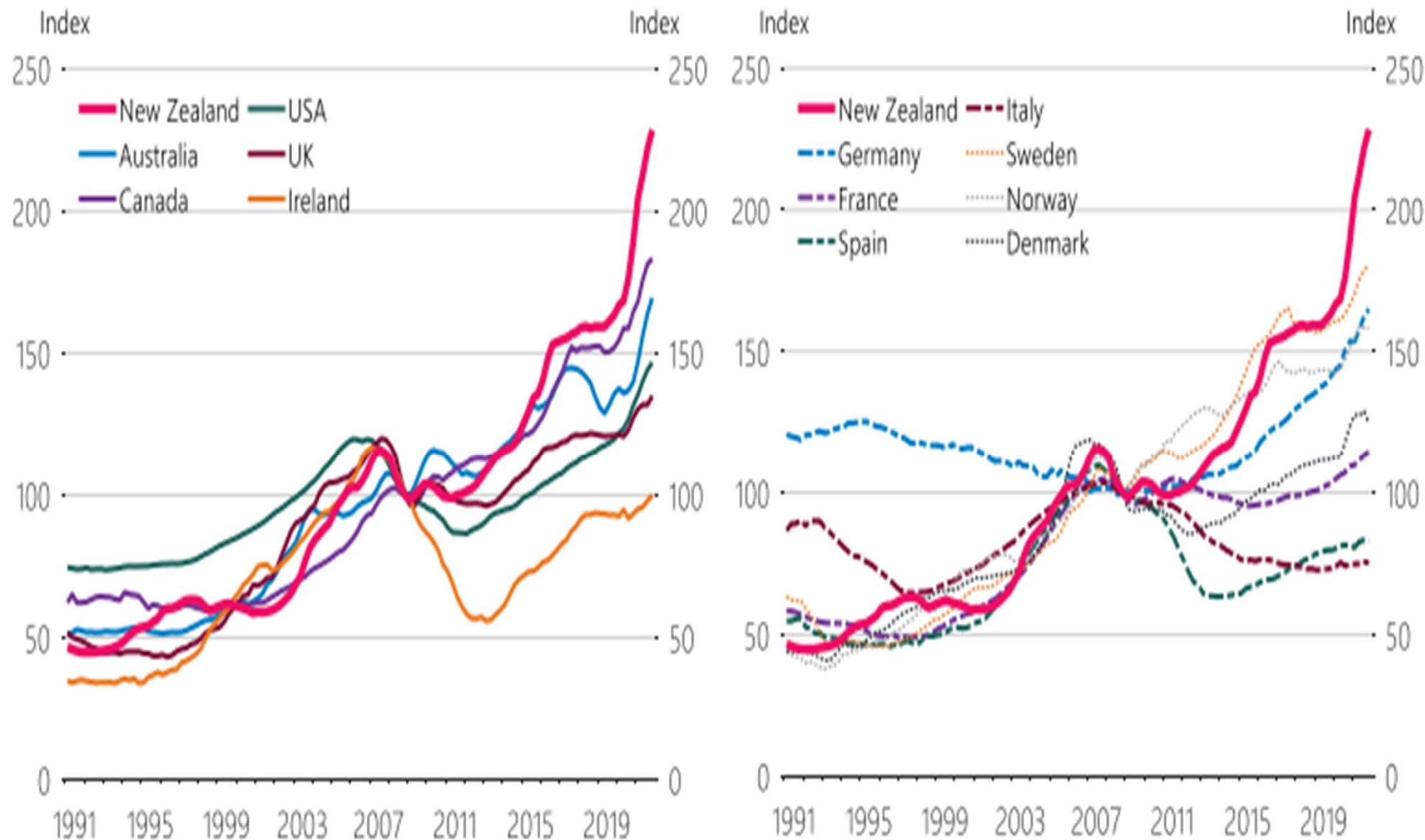
"What we really have is a serious, systemic wealth distribution issue to deal with – housing is the prism through which you see this inequality of wealth most clearly." Mark Todd

1. Scary bubble

Speculators may do no harm as bubbles on a steady stream of enterprise. But the position is serious when enterprise becomes the bubble on a whirlpool of speculation.... the capital development of a country becomes a by-product of the activities of a casino (Keynes, 1936, p. 159).

Our economy is already a housing market with bits tacked on and has been for 20 years... **Aotearoa-NZ's entire society and future is a housing market with bits tacked on. B Hickey**

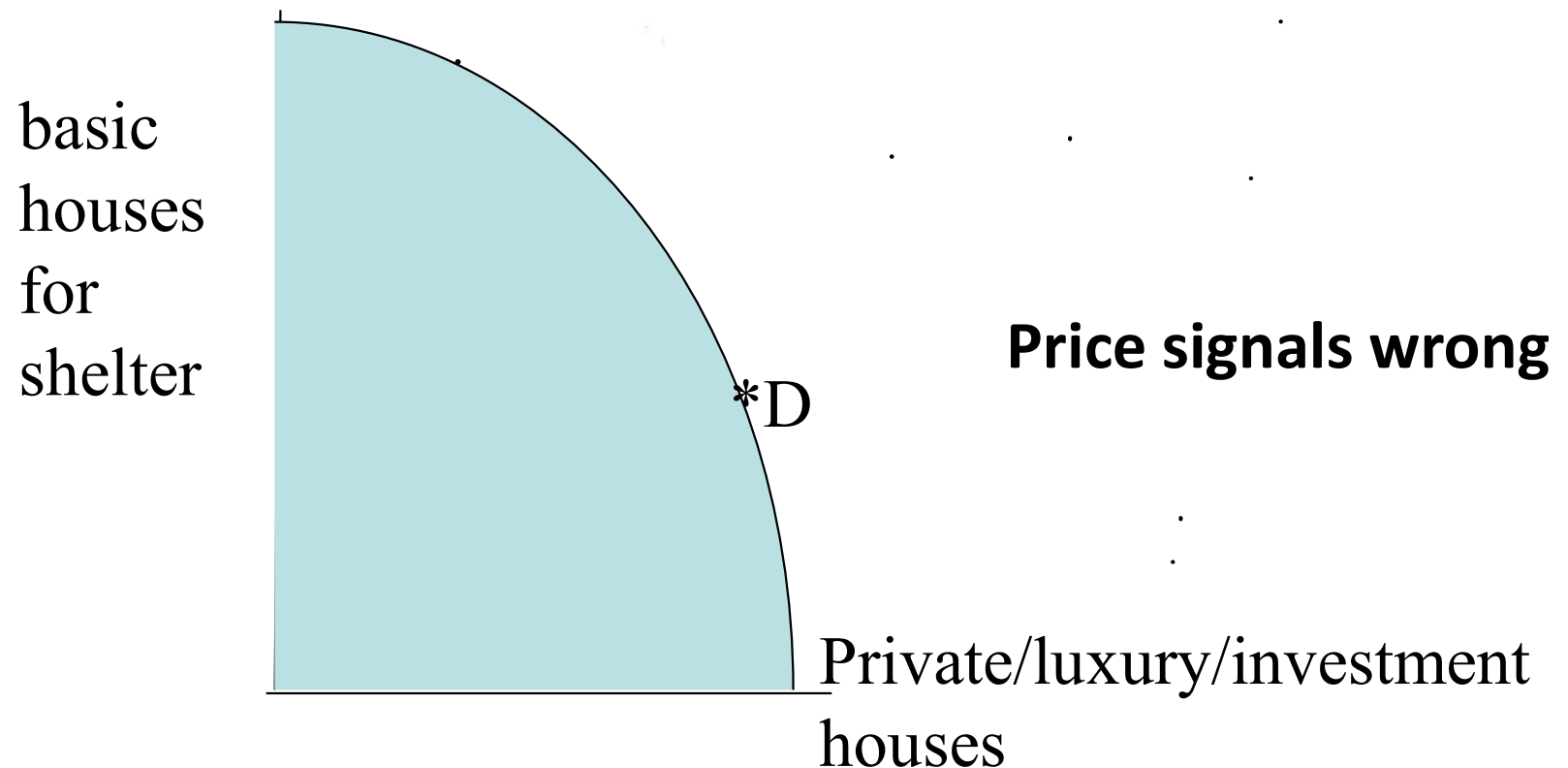
Nominal price index RB June 2022

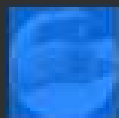


Notes: Data are sourced from the [OECD housing database](#). The benchmarking to 2008Q4 is based on the authors' calculations.

2. Real resource problem

Using our scarce resources for things that enhance all lives now and for the future.





Waiheke Island Helipads

Robin Tucker



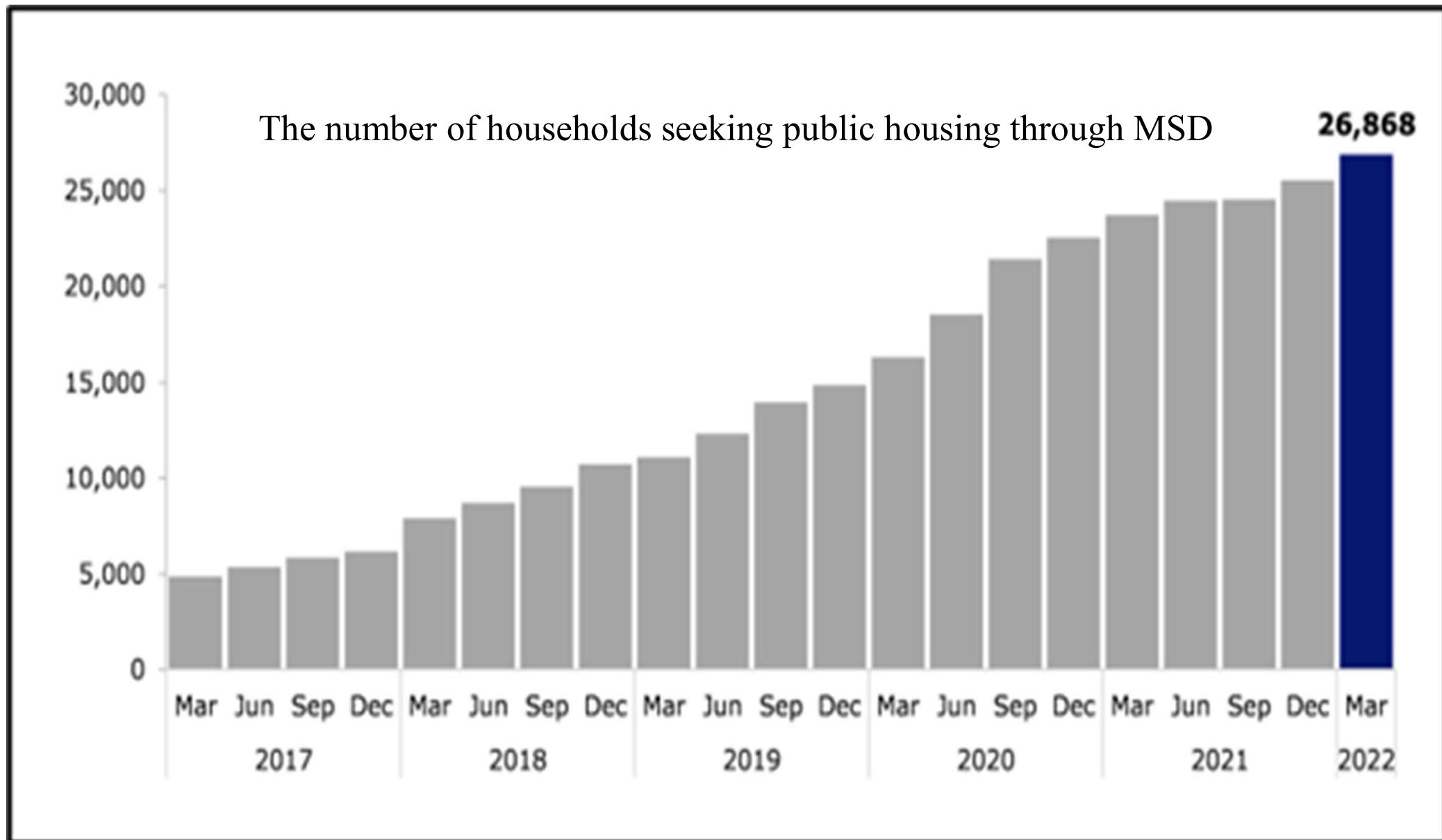
i This map was made with Google My Maps. Create your own.





CV= \$22m largely empty since 2017

3. Accelerating Misery and degradation



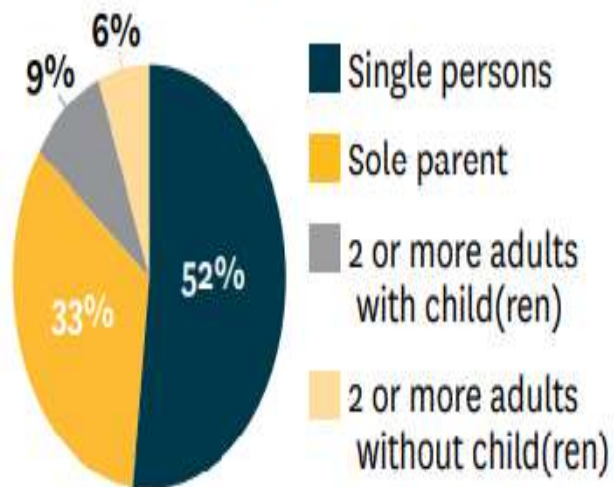
Priority A (90%) applicants 'at risk' includes households that have **a severe and persistent housing need that must be addressed immediately.**

Priority B (10%) have a 'serious housing need' and includes households with a significant and persistent need

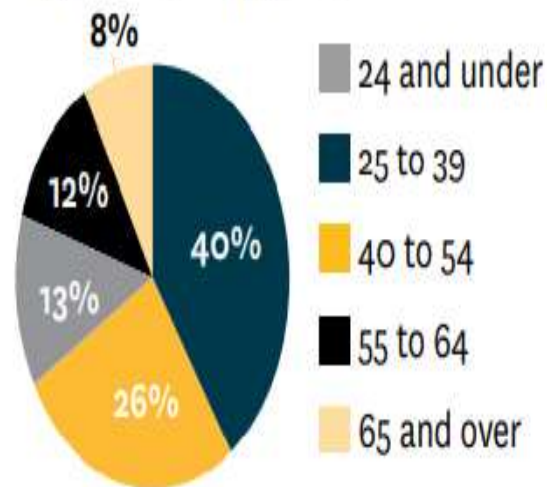
Characteristics of applicants on the Housing Register

As at the end of December 2020 the main characteristics of applicants on the register were:

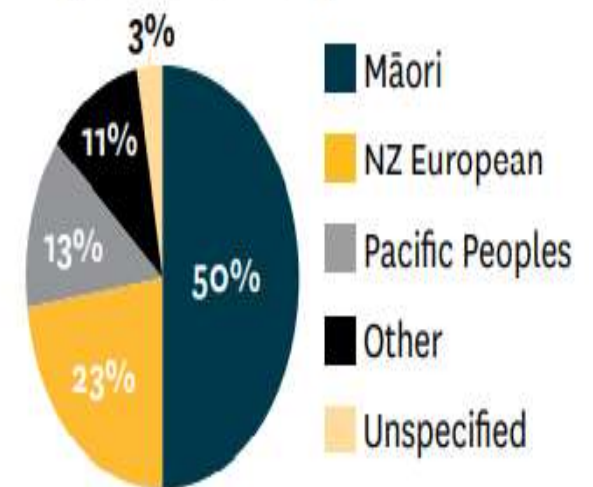
Household composition:



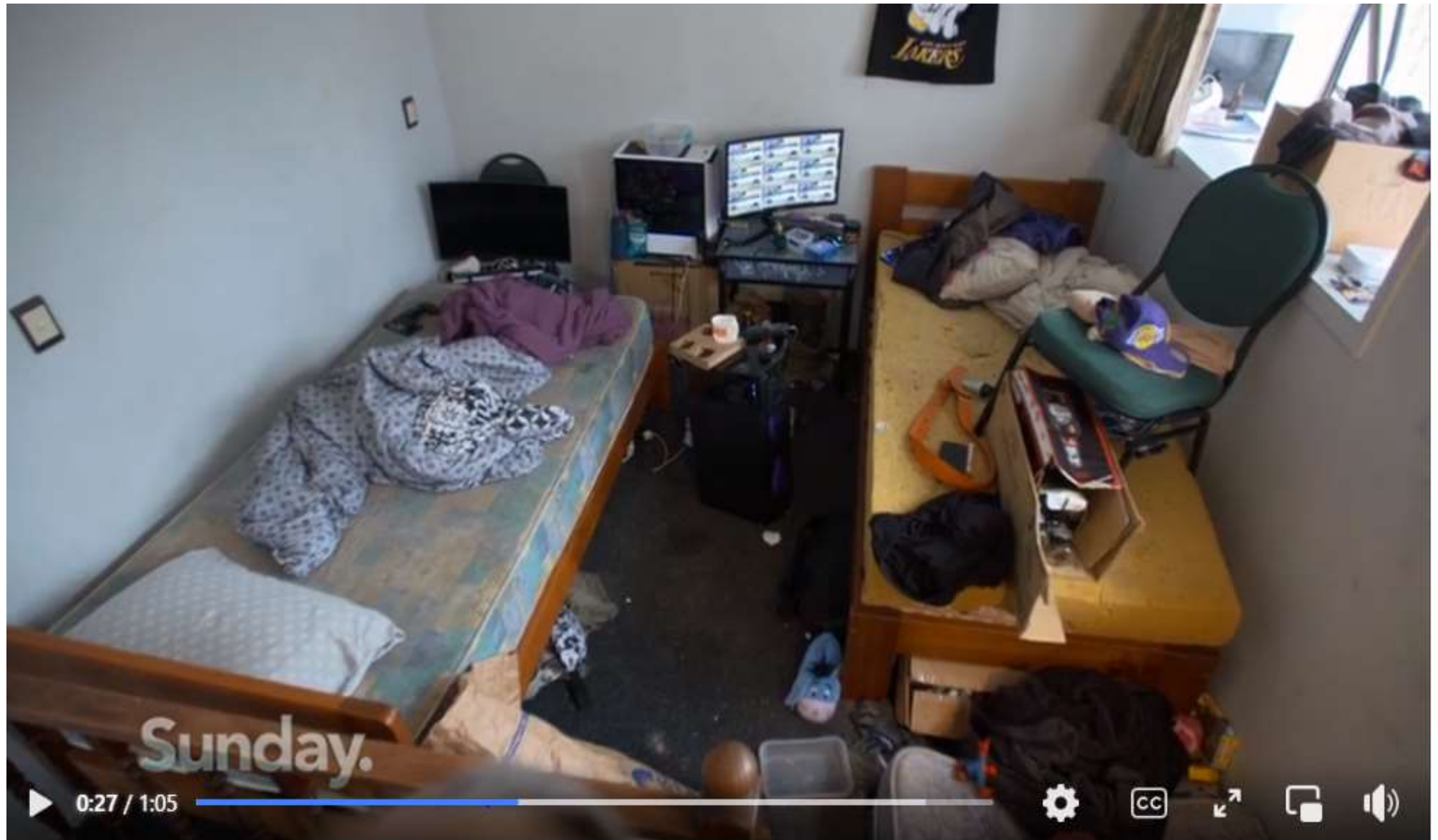
Age of main applicant:



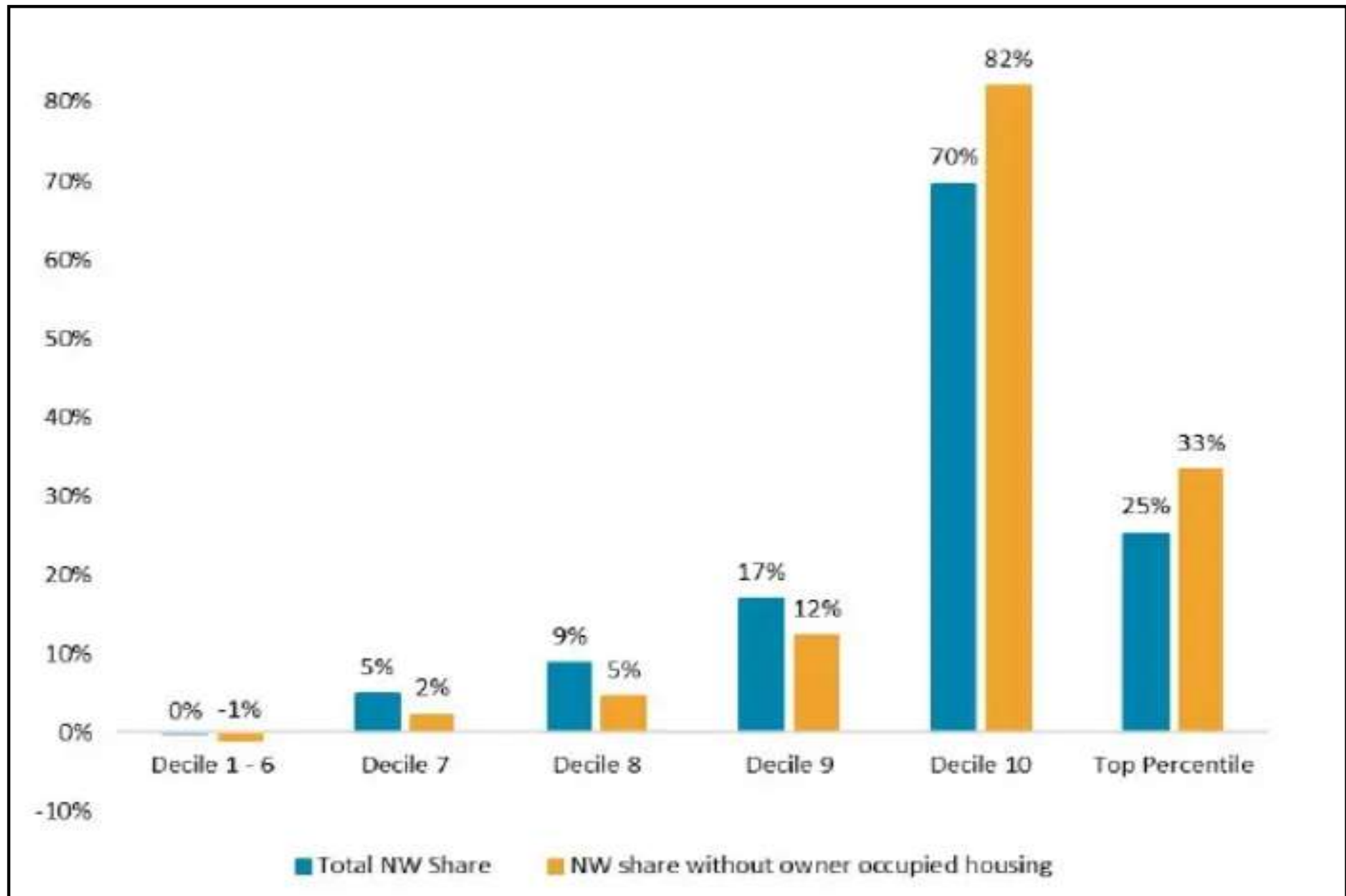
Reported Ethnicity:



Sunday GOLDEN MILE | TVNZ+



4. Unsustainable growth in inequality.



Treasury 2021 estimates of wealth distribution 2016

Where is the damaging inequality?

New Zealand Asset Classes



RESIDENTIAL REAL ESTATE

\$1.35 trillion

\$298 billion in home loans



COMMERCIAL/INDUSTRIAL REAL ESTATE

\$229 billion



NZ LISTED STOCKS

\$197 billion



NZ SUPER & KIWISAVER

\$126 billion

Source
Corelogic April 2021

Value of the housing stock (Reserve Bank)

Housing - Reserve Bank of New Zealand - Te Pūtea Matua

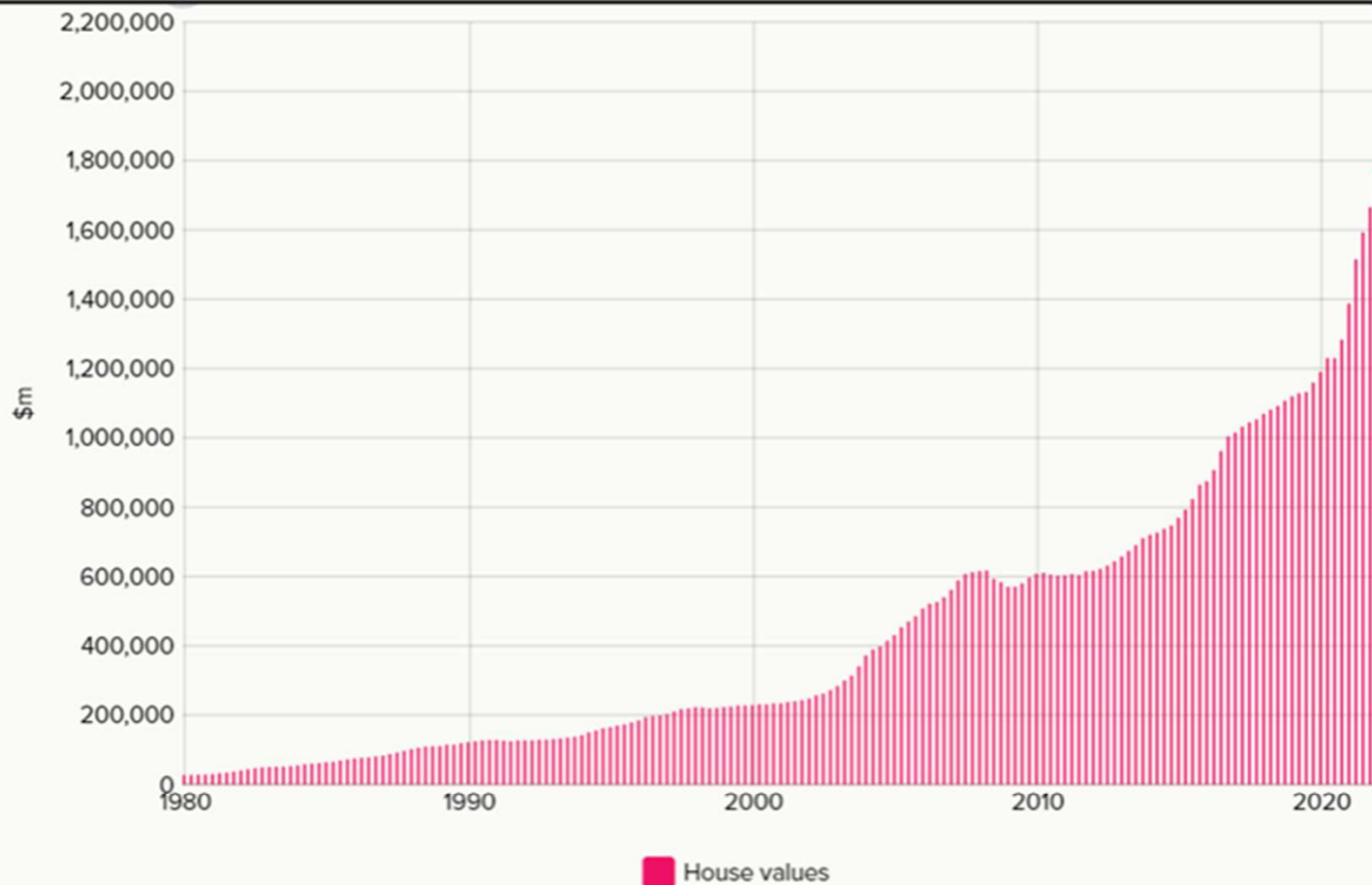


Chart Summary

The value of housing stock includes all private sector residential dwellings (detached houses, flats and apartments), lifestyle blocks (with a dwelling), detached houses converted to flats and 'home and income' properties. It does not include vacant land. This is an estimate of the current market value of houses in New Zealand and is based on current house prices (see the metadata for aggregate quarterly non-farm residential dwelling value data). The data is compiled by CoreLogic and published by the Reserve Bank.

Emmerson: the tools for a housing emergency



Govt has been using the hose

BUT sadly one full of petrol

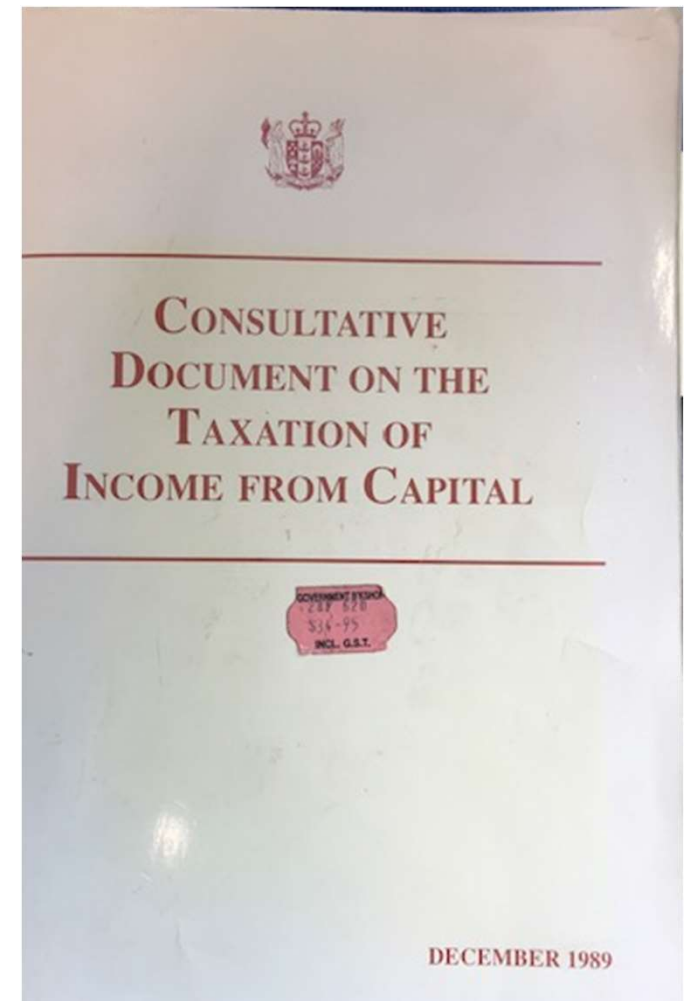
- Monetary policy has inflated the property market with cheap money.
- **Housing is a taxpayer subsidised investment asset**

Bright-line test only applies to future purchase and sale—
Does not capture tax-free accumulated capital gains

Removal of interest deductibility – reduces ability to
generate losses for leveraged rentals
Accrued tax losses can still be passed forward
Does not impact on 100% equity financed or owner-occupied
properties

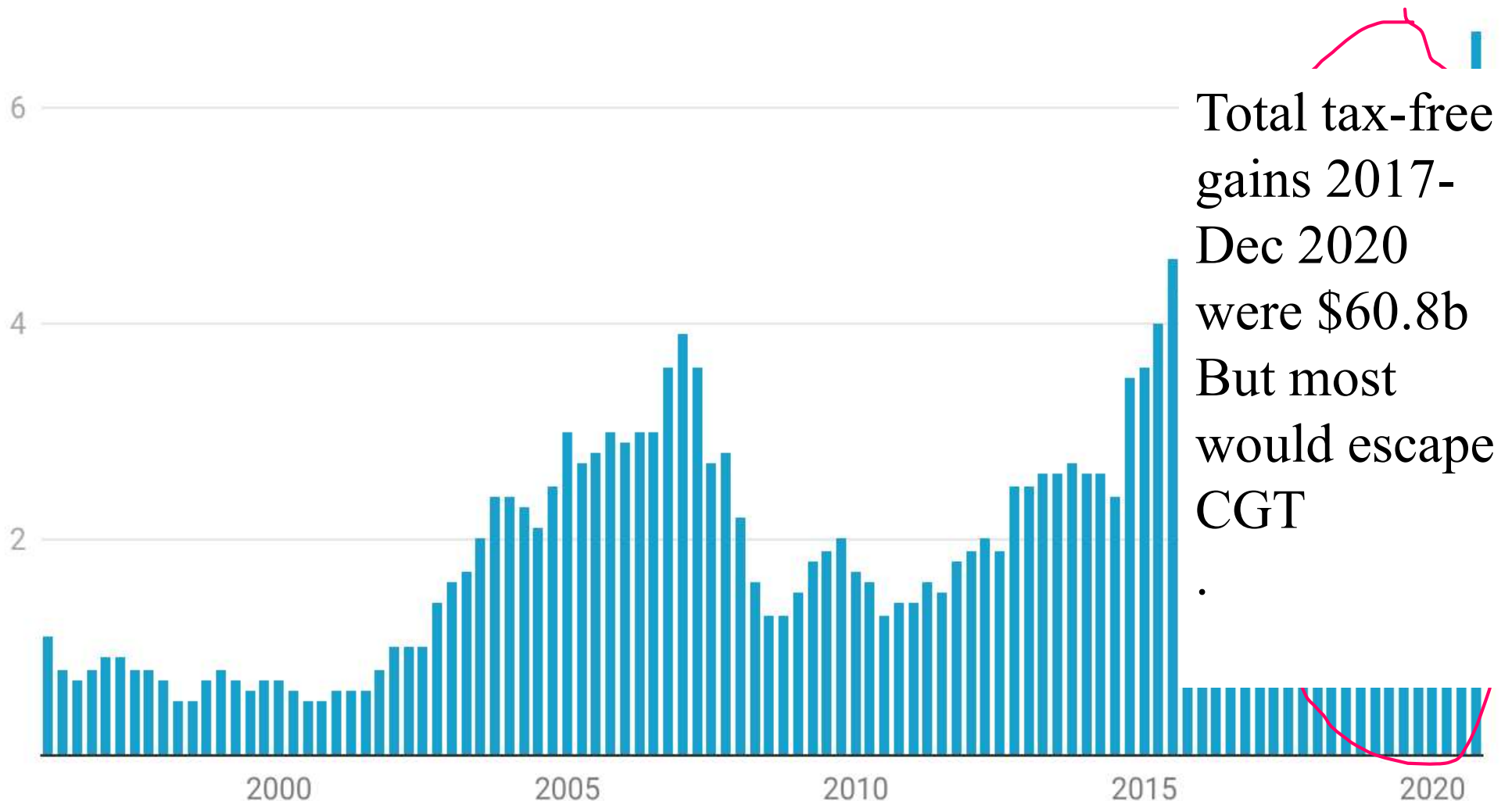
Why not Capital Gains Tax?

- 1967 Ross Committee
 - 1982 McCaw Committee
 - 1987 Brash Consultative Committee Accrual Tax
 - 1988 Valabh Consultative Committee International Tax Reform
 - 1989 Report of the Consultative Committee
Income from Capital
 - Abandoned 20th March 1990 by David Caygill
 - 1988 Royal Commission Social Policy
 - 1988 Brash Committee Superannuation
 - 1988 Brash Committee Life insurance
 - 2001 McLeod Tax Review
 - 2010 Tax working group report
 - 2019 TWG report
- “No CGT on my watch” PM



A CGT in place would have missed most of it

Realised capital gains from NZ home sales (qtrly, \$b)



Only two tax hoses left

- Capital Gains Tax- off the table
- Land tax
 - Bernard Hickey 0.5% land tax raises \$6 billion
- FER approach
 - 2% FER on a taxable base of around \$500b gives \$10b taxable income: \$3.3b tax
 - 4% FER \$6.6b tax

Can we move with urgency?

Reform must

- Address the actual problem
- Remove pernicious tax distortions
- Be progressive in design
- Encourage a better rental market
- Produce revenue for redistribution
- Be simple, fair and above all doable

Land tax v FER

Fair economic return FER

(Origins in RFRM- 2001, minority report TWG 2019,
The FIF regime.)

- All housing wealth held by individual is aggregated and registered first mortgages deducted
- **Net equity less \$1m** treated as if on term deposit earning say 2-4%
- Housing income is taxed at individual's marginal tax rate

FER would

Do away with the need for landlords to feed tax accountants

- No rental losses
- No interest write offs
- Capture capital gain in the equity base over time
- Divert resources from luxury housing
- Change the culture of housing as an investment commodity- better use of housing stock
- *Be supported* by tighter current bright line tests for short term gains, LRVs 40%, removal of interest only loans.
- *Be progressive*
 - Affect only the top 20% of wealthiest property owners and absentee owners

FER is practical, simple and fair

- Could start 2023/24
- Based on 2022 CVs (government valuation)
- IRD holds a register of housing interests for each taxpayer

Net equity aggregated as at 1 April 2022.

Net equity*FER rate = taxable income

- Low FER rate to start— 2%-- rate set as policy tool at range sitting below the mortgage rate

Example of how FER would work

As at 1 April 2024,

Couple own

home CV = \$5m

bach CV = \$2m

rental CV = \$800,000 with mortgage of \$200,000

Total net equity = \$7.6m

each person = \$3.8 m

after exemption = \$2.8m

FER taxable income @ 2% = \$56,000 each additional taxable income

FER taxable income @ 4% = \$112,000 each additional taxable income

What about a Land Tax?

- A low rate applied to value of land could raise significant revenue
- Land Tax had been part of tax system but repealed as part of 1980s reforms because too many exemptions minimised the base
- Not considered by 2001 McLeod Review
- 2010 VUW TWG “most members...support the introduction of a low-rate land tax as a means of funding other tax rate reductions”

Could it apply to residential land?

A land tax is regressive

A land tax attaches to the land itself and is not tailored for individual circumstances

“Given that we have an effective land tax already in the rates we pay and that it has the potential to be regressive, it is hard to see that introducing an additional land tax, even at a low rate would be acceptable”. St John and Baucher

Example *A low-income family living in a rundown house in Ellerslie with a backyard and a \$400,000 mortgage general rates of \$4000. .*

CV = \$1.8m

house value = \$125,000

0.5% Land tax = \$8375

For someone on a higher income in a city apartment no mortgage CV = \$1.8m

land value = \$280,000,

land tax at 0.5% = \$1400.

How would they fare with FER

- Low income family in Ellerslie

FER @ 2% = taxable income \$8000

tax = \$2640 single

Tax = 0 couple

- High income apartment dweller

FER @ 2% = \$16,000 taxable income - \$5280 tax single

FER = 0 if a couple



Land value

\$13,750,000

Value of improve

\$8,250,000

CV= \$22m largely empty since 2017

Land tax 0.5%= \$68,500

FER @2% = \$440,000 taxable income = \$132,000 tax

Conclusions

- Housing market problems systemic & long-standing
- Existing policy options have not worked
- Capital gains tax off the table
- Land tax is regressive and doesn't discourage over investment in housing.
- Fair Economic Return is a circuit breaker
 - FER captures accumulated gains which a CGT cannot
 - Addresses wealth inequality
 - Should force a reallocation of resources away from top end housing
 - Builds on existing tax rules in FIF regime and associated persons so can be implemented quickly