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A plan to end Stamp Duty: Making property taxation fairer in New South Wales

**IMPROVING HOUSING AFFORDABILITY
FUNDING INFRASTRUCTURE**

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William McKell made a powerful contribution to both New South Wales and Australian society through significant social, economic and environmental reforms.

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NOTE

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The economic case for a land value tax is simple, and almost undeniable.

Why, then, do we not have one already?

Why hasn't it been adopted widely in the western world?

Even more puzzling is that, right now, as western economies struggle with the global financial crisis, why isn't this form of taxation being seriously considered as an alternative?

SIR JAMES MIRRLEES

EMERITUS PROFESSOR OF POLITICAL ECONOMY, CAMBRIDGE UNIVERSITY,
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REFORMING THE TAX SYSTEM FOR THE 21ST CENTURY, 2011



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Executive summary and recommendations

A proposal to make property taxation fair in New South Wales

There are few, if any, taxes in Australia that are more widely derided than stamp duty. Levied by state and territory governments at the time of purchasing a home, the tax discourages homeowners from moving, and represents a significant up-front cost when moving home.

While there is immense public and expert support for the abolition of stamp duty – neither the New South Wales (NSW) Government, nor the NSW Opposition, currently propose its abolition. The reason is that stamp duty represents up to one quarter of state government tax revenue. It cannot be abolished without the introduction of a replacement revenue source.

Some have advocated that the federal Goods and Services Tax (GST) could be increased to facilitate the abolition of stamp duty. Such a proposal has always presented a substantial challenge: requiring the federal government and all state and territory governments to agree to such a reform.

Following the 2014 Federal Budget which cut \$80 billion in funding to state and territory governments, achieving a broadening of the GST still may not allow the government to abolish stamp duty, due to the increased need for state funding for health and education services.

There is another way to replace stamp duty revenue.

Land tax, which is currently levied by the NSW Government on limited properties, could be extended and levied on all land in New South Wales. This would include land that is currently exempt from taxation such as the primary place of residence, the family home. This replacement revenue would allow for the abolition of stamp duty in New South Wales.

The extension of land tax would deliver a range of benefits in addition to the abolition of stamp duty including improving housing affordability, and helping to provide transport infrastructure funding. Additionally, for the majority of New South Wales homeowners, the replacement of stamp duty with a land tax will reduce the amount of property taxes paid during their lifetimes. These are some of the reasons why numerous taxation reviews and expert reports have recommended extending land tax in order to abolish stamp duty.

New South Wales' over-reliance on an unfair tax: stamp duty

Stamp duty is an unfair, volatile and inefficient form of taxation. It can represent over a quarter of up-front costs for first homebuyers (often making home ownership prohibitive), and inhibits mobility as homebuyers avoid the tax.

A homebuyer seeking to purchase a median priced Sydney home costing \$1,032,000 will face a stamp duty bill of \$42,250.¹

The Australia's Future Tax System Review

(Henry Tax Review) did not hold back in its outright condemnation of stamp duty stating that:

“Stamp duties on conveyances are inconsistent with the needs of a modern tax system. While a significant source of state tax revenue, they are volatile and highly inefficient and should be replaced with a more efficient means of raising revenue. Conveyance stamp duty is highly inefficient and inequitable”.²

Land Tax

Land tax has been levied in one form or another in New South Wales since 1895, and was the first federal tax to be introduced in Australia in 1910. Land tax in New South Wales is levied annually on the unimproved value of land as assessed by the NSW Valuer General. It does not include the cost of buildings or other improvements to the land.

While land tax is currently levied in New South Wales, the majority of homeowners do not pay land tax as the family home receives an exemption. New South Wales homeowners currently pay land tax to their local municipal councils in the form of council rates.

A fair, efficient and simple tax

While stamp duty is inefficient and inequitable, land tax is one of the most equitable and efficient forms of taxation.

If broadly applied, land tax is extremely fair. All landowners pay the tax annually based on the value of their land, not what improvements they have made to their land, thus not penalising home renovations.

If broadly applied, land tax is perfectly efficient as it is impossible to avoid the tax.

Finally, the tax is simple to understand and administer. An annual land tax notice is provided, identical to council rates, and paid by the landowner.

Transition arrangements

Three key concerns are rightly raised when considering the extension of land tax to abolish stamp duty in New South Wales: the impact on homebuyers who have recently paid stamp duty, the impact on asset rich but cash poor homeowners, and the impact on agricultural primary producers.

While a range of transition proposals have been

canvassed by policy makers, this paper endorses transition arrangements proposed by the NSW Financial Audit 2011 (Lambert Report).

Following the abolition of stamp duty, land tax would only be applied to homeowners after they purchase a new family home. This means that homeowners would not pay land tax until they move to a new home. Therefore, buyers that have recently paid stamp duty will not pay land tax until they buy a new home.

Homeowners who are cash poor (often retirees) will not become liable to pay land tax unless they move home. It is further proposed that a rate deferral scheme (which currently exists in the ACT), be introduced to allow cash poor homeowners to defer their land tax liabilities.

Finally, a land tax calculation method based on the square metre value of land (as opposed to the current aggregate holdings calculation) would mean that almost all primary producers would fall below the tax-free threshold for land tax.

Helping first home buyers and improving housing affordability

Sydney is the third most unaffordable city in the world to buy a home. Abolishing stamp duty and extending land tax will improve housing affordability in Sydney and New South Wales.

First home buyers will benefit immediately by no longer facing the substantial up-front cost stamp duty represents when saving for a first home. Existing homebuyers will also benefit as they are free to move homes without facing the transaction cost of stamp duty.

This will allow homeowners to move more easily to find work. As workers move more freely to accept jobs, downward pressure will be placed on unemployment levels and regional skill shortages will be met.

Through this improved allocation of housing stock, housing will become more affordable in New South Wales.

Lower tax burden for most homeowners

Replacing stamp duty with land tax will reduce the amount of up-front costs homebuyers must pay when buying a home. The cost of land tax to be paid annually is a percentage of the value of the land homeowners own, not the value of the property. On average, it would take eight years for a homeowner to pay the same amount in land tax as they would normally pay upfront in stamp duty costs, allowing people to move home more regularly and avoid being penalised for doing so.

According to the 2011 Census data, 67 per cent of Australians are homeowners: 35 per cent with a mortgage; 32 per cent own their homes outright and the remainder of Australians are renters or live in other arrangements. 16 per cent of outright homeowners moved house in the previous five years to the 2011 census, and nearly every second homeowner with a mortgage moved between 2006-2011.

The average amount of time spent in a home for those homeowners with a mortgage is 8 years; the average time spent for those who own their homes outright is 18 years in the same dwelling.³

This means that over half of Australians who own their own home (with or without a mortgage) move house on average every 8 years. A transition to a land tax arrangement away from stamp duty will result in many Australians paying less property tax in total over the course of their lives. For the remainder of Australians who live in their homes for longer, property tax will be spread more evenly over the space of their lives, resulting in homeowners being able to utilise their income more efficiently.

Funding infrastructure

New South Wales has a considerable transport infrastructure project backlog. The reason more transport infrastructure is not being built across the state is simple: the NSW Government does not have the funds to pay for it.

A key benefit of a broad based land tax is the ability to receive additional infrastructure funds through a process known as 'value capture' financing.

When the NSW Government builds transport infrastructure projects, nearby landowners generally receive a significant boost to their land value as new transport services are built nearby.

Currently the majority of residential landowners, who are exempt from land tax, receive a significant personal financial gain without making any additional contribution.

A broad based land tax would allow for the NSW Government to 'capture' some of the value, through a small increase in land tax, which is being created through the nearby infrastructure project.

Homeowners would still receive a personal financial windfall, but would make some small contribution towards the transport project. This would help to fund the transport project, and allow for additional transport infrastructure to be built elsewhere.

Communicating the case for change

The economic and social case for abolishing stamp duty and extending land tax is overwhelming. Such a reform would be a fairer, simpler and more efficient way to tax property in New South Wales, while creating a range of additional benefits.

However, tax reform is a difficult task.

For a tax reform proposal to succeed, it must be clearly articulated and advocated over a period of time. Public awareness of the need for tax reform must be raised, and questions and concerns surrounding the reform addressed.

The proposal would ideally be endorsed and promoted by economists, policy makers, industry and civil society leaders, while vested interest scare campaigns are methodically debunked.

By working to create the political environment for change, New South Wales industry and civic leaders can help to improve housing affordability and finance infrastructure, while making property taxation fair in New South Wales.

Executive summary and recommendations

While the economic and social case for abolishing stamp duty and extending land tax is extremely strong, the political challenges associated with such a reform are formidable.

Thus, if such a reform is to be realised, an incremental approach is recommended.

This paper makes three recommendations to begin to communicate this proposal to the New South Wales people so that the political environment for this reform can be created.

RECOMMENDATION 1

The New South Wales Government commission an independent expert panel to review property taxation in New South Wales.

RECOMMENDATION 2

New South Wales community leaders and representatives of peak bodies publicly advocate the abolition of stamp duty and extension of land tax.

Our community leaders can play a crucial role in generating momentum to create a fairer property taxation system through promoting the benefits of this reform to the people of New South Wales.

RECOMMENDATION 3

New South Wales advocacy groups who represent individuals and organisations that will benefit from this reform, communicate the benefits to their members.

Ensuring that those who will benefit are aware of the proposal, will help to create public support for property taxation reform in New South Wales.



FIGURE 1 THE PROPOSAL IN SHORT

So what is the proposal?

To abolish stamp duty and extend land tax.

It's great abolishing stamp duty. But how would land tax be extended?

Currently family homes are exempt. Over time land tax would extend to include the family home.

Really? I just bought a new house and paid stamp duty and now I'll be paying land tax?

No. Under the proposal you will not start paying land tax until you purchase a new home. When you next move you won't pay stamp duty but will start paying land tax.

Ok. How much will I pay when I next move?

It will depend on the value of your land. But for example, on your current house, which you paid \$19,000 in stamp duty, you would pay around \$2,260 in land tax each year.

Sounds good. But what about my grandmother, who lives alone in the house my grandfather built?

She won't pay land tax unless she moves. If she did move she would begin to pay land tax annually. However, she could apply for a deferral of her land tax payments if she couldn't afford to pay them.

That's a relief. Are there other benefits?

There are lots of benefits. It will make housing more affordable, help to reduce unemployment, and fund infrastructure across NSW.

Tell me more



2. Introduction

Applying a tax on the unimproved value of land is widely regarded by many economists as one of the most equitable, efficient and simplest forms of taxation.

The introduction of a tax on land has been advocated by economists since the 18th century, following its endorsement by Adam Smith, in his seminal work *An Inquiry into the Wealth of Nations*.⁴

Australia's first land tax was introduced in Victoria in 1877⁵ and the first federal tax introduced in 1910 was a land tax.⁶ Currently all Australian states, and the Australian Capital Territory (ACT), apply a tax on land ownership, although significant exemptions apply. These exemptions create a distortive effect: reducing the equity and efficiency of land tax.

On the other hand, each state and territory levies stamp duty⁷ on property transactions, which is widely regarded by economists and policy makers as an unfair, inefficient, volatile, and distortive form of taxation.

The reason stamp duty has not been abolished, and is still levied by all states and territories, is due to the significant revenue raised from the tax.

Stamp duty contributes about one quarter of annual state taxation revenue.⁷ Given the structural challenges of state and territory budgets, calls to abolish stamp duty without proposing viable replacement revenue sources are naïve.

A considered proposal, which is gaining support from economists, policy makers, industry and community leaders, is to abolish stamp duty and replace the revenue it generates through an extension of the land taxation base. This would involve removing current exemptions from land tax, such as the exemption for the family home.

This paper will examine this proposal, including assessing the economic and social impact of such a reform, in order to determine whether abolishing stamp duty and extending land tax will deliver economic and social benefits to the majority of New South Wales residents.

* Stamp duty may also refer to transfer duties unrelated to property such as motor vehicles. Property stamp duty can also be described as conveyance stamp duty, transfer duty and property duty. However in general contemporary usage stamp duty refers to exclusively to stamp duty paid on property transactions, which is the way in which the term will be used throughout this paper.

3. A proposal to make property tax fair: abolish stamp duty and extend land tax

3.1 The fiscal challenge New South Wales faces

In 2015-16, the NSW Government expects to raise slightly over half of its predicted expenditure through taxation, royalties and other measures.⁸ New South Wales is not alone. All of Australia's states and territories raise significantly less revenue than they require to provide the services expected of state and territory governments.

In addition, despite a recent increase in infrastructure spending, New South Wales continues to face a long-term infrastructure deficit – particularly in relation to transport infrastructure.⁹

The states' and territories' taxation powers have been eroded in favour of the federal government over many years. Income taxation responsibilities were seized by the federal government during World War Two and never relinquished. Throughout the post-war period, a gradual centralisation of taxation powers occurred, culminating at the turn of the millennium with the introduction of the GST, as the federal government required the concurrent reduction of some state levied taxes.

Despite this steady transferral of revenue raising powers, there has not been a commensurate transferral of expenditure responsibilities. State and territory governments are still expected to fund schools, hospitals, police forces, roads, public transport and various other services.

As a result, the federal government transfers billions of dollars in revenue to each state and territory annually to maintain their expenditure. This disparity between state and federal revenue and expenditure is known as a Vertical Fiscal Imbalance (VFI).

While some argue that a degree of VFI is not damaging and can in fact be a good thing, most agree that high levels of VFI are inefficient and encroach upon the fiscal independence of democratically elected state and territory governments.¹⁰ A number of taxes that are currently levied by state governments are regarded as distortive and inefficient when compared to federal taxes.¹¹ There are thus calls to abolish these state taxes and replace them with more efficient federal taxes, which would exacerbate VFI.

In New South Wales, one of the most distortive and inefficient taxes levied by the state government is stamp duty. There are regular calls for the abolition of stamp duty in New South Wales. This paper will briefly consider why stamp duty is such a widely condemned form of taxation.

3.2 Why stamp duty is a scourge on NSW

“Ideally, there would be no role for any stamp duties, including conveyancing stamp duties, in a modern Australian tax system.”¹²

Australia’s Future Tax System Review, 2010

Stamp duty, which is payable at the time of purchasing a property, is the principal way in which the NSW Government raises revenue from property and represents up to one quarter of state tax revenue. It is levied as a proportion of the sale price of both residential and commercial property.

Stamp duty originated as a tax levied on documents that required government approval. The document was not legally binding until the government had stamped it. Australian states introduced stamp duties in the nineteenth century and have continued to levy this form of taxation to the present day.

While the majority of criticism levelled at residential stamp duty also applies to commercial stamp duty, this paper will focus solely on stamp duty paid on residential properties.

Stamp duty has few, if any, advocates. Countless reviews, enquiries and reports commissioned by governments, independent bodies, peak organisations, universities and charities have called for its abolition (see Table 2).

The Henry Tax Review was unequivocal in its condemnation of stamp duty:

“Stamp duties on conveyances are inconsistent with the needs of a modern tax system. While a significant source of state tax revenue, they are volatile and highly inefficient and should be replaced with a more efficient means of raising revenue. Conveyance stamp duty is highly inefficient and inequitable”.¹³

Ken Henry’s successor as Secretary to the Treasury, Dr Martin Parkinson, reiterated this point in 2011, telling an industry forum that stamp duty is the worst tax levied in Australia and should be abolished.¹⁴

One of the strongest arguments in favour of abolishing stamp duty is its inequity. At face value, stamp duty may appear to be a progressive and equitable form of taxation. It is levied as a proportion of the sale price of a property, and higher value properties are generally purchased by individuals with higher incomes.

However, further scrutiny exposes stamp duty as a grossly inequitable tax. The tax falls only on people who purchase property. Therefore, the tax burden falls on those who regularly move house, by choice or necessity, while those that remain in the same home for a long period of time avoid stamp duty.

As illustrated in Figure 2, a family of modest means who move regularly will pay far more in stamp duty costs than a wealthy family who do not move. Homeowners who move more frequently for work or due to changes in personal circumstances such as divorce or the birth of a child, pay more tax regardless of their means.

FIGURE 2 **HOW STAMP DUTY OPERATES**

Current System: Stamp Duty



HOUSE \$2 MILLION

FAMILY 1

Purchases a \$2 million home

Pays \$95,000 in Stamp Duty

Doesn't move for 20 years

**TOTAL STAMP DUTY
PAID: \$95,000**



HOUSE \$600,000

FAMILY 2

Purchases a \$600,000 home

Pays \$22,500 in Stamp Duty

Over the next 20 years is required to move 6 times for work

Each time purchases a \$600,000 home

**TOTAL STAMP DUTY
PAID: \$135,000**

Stamp duty is an extremely volatile tax

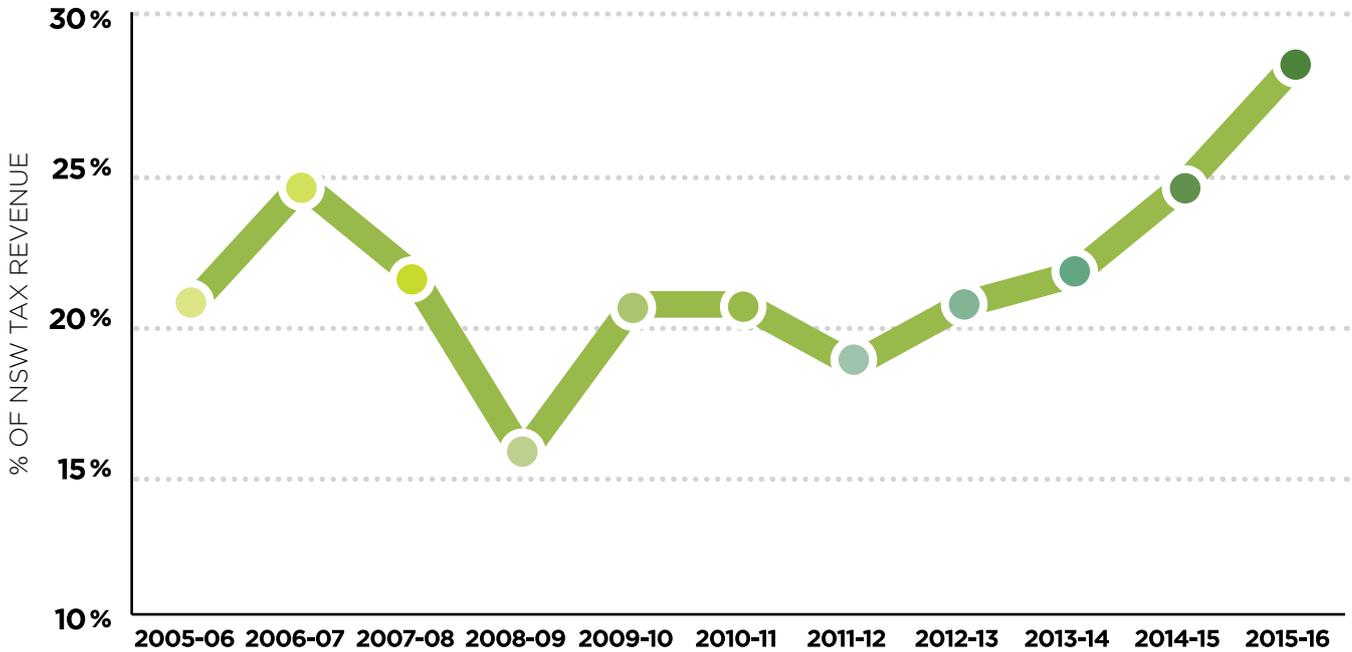
In New South Wales stamp duty has fluctuated in recent years between 15 per cent and 28 per cent of total tax revenue. See Figure 3.

Such dramatic swings in revenue often lead to sizeable inconsistencies between budget forecasts and final levels of revenue. Due to a property boom

in 2014-15 in Sydney, stamp duty revenue surged to \$1.2 billion above the original forecast.¹⁵

The NSW Financial Audit 2011 (Lambert Report) revealed that “Stamp duty on property transfers is the largest single component of stamp duty revenues and is the most volatile revenue source collected by the State.”¹⁶

FIGURE 3 **STAMP DUTY AS A PROPORTION OF NEW SOUTH WALES TAX REVENUE**



SOURCE: GRAPH CREATED USING NSW BUDGET PAPERS 2005-06 TO 2015-16

TABLE 1 **KEY PROBLEMS WITH STAMP DUTY**

INEFFICIENT TAX

Stamp duty is an inefficient tax because it changes consumer behaviour. The principal problem with stamp duty is that it is a transactional tax, and therefore can be avoided by not buying or selling property. Stamp duty acts as a significant deterrent to people changing homes. This results in a misallocation of housing, meaning that people stay in homes that are too large or too small for their needs.

VOLATILE TAX

Stamp duty is based on the sale price of a property, including the land and the buildings on the land. This means when a property boom is occurring, stamp duty revenues increase significantly (as occurred in 2003) however, plummet when property values drop (as occurred in 2008). The tax is purely driven by the volatile New South Wales real estate market.

PUNISHES FIRST HOME BUYERS

Stamp duty adds a significant cost to the price of a home which particularly impacts upon first home buyers. Stamp duty cannot be included in the cost of a mortgage. Thus, first home buyers are required to save for a deposit, fees and the cost of stamp duty. For example, a first home buyer in Sydney seeking to purchase a median price home for \$1,032,000* would face a stamp duty bill of \$42,250. Assuming a 10 per cent deposit of \$103,200 and an average of \$10,000 in legal fees and insurance fees, stamp duty would make up a quarter of up-front costs.

* SYDNEY MEDIAN HOUSE PRICE SEPTEMBER 2015

Bi-partisan opposition to stamp duty

Australia's federal, state and territory leaders generally deliver bi-partisan condemnation of stamp duty. While three of Australia's most recent prime ministers and treasurers have vocally advocated the abolition of stamp duty, they (perhaps unsurprisingly) have not proposed to provide an alternative revenue source. While New South Wales' premiers and treasurers acknowledge the flaws of stamp duty, they are more reserved in criticism due to the state's significant reliance on its revenue. Table 1 briefly summarises the key problems with stamp duty.



Support for stamp duty?

Only two arguments are put forward in favour of stamp duty.

Firstly that is a relatively simple tax to administer, and secondly that it is the status quo form of property taxation. Nevertheless, even those that make these arguments in favour of stamp duty do not advocate its retention.¹⁷

INHIBITS MOBILITY

Stamp duty results in people moving less to avoid the significant burden of this taxation. This creates a litany of public policy challenges, including, but not limited to:

- Homeowners not moving to find new employment and remaining unemployed;
- Homeowners not moving to find new employment and remaining unemployed;
- Homeowners not moving closer to their current place of work and instead commuting and adding to traffic congestion;
- Homeowners not being able to move closer to family or friends; and
- Homeowners remaining in homes that are ill-suited to their needs and could be more efficiently used by others; for example, a retired couple remaining in a six bedroom family home.

INEQUITABLE TAX

Stamp duty is not levied based on an individual's ability to pay, but rather on how often they move. This is particularly unfair when we consider that moving home often occurs during times of financial or emotional stress such as being forced to move to seek new work or due to family separation.

3.3 A fairer way: abolishing stamp duty and extending land tax

As stamp duty makes up between one fifth and one third of NSW Government annual taxation revenue, any effective calls to abolish stamp duty must be accompanied by a suggested alternative revenue source. This paper advocates the abolition of stamp duty and the extension of land tax to replace it as a source of state revenue in New South Wales.

Some advocate that the GST should be increased to provide a replacement revenue. While the belief that a federal government will increase a tax in order for Australia's state and territory governments to abolish a tax has always been somewhat far-

fetched, following the 2014-15 Federal Budget, it seems extremely unlikely.

In the 2014-15 Federal Budget, the Federal Government announced an \$80 billion cut in funding to state and territory governments over the next decade. The NSW Government estimates that New South Wales will experience a cut of \$2 billion in funding over the next four years.¹⁸ If the GST is increased in the future, this increase will be directed to fund existing expenditure, leaving no room for the abolition of other revenue sources such as stamp duty.

Numerous taxation reviews and reports have endorsed the proposal to abolish stamp duty and extend land tax. A selection of notable reports are listed in Table 2.

TABLE 2 **NOTABLE REPORTS ADVOCATING THE ABOLITION OF STAMP DUTY AND EXTENSION OF LAND TAX**

COMMISSIONING ORGANISATION	REPORT	YEAR
NSW GOVERNMENT	<i>New South Wales Tax Taskforce Report</i>	1988
NEW SOUTH WALES INDEPENDENT PRICING AND REGULATORY TRIBUNAL	<i>Review of State Taxation</i>	2008
FEDERAL GOVERNMENT	<i>Australia's Future Tax System Review (Henry Tax Review)</i>	2010
NSW GOVERNMENT	<i>NSW Financial Audit 2011 (Lambert Report)</i>	2011
PRODUCTIVITY COMMISSION	<i>State Land Tax – A Critical Review</i>	1998
PRODUCTIVITY COMMISSION	<i>First Home Ownership</i>	2004
PRODUCTIVITY COMMISSION	<i>Geographic Labour Mobility</i>	2014
PRICEWATERHOUSECOOPERS	<i>Protecting prosperity: Why we need to talk about tax</i>	2013
GRATTAN INSTITUTE	<i>Renovating Housing Policy</i>	2013
BUSINESS COUNCIL OF AUSTRALIA	<i>Action Plan for Enduring Prosperity</i>	2013



A range of models have been proposed to abolish stamp duty and extend land tax.

For the purposes of this paper, a model set out below (Table 3), informed by the Lambert Report, will be advocated in this paper and referred to as 'the proposal'.

Before this paper assesses the economic and social impact of this proposal, we will briefly consider the history and context of land tax in Australia.

TABLE 3 A PROPOSAL TO ABOLISH STAMP DUTY AND EXTEND LAND TAX IN NEW SOUTH WALES

TAX	ELEMENT	ACTION
Stamp duty		Abolish stamp duty.
Land tax	Exemptions	Remove all current exemptions from land tax including primary place of residence and primary production land.
	Rate	Progressive rate. Tax free threshold of \$120 per square metre. 0.75% of assessed land value under \$775 per square metre. 1% of assessed land value over \$775 per square metre.
	Method	Applied on a per square metre basis, not aggregate holdings.
	Special circumstances	Provide for the deferral of land tax liability under special circumstances.

FIGURE 4 **STAMP DUTY AND LAND TAX IN OPERATION OVER 20 YEARS**

Current System: Stamp Duty



HOUSE \$2 MILLION
FAMILY 1

Purchases a \$2 million home
Pays \$95,000 in Stamp Duty
Does not move for 20 years.

TOTAL STAMP DUTY PAID: \$95,000



HOUSE \$600,000
FAMILY 2

Purchases a \$600,000 home
Pays \$22,500 in Stamp Duty
Over the next 20 years is required to move 6 times for work
Each time purchases a \$600,000 home

TOTAL STAMP DUTY PAID: \$135,000

Proposed System: Land Tax



HOUSE \$2 MILLION
LAND VALUE \$1.3 MILLION

FAMILY 1

Each year pays land tax of \$9,750

TOTAL LAND TAX PAID OVER 20 YEARS: \$195,000



HOUSE \$600,000
LAND VALUE \$400,000

FAMILY 2

Each year pays land tax of \$3,000

TOTAL LAND TAX PAID OVER 20 YEARS: \$60,000

4. The history of land tax

Land tax is one of the oldest forms of taxation, having been applied in Ancient China and Europe. In many ways the two fathers of modern land tax advocacy are Adam Smith and Henry George.

In *An Inquiry into the Wealth of Nations* Adam Smith articulates the economic case in support of land tax that is still relevant today: if the unimproved value of land is taxed broadly then economic behaviour is not distorted as all are paying the same tax and land is immobile.

It was Adam Smith who made the case for land tax, but it was Henry George who made it his life's obsession. Henry George, a North American political economist, called for the introduction of a land tax in his influential *Progress and Poverty*.

While Adam Smith advocated land tax based on economic efficiency, Henry George advocated it on social and philosophical grounds. George observed that the United States government taxed productive activities such as labour and commerce, but did not tax the greatest source of wealth concentration – land ownership.

Like Smith, George advocated a broad based tax on the unimproved value of land, which would not create any form of economic distortion. George went further and asserted that if land tax was introduced at appropriate levels, all others forms of taxation on productive activities could be abolished.

4.1 Land tax in Australia

The first tax introduced by the Australian federal government was a land tax in 1910. The tax continued until 1952 when it was abolished primarily due to administrative costs and the growth of other revenue sources such as income tax.¹⁹

However, land tax predated federation. The colony of Victoria introduced Australia's first land tax in 1877, in part to break up large land estates.²⁰ This land tax was abnormal by later Australian standards in that it was a capital land tax (taxing the improved value of the land) not an unimproved value land tax. Tasmania followed Victoria in 1880 also introducing a land tax on the capital value of land.²¹

The first Australian colony to introduce a tax on the unimproved value of land was South Australia in 1884. This tax was notable for three reasons: it taxed the unimproved value of land, it taxed land at a flat-rate, and it was broadly based applying to almost the entire colony.

Due to significant financial pressure, Western Australia introduced a land tax on the unimproved value of land in 1907, while Victoria and Tasmania altered their land taxes from capital land taxes to a tax on the unimproved value of the land in 1910.

Queensland introduced a tax on the unimproved value of land in 1915 following several unsuccessful attempts in the late nineteenth century.

The Australian Capital Territory (ACT) has levied land tax on the unimproved value of land in the form of general rates since self-government in 1989, while the Northern Territory is Australia's only jurisdiction that does not levy a land tax.

4.2 Land tax in New South Wales

In New South Wales, attempts to introduce a land tax in the 1880s were thwarted by New South Wales' landed gentry who held seats in the Legislative Council by right of their property ownership. In 1895, free-trader George Reid, who would go on to become Australia's fourth Prime Minister, was elected Premier with a clear mandate to reduce tariffs and introduce land and income taxes to replace them.

While the tax was primarily introduced as a revenue raising measure, a secondary objective was present: to break-up the large estates owned by New South Wales' well-heeled property owners so that the land could be more effectively utilised and cultivated. A study conducted some years later concluded that the New South Wales' land tax had succeeded in breaking up large estates and making land more productive.²²

No doubt in part due to this success, but primarily as part of a local government reform package, land tax was abolished in New South Wales in 1906. The objective was to provide local councils with an independent revenue stream on which they could rely to provide services and amenities. Land tax or council rates, remain to this day the primary source of revenue for local councils in New South Wales.

However, four years after the federal government abolished the national land tax in 1956, New South Wales re-introduced land tax. The reason for its re-introduction was the same as for its introduction in 1895: the need for an independent revenue stream.

The new land tax was applied to all land in New South Wales, with some rebates for primary production land. In 1970, land used for primary production became wholly exempt from land taxation. In 1973, residential land less than 1,200 square metres occupied solely for residential purposes became exempt from land tax. The family home was now exempt from land tax in New South Wales.

While changes were made to land taxation arrangements during the 1980s and 1990s, the primary structure of land tax remained.

In 2005, significant changes to land tax were introduced. Prior to these changes NSW land tax was applied at a flat rate of 1.7 per cent, the primary place of residence and land used for primary production were exempt, and a tax free threshold of \$317,000 was provided.

In 2005, the tax free threshold was removed and a progressive land tax scale was introduced, starting at 0.4 per cent and increasing to 1.4 per cent.²³ This new structure was only in place for the year of 2005.

In 2006, following community opposition and political pressure, the NSW Government reinstated the tax free threshold (\$352,000) and reverted back to a flat rate of land taxation of 1.7 per cent.

In 2009, a new premium land tax marginal rate was introduced for land valued at over \$2,225,000 at a rate of 2 per cent while all land under this rate (and above the tax free threshold) was taxed at 1.6 per cent. This restored a form of progressive land taxation.

Current Land Tax Arrangements in New South Wales

Land tax in New South Wales in 2016 is currently levied at the rates and thresholds set out in Table 4.

Land tax exemptions include the principal place of residence, primary production land, boarding houses, low cost accommodation, residential parks including caravan parks, non-profit organisations and retirement villages, aged care facilities and nursing homes.

Land on which land tax is levied includes vacant land, land with a house or unit that is not a primary residence, and commercial properties.

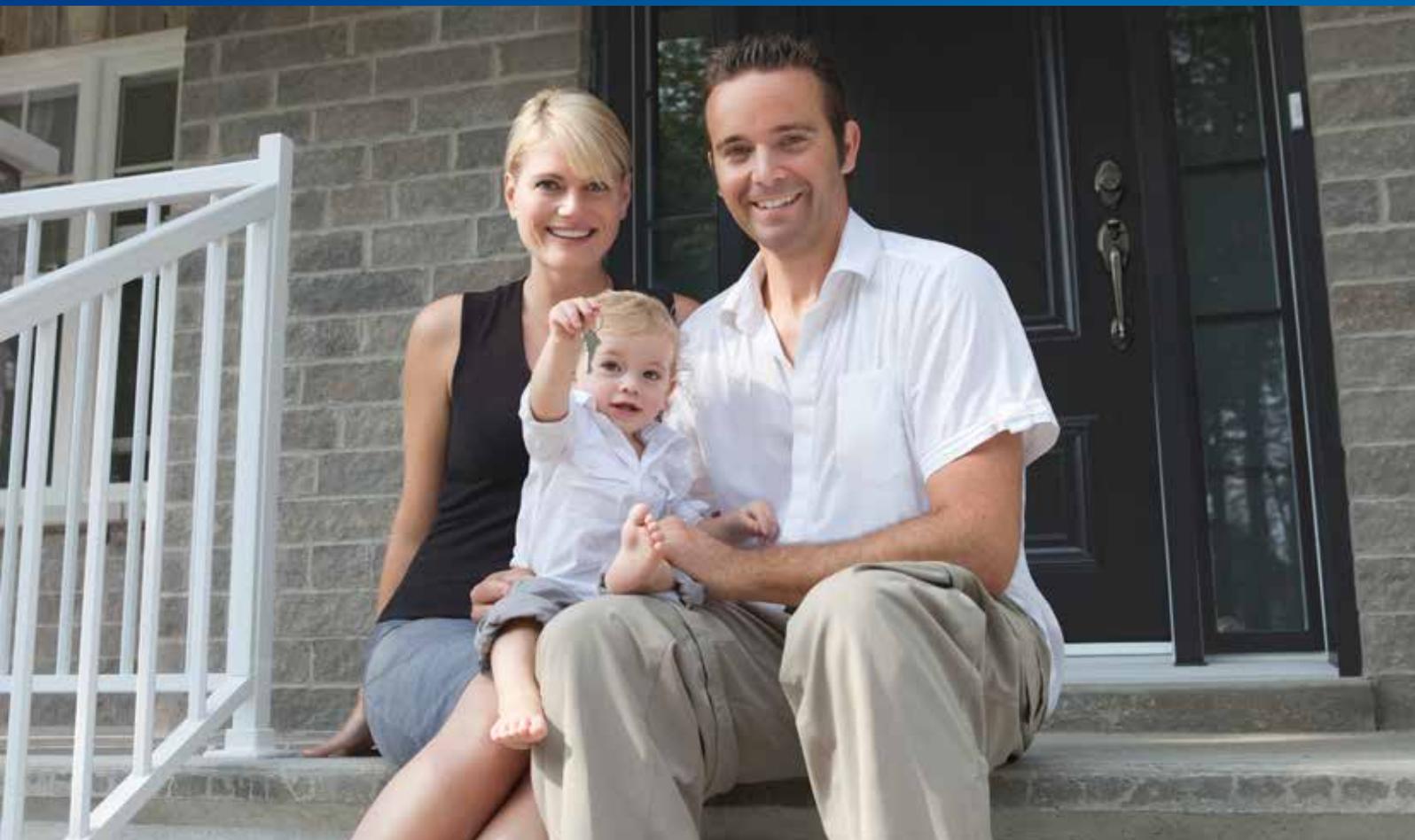


TABLE 4
CURRENT LAND TAX THRESHOLDS IN NEW SOUTH WALES

THRESHOLD	RATE
UNDER \$482,000	Tax free threshold.
\$482,000 to \$2,947,000	\$100 plus 1.6% of land value up to the premium threshold.
\$2,947,000 AND OVER (PREMIUM THRESHOLD)	\$39,540 for the first \$2,947,000 then 2% of land value over that.
EXEMPTION	<ul style="list-style-type: none"> ■ Principal place of residence ■ Primary production land ■ Boarding houses ■ Low cost accommodation ■ Residential parks, including caravan parks ■ Non-profit organisations ■ Retirement villages, aged care Establishments and nursing homes

FURTHER DETAILS OF CURRENT LAND TAX ARRANGEMENTS IN NEW SOUTH WALES ARE PROVIDED IN THE APPENDIX.

5. An economic assessment: is the proposal equitable, efficient and simple?

This section will provide an economic assessment of the proposal to remove stamp duty and extend land tax in New South Wales. Other impacts of the proposal will be considered in Section 6: A social assessment.

A significant body of economic analysis has been undertaken evaluating such a proposal, both in general and specifically in New South Wales.

There are many principles used to assess good tax design. Some economists use as many as ten

principles²⁴ to assess taxes but generally most are satisfied with three key principles: equity, efficiency and simplicity.

These key principles will be used to assess this proposal.

TABLE 5 **KEY PRINCIPLES OF GOOD TAX DESIGN**

EQUITY	<ul style="list-style-type: none"> While there is broad consensus that equity or fairness should be a fundamental principle of good tax design, the definition of equity is more subjective. A relatively uncontroversial definition would include criteria that those with the same economic means should face the same tax burden (horizontal equity), and that those with greater economic means should face a higher tax burden (vertical equity).
EFFICIENCY	<ul style="list-style-type: none"> Taxes are not levied in isolation; they impact the economic decisions and behaviour of those who are being taxed. A key priority in tax design is to ensure that taxes have a limited impact on the productive capacity of individuals, households and businesses. That tax is not levied in such a way that it is easily avoided.
SIMPLICITY	<ul style="list-style-type: none"> Taxes should be as simple as possible to administer and understand. This involves tax design that taxpayers can easily understand and comply with, and that the costs to government of administering the tax are low.

5.1 Equity

Land tax if applied broadly and progressively, is an extremely equitable tax. If you have the means to own land then you will generally have the means to make a small annual land tax payment. Further, if land tax is progressively levied (increasing the rate based on the value of the land) then it satisfies the vertical equity criteria – that those with greater means should pay more in tax.

However, land tax as it currently is levied in New South Wales includes two features that reduce its equity.

The first is the manner in which land is assessed based on the value of total land holdings held by a taxpayer, rather than assessed based on the square metre land value. This penalises landowners who own large amounts of land, for example institutional property investors.

The second equity concern with the existing land tax system is that due to the exemptions provided for homeowners, land tax is often paid by renters in the form of higher rents.

If equity concerns with the current land tax system are resolved, additional equity issues must be considered which may arise during the introduction of land tax.

Firstly, ensuring equity in the transition from stamp duty to a broad based land tax, so that homeowners who have recently paid stamp duty are not 'double-taxed'.

Secondly, addressing the fairness of levying taxation on asset rich homeowners who are cash poor, often retirees living on a pension.

And finally, the equity of extending land tax to include agricultural primary production land which is the source of income for many New South Wales regional families.

All of these equity issues will now be considered to assess if land tax is a fair tax.

Ensuring all land is valued equally

Land tax is currently applied to the aggregate or total amount of land held by a landholder. This means that if you own multiple properties you are likely to pay a higher rate of land tax, therefore discouraging large scale investment in land.

As discussed in Section 4, discouraging land scale rural land holdings was one of the initial objectives of land tax. Today, remembering that land from primary production is exempt from land tax, large landholders impacted by land tax are more likely to be institutional investors seeking to invest in private rental housing.

At a time when Sydney is failing to deliver enough housing supply to meet demand, land tax levied on aggregate land holdings discourages large scale investors from investing in housing in New South Wales.

For example, if a property fund owns five blocks of low value land in Western Sydney to provide housing, the value of all five properties will be combined in order to assess its land tax liability. The property fund would undoubtedly pay land tax, and likely at the highest marginal rate. However, if five individuals owned the same five blocks of land, it is likely the land would fall below the tax free threshold and none would pay land tax.

A far more equitable alternative would be to apply a progressive land tax based on land value per square metre. This would not discriminate against large landholders, but would still retain a progressive levying of land tax ensuring equity.

The land value per square metre method was strongly endorsed by the Henry Tax Review which argued that this reform would encourage institutional investment, such as superannuation funds, in rental properties which in turn would increase housing supply and improve housing affordability.²⁵

This approach could also allow for the current primary production land tax exemption to be

removed, without financially impacting farmers as agricultural land when assessed based on land value per square metre would be quite low, falling below a tax free threshold (see further discussion in **Primary production land** below).

Tax incidence – who really pays land tax currently?

An additional equity concern is the unfair tax incidence caused by the limited land tax base.

Tax incidence is the examination of who actually pays a tax, not who technically or legally pays a tax. For example, following the introduction of the previous Federal Government's tax on carbon emissions, some businesses explicitly stated that they would pass on the cost of the tax to consumers. While the businesses were technically and legally paying the tax, in these cases, the tax was actually paid by these businesses' customers.

As the family home is exempt from land tax, the majority of land tax is paid by the owners of residential investment properties or commercial properties.

Therefore there is a temptation for landlords to pass on the cost of land tax to their tenants.

Whether this is done generally depends on the levels of supply and demand within the rental market. If supply of housing is high it is difficult to pass on the cost of land tax. But if supply of housing is low, it is easy for landlords to pass the cost on.

A residential rental vacancy rate of 3 per cent is considered to be a balanced rental market, where the market favours neither tenants nor landlords. Sydney's current rental vacancy is 1.7 per cent.²⁶ It is therefore a safe assumption that land taxes on residential properties are being passed on to renters in the form of higher rents.

This makes aspects of New South Wales' current land tax regressive, as it is more likely to fall on renters than home owners who, on average, have higher levels of net wealth.

Thus, the current form of land tax levied in New South Wales has some inequitable elements due to the method of calculation and extensive exemptions provided.

If land tax was calculated on a square metre basis, and all residential property was taxed equally as per the proposal, these equity concerns would be removed.

A broad based land tax, with a progressive threshold applied based on a square metre holding, is a very equitable tax.

Transition arrangements

The guiding principle behind any consideration of transition arrangements when abolishing stamp duty and extending land tax is to limit, or avoid, double taxing homeowners who have recently paid stamp duty.

Many transitional arrangements have been proposed. The Henry Tax Review canvassed several transition options including:

- Providing a purchaser with a choice to pay stamp duty or land tax while grandfathering existing landholders;
- Providing credits for land tax on a sliding scale for those that have recently paid stamp duty; or
- Providing land tax exemptions for a period of time for those that have recently paid stamp duty.

All of these approaches have benefits and drawbacks.

The transition arrangement that this paper considers to be the most equitable is the transition model proposed by the Lambert Report.²⁷ This proposal recommends that land tax should only apply to residential owner-occupied properties after the property is transferred for the first time following the extension of land tax.

This would mean that homeowners who do not move from their existing home will never be liable

for land tax in New South Wales. Land tax would only be applied to a property following its purchase under the new system.

Therefore a homebuyer would not pay for example \$19,000 in stamp duty when purchasing a home but would then pay an average of \$2,260 per year based on the value of their land.

The Lambert Report estimates that under this approach around 50 per cent of residential properties would be subject to land tax after nine years, 70 per cent after 15 years, and 80 per cent after 20 years.

This model would satisfy all equity concerns relating to the transition of abolishing of stamp duty and extending land tax. This approach would lead to a short-term revenue shortfall, which will be discussed at the conclusion of Section 6.

Asset rich and cash poor

The equity concern most often cited in opposition to extending land tax to include the family home is that of taxing homeowners who are asset rich but cash poor. Such homeowners are generally (although not always) retirees who have limited cash flows, often relying on the pension or modest levels of superannuation. The concern is that these homeowners could face annual land tax bills they cannot afford to pay and would need to sell their family home.

The transition arrangements proposed above ensure that no existing homeowner in this position will be required to pay land tax on their home. However, we must consider the impact on homeowners that become liable for land tax in the future and have reduced household incomes through retirement or some other event.

This equity concern should be considered through two lines of inquiry:

1. Is it fair for a government to levy tax in such a way that homeowners are forced to sell their family home?

2. Is it fair for individuals who own property to avoid taxation because of the manner in which they structure their assets, while often simultaneously benefitting from other forms of taxpayer assistance such as the aged pension?

This paper takes the view that neither outcome could be considered to be fair or equitable.

Therefore a mechanism must be put in place to balance this impact.

Such a mechanism exists, where land tax is broadly applied by local government in New South Wales and the ACT Government. A feature of the ACT's broadly based land tax system is the ability to defer payments. The Rates Deferral System allows eligible households to defer their land tax payments, with a relatively low rate of interest charged.

Households eligible for a deferral of rates include pensioners, homeowners suffering substantial financial hardship and people with disabilities. Under the *ACT Rates Act 2004*, pensioners have a statutory right to defer their land tax payment. Eligible households are able to defer their payment if they satisfy certain criteria including age and income.²⁸

As the ACT Government progressively increases their rate of land tax (discussed in Section 7) this deferral option is being extended to non-pensioners over the age of 65 years. This will allow the deferral system to be accessed by homeowners who have low levels of savings and for whom additional income is unlikely to become available.

A rates deferral system ensures that land tax can be applied broadly without adversely impacting on cash poor homeowners.

Primary production land

Land used for primary production has been exempt from land tax in New South Wales for longer than the family home.

This exemption reflected the view that it is unfair to levy land tax on agricultural land as the size of land owned by farmers would result in large land

tax liabilities, making many farms economically unviable.

This is a legitimate concern, and would undoubtedly eventuate if land tax was extended to primary production land and assessed based on the aggregated land holding.

However, if land tax is levied on a per square metre basis (as discussed above) on a progressive scale starting at zero, then it is likely that no tax would be paid on the majority of primary production land.

The reason for this is that a square metre of agricultural land is much less valuable than a square metre of land in Sydney or New South Wales' towns or cities. If land is assessed on a square metre basis with a tax free threshold, then it is likely that few, if any, primary producers would be adversely impacted by removing the primary production exemption for land tax.

This approach is fair and preferable to continuing to exempt primary production land for two reasons.

Firstly, removing the exemption would reduce administration costs improving the simplicity of land tax.

Secondly, it would ensure that low value land could also be used for purposes other than primary production, such as conservation or affordable housing, without attracting a land tax.

Extending land tax in New South Wales calculated on a square metre basis would ensure that New South Wales' primary producers are not negatively impacted, while allowing for low value land to be utilised in other productive ways without attracting a land tax.

5.2 Efficiency

Taxes are not levied in isolation: they impact behaviour and usually create a cost, referred to as a welfare cost, over and above the cost of the tax revenue raised by government. The efficiency of a tax is assessed based on its deadweight loss or excess burden.

Excess burden costs are generally calculated using two measurements: marginal excess burden and average excess burden. Both excess burdens are measured in cents per dollar of revenue raised.

Excess burden levels are modelled based on an assumption that the assessed tax is increased (marginal excess) or abolished (average excess).

An excess burden of 0 cents would demonstrate that a tax measure is extremely efficient and creates no excess burden to society, while an excess burden of 100 cents signifies an extremely inefficient form of taxation, creating an additional dollar of welfare loss to the community for every dollar raised for the government.

If a tax were abolished or replaced with a more efficient tax, the amount of excess burden could be returned to the community and used in a productive manner, or collected in the form of additional government revenue without having an impact on society.

The key determinants of the economic efficiency of taxes can be explained by two economic principles: the ***mobility principle*** and the ***narrowness principle***.

The ***mobility principle*** recognises that the more mobile a tax base is, the higher the excess burden. When taxes are applied to highly mobile tax bases the tax is likely to shrink, distorting economic activity, and becoming less efficient. For example, a highly mobile tax base would be international corporations or individuals, while an immobile tax base would be land or resources.

The ***narrowness principle*** recognises that the narrower a tax base is, the higher the excess



burden. A narrow tax base makes it possible for individuals or companies to avoid taxation, reducing revenue and making the tax less efficient.

The excess burden of land taxes and stamp duties has been modelled in Australia and New South Wales.

In 2011, the Lambert Report commissioned KPMG Econotech to model the excess burden of selected New South Wales taxes including land tax and stamp duty.

The modelling showed that New South Wales land tax, in its current form, has an average excess burden of 6 cents. Stamp duty has an average excess burden of 62 cents, making it the most inefficient tax levied in New South Wales. The average excess burden for New South Wales taxes is 26 cents.

The reason for this disparity can be explained when considering the economic principles of mobility and narrowness. The subject of land tax is land, which is immobile. The subject of stamp duty is not the land but a transaction on the land, which can be avoided by not purchasing property.

Stamp duty is levied on a narrow base of those transacting property, which is further narrowed by individuals avoiding purchasing property and instead renting or staying in their current property to avoid the cost of stamp duty.

As New South Wales' current land tax provides a range of exemptions, they narrow the taxation base and thus increase the excess burden of the tax. If land tax was broadly applied in New South Wales as proposed, the KPMG Econotech Review found that it would be a perfectly efficient form of taxation with an excess burden of 0 cents.²⁹

The loss of welfare that stamp duty creates in New South Wales due to its excess burden was estimated by the Lambert Report to be \$2.6 billion annually, or around \$370 per New South Wales resident.

This \$2.6 billion could be returned to the people of New South Wales, or delivered to the NSW Government in the form of additional revenue if stamp duty was replaced with a form of taxation that had zero excess burden, such as a broad based land tax.

The Lambert Report stated that:

“Transfer duty [stamp duty] is the most inefficient of NSW state taxes (average excess burden is 62 per cent). By comparison, a well-designed tax on land values is highly efficient (zero excess burden).”³⁰

NSW Financial Audit 2011

TABLE 6
MARGINAL AND AVERAGE EXCESS BURDENS OF SELECTED TAXES

REVENUE SOURCE	REVENUE 2011-12 (\$M)	TOTAL EXCESS BURDEN (\$M)	MARGINAL EXCESS BURDEN (cents per dollar of revenue)	AVERAGE EXCESS BURDEN (cents per dollar of revenue)
STAMP DUTY (PROPERTY)	4,126	2,558	80	62
EMERGENCY SERVICES LEVY	633	373	68	59
VEHICLE STAMP DUTY	608	188	33	31
INSURANCE DUTY AND HEALTH INSURANCE LEVY	893	259	31	29
VEHICLE REGISTRATION	1,895	474	31	25
PAYROLL TAX RATE	6,855	1,371	35	20
PAYROLL TAX THRESHOLD	-	-	-8	-
LAND TAX RATE	2,483	149	9	6
LAND TAX THRESHOLD	-	-	-8	-
ROYALTIES	1,809	72	13	4
GAMBLING TAXES	1,878	0	0	0
TOTAL FOR STATE TAXES	21,180	5,445	-	26
PERSONAL INCOME TAX	-	-	24	16
CORPORATE INCOME TAX	-	-	40	23
GST	-	-	8	6
NSW COUNCIL RATES	3,284	66	3	2

SOURCE: NSW FINANCIAL AUDIT 2011

5.3 Simplicity

The simplicity principle of good tax design assesses how simply taxes can be understood and complied with by the public and administered by government.

Land taxes are simple for taxpayers to understand and comply with. Land tax assessments are generated by the NSW Office of State Revenue (OSR) and mailed to taxpayers in the same manner as council rate notices. This makes compliance costs low.

The administration of land tax is relatively simple, although it involves slightly higher costs than some other forms of taxation, as the value of land must be assessed annually by the NSW Valuer General.³¹ As these land valuations are also used for local government rate assessments, New South Wales municipal councils also contribute

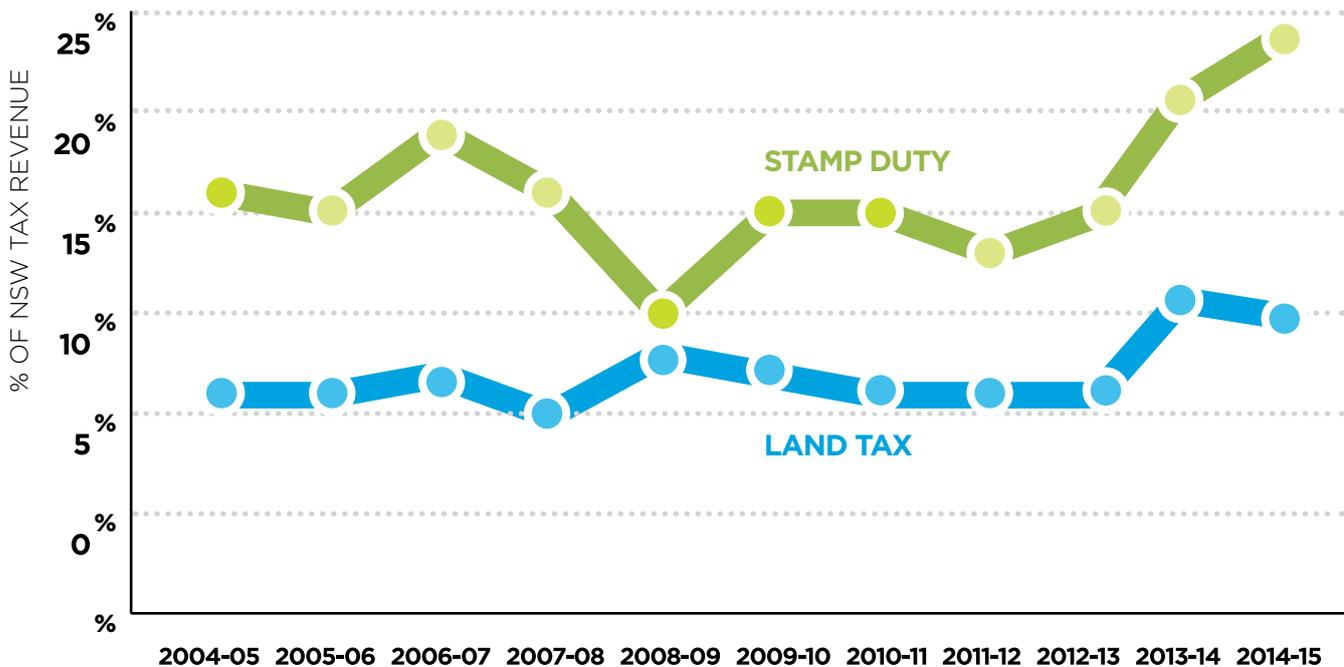
to the administration costs. As the NSW Valuer General currently undertakes assessments on behalf of multiple councils, if land tax was extended its administrative costs would fall relative to its revenue take.

Land tax is a stable form of taxation, as shown in Figure 5, providing the NSW Government with a far more reliable revenue source than stamp duty.

Furthermore, unlike many other forms of taxation, land tax volatility can be reduced by calculating land tax based on a three year rolling average assessment. This assessment method is applied in the ACT.

Land tax is an extremely simple tax. It is simple to understand, simple to comply with and provides a stable form of revenue for government unlike extremely volatile stamp duty.

FIGURE 5
**STAMP DUTY AND LAND TAX
AS A PROPORTION OF NEW SOUTH WALES' TAX REVENUE**



SOURCE: PRODUCED USING NSW BUDGET PAPERS 2004-05 TO 2014-15.

6. A social assessment: will the proposal improve the lives of New South Wales residents?

All public policies produce a range of impacts. The key impacts of this proposal will be examined in five categories:

- 1 Impact on taxpayers;
- 2 Impact on housing prices and housing affordability;
- 3 Impact on employment mobility;
- 4 Impact on infrastructure and transport investment; and
- 5 Impact on state government revenue.

These impacts will be considered in the context of the proposal having been implemented, as transition arrangements have been considered in Section 5.

6.1 Impact on New South Wales taxpayers

While this proposal has been calculated to produce no net increase to overall levels of property taxation, it will significantly benefit New South Wales taxpayers through reducing up-front housing costs and ceasing to penalise those that move homes regularly.

As the Lambert Report identifies:

“For homebuyers, instead of paying transfer duty averaging about \$19,000 based on the market value of the property, the purchase would trigger application of the SDRT [land tax] averaging about

\$2,260 per year based on the land value of the property.

That is, the up-front tax payments involved in buying a home would be significantly reduced.

In most cases, the present value of SDRT [land tax] payments will be about the same as the transfer duty that would otherwise have been paid.”³²

Homebuyers will no longer pay up-front costs in the form of stamp duty, but rather defer the costs and pay it annually in the form of land tax. It would take a homebuyer around eight years to pay the amount of land tax that they would currently pay in up-front stamp duty costs.

Households who move on average once every eight years will pay less overall property tax than they currently do.

This change will significantly benefit younger homeowners and families, who are more likely to move home regularly. A recent Australian Bureau of Statistics (ABS) survey found that over a three year period, the majority of New South Wales residents (53%) who moved home were aged between 18-34 years of age. In contrast, only 12% of New South Wales residents aged over 55 years moved during the period.³³

FIGURE 6
THE PROPOSED SCHEME'S IMPACT ON HOMEOWNERS

Current System: Stamp Duty



HOUSE PRICE \$600,000

Stamp Duty paid: \$22,500

TOTAL UP-FRONT COSTS*: \$632,500

Annual Land Tax: \$0

Proposed System: Land tax



HOUSE PRICE \$600,000

Stamp Duty paid: \$0

TOTAL UP-FRONT COSTS*: \$610,000

Annual Land Tax: \$3,000

*ASSUMING AN AVERAGE \$10,000 IN LEGAL AND ADMINISTRATIVE FEES.

6.2 Impact on housing prices and housing affordability

Just under two-thirds of New South Wales residents live in the greater Sydney area. Sydney is the most unaffordable housing market in Australia, and the third most unaffordable housing market in the world.³⁴

While Sydney's housing affordability crisis has primarily been caused by over a decade of restricted housing supply, the imposition of stamp duty is a significant factor that makes housing

unaffordable, particularly for first home buyers. This proposal is unlikely to impact on house prices, but will significantly improve housing affordability.

House prices

The abolition of stamp duty and the extension of land tax are unlikely to impact on housing prices in New South Wales.

Taxes on fixed assets generally reduce their value, as the future liability of the taxation is factored into the value of the asset – in this case land.³⁵ It is

therefore likely that a broad based land tax would place downward pressure on land values and as a result house prices.

Conversely, most economists emphasise that the removal of stamp duty in isolation would increase house prices, as sellers would simply increase the asking price of their property by the amount previously paid in stamp duty. A similar practice was witnessed when federal and states governments increased first home buyers grants: sellers would simply increase the asking price of properties targeted at first home buyers.³⁶

Therefore, if stamp duty was abolished and the revenue source replaced with an increase in GST, as some have proposed, it is likely that house prices would rise – providing no relief for home buyers.

This view was supported by the ANZ Bank in a submission to the Productivity Commission Inquiry into First Home Ownership noting that:

“A fall in stamp duties is likely to lead to a corresponding rise in house prices.

House buyers would be little better off, and house sellers would obtain a windfall gain at the expense of state governments.”³⁷

ANZ Bank 2004

The combined effect of abolishing stamp duty and extending land tax is likely to ensure that house prices remain stable in New South Wales: having little or no impact on existing home owners, while ensuring that the benefits of abolishing stamp duty are not simply subsumed by sellers.

Housing affordability

While this proposal is unlikely to have a direct impact on house prices, it will significantly improve housing affordability in New South Wales. This will occur in two key ways.

Firstly, the up-front housing cost of stamp duty will be removed. As examined in Section 3, stamp duty of \$42,250 is payable on the median priced Sydney home, representing one quarter of up-front housing costs. This abolition will play a major role in improving house affordability for home buyers.

Secondly, the proposal will considerably improve housing affordability through incentivising a more appropriate allocation of housing stock. Stamp duty reduces the transfer of housing stock as individuals and families seek to avoid paying tax by not moving home. As a result, a misallocation of housing stock exists in New South Wales.

For example, a single retiree living in a five bedroom home on a double block of land is less likely to downsize to a two bedroom apartment when they face substantial stamp duty costs. Stamp duty acts as an inhibitor to their mobility and creates a misallocation of housing stock. A better allocation of housing stock would be for a family of six to live in a five bedroom home rather than one person.

If stamp duty is abolished this inhibitor is removed. It is more likely that people will consider moving to a home that better suits their needs as they do not face significant costs to do so.

Further, if a land tax is introduced based on the value (and size) of land, this will further incentivise a more appropriate allocation of housing in New South Wales.

Using our example of a single retiree, they would be liable for higher land tax payments living in a five bedroom home on a double block of land than if they lived in a two bedroom apartment. Thus land tax would incentivise landowners to select housing that best fits their needs.

While a middle-aged couple may decide to move to a smaller home and ‘down-size’ when their children leave home, a young expanding family may seek a larger home to meet their needs by ‘up-sizing’. This combined process has been described as ‘right-sizing’ as homeowners select housing based on their needs.

Policies such as a broad based land tax that encourage right-sizing ensure that more appropriate housing is available, which in the long-term will improve housing affordability.

6.3 Impact on employment mobility

Stamp duty acts not only as an inhibitor to appropriate housing allocation, it also acts as an inhibitor to appropriate employment. A recent Productivity Commission report, *Geographic Labour Mobility* stated that “Stamp duty imposed on housing purchases stands out as the main transitional impediment [to labour mobility]”.³⁸

Stamp duty creates an artificial barrier that restricts employment mobility. Any worker considering moving home to seek or accept new employment must make a cost-benefit assessment based on the costs of relocating. The primary cost being stamp duty.

Business groups stated in submissions to the Productivity Commission that “potential employees were unwilling to sell their property and purchase another due to the high burden of stamp duty”.³⁹

A 2007-08 ABS survey revealed that one quarter of households stated that they were unlikely to move in the near future as they could not afford the costs associated with moving.⁴⁰

In the same manner that stamp duty creates a misallocation of housing stock, it also creates a misallocation of labour. This misallocation of labour results in unnecessary unemployment and skill shortages as workers cannot afford to move to areas where jobs are available. For this reason, the *Geographic Labour Mobility* report recommended that stamp duty be abolished and its revenue replaced by extending land tax.⁴¹

This proposal will help to reduce unemployment and skill shortages across New South Wales, providing a boost to households and businesses across the state.

6.4 Impact on transport infrastructure and investment

New South Wales faces a significant transport infrastructure backlog. An innovative way to fund infrastructure is through a process known as tax incremental financing, or value capture financing. This form of financing is only possible if land is regularly valued by an independent body and a land tax is levied.

Value capture financing allows governments to recover some of the costs of funding public transport infrastructure by ‘capturing’ the increases in land values that private residents enjoy as a result of this investment.

The concept behind value capture is simple. Land values are driven by location – as any real estate agent will confirm. One of the key factors that increase the value of land is its proximity to public transport and good roads. Both are financed by the state government through taxes raised from New South Wales residents. However, when a new rail line or major motorway is built, those living nearby will generally receive a personal windfall through an increase in their land values. If land values are taxed, then the annual tax bill would increase slightly to reflect the increased value of the land. Therefore those who are receiving a significant windfall from public expenditure would make a small contribution towards the project.

This is currently not the case in New South Wales due to significant land tax exemptions. Currently, owner occupiers that are lucky enough to live nearby new transport infrastructure receive a personal windfall without making any direct contribution.

In New South Wales, we socialise transport infrastructure costs and privatise transport infrastructure gains.

Value capture would reverse this process, and provide a significant revenue stream to fund infrastructure. In Hong Kong for example, the city’s entire rail transit system is funded by land taxes paid through value capture.⁴²

How value capture could work: light rail in Sydney

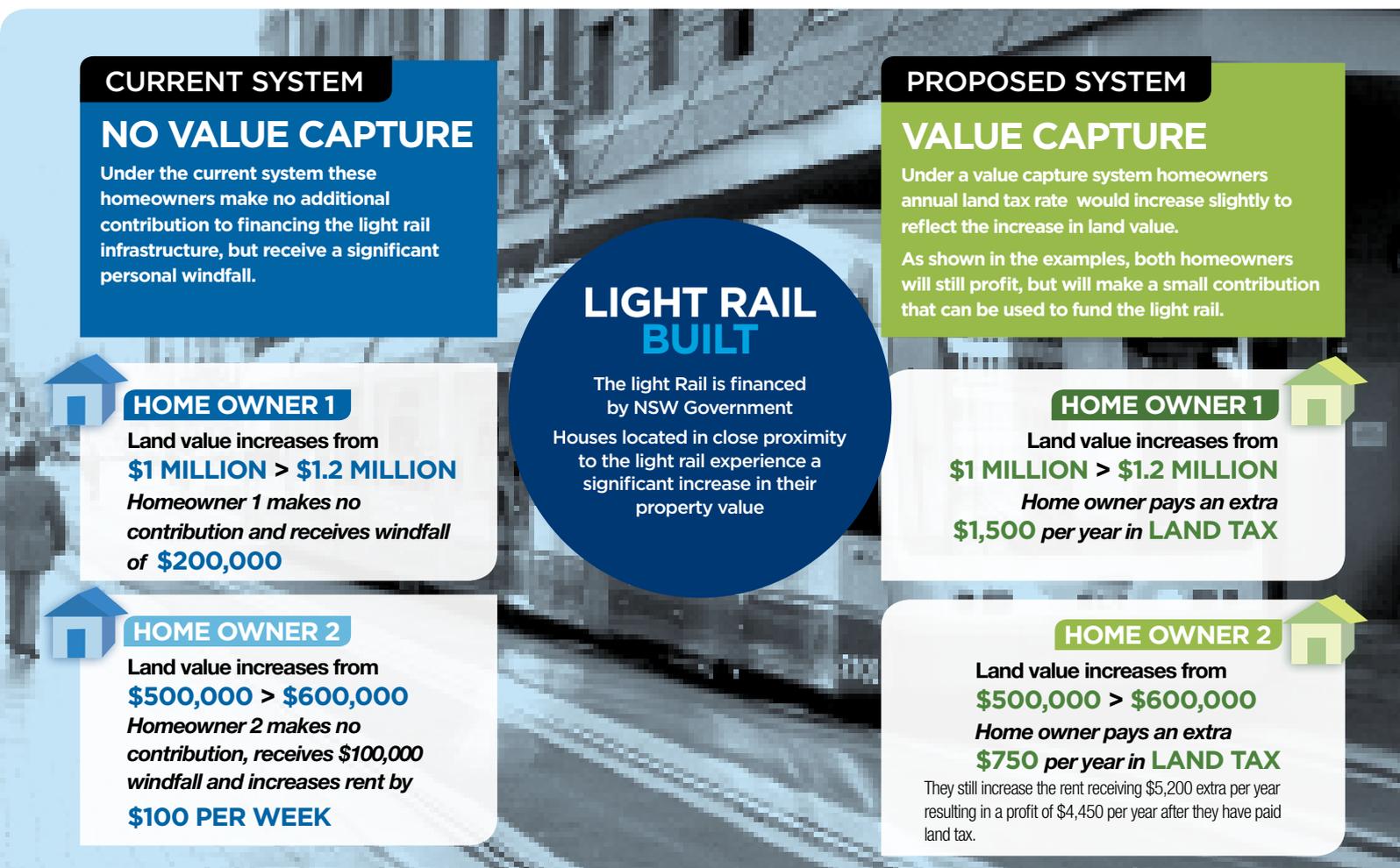
The NSW Government has announced the construction of a new light rail line in Sydney running from Circular Quay to the University of New South Wales (UNSW) in Randwick. It is estimated that this project will cost \$2.2 billion and is being financed through consolidated state government revenue.⁴³

Homes within walking distance of the proposed light rail will experience a significant increase in land value. Residents and investors in Sydney's inner city and eastern suburbs will receive a significant personal financial windfall from this infrastructure

project while making no more of a contribution than every other taxpayer in New South Wales. It is likely that residents of Western Sydney and regional New South Wales who struggle with deficient transport infrastructure, would be irritated to learn that they are making the same contribution to a light rail project as the nearby residents who will benefit both from the service, and a significant land value increase.

If a broad based land tax existed, this would not be the case, as illustrated in Figure 7 below. Residents who live nearby the new light rail line and benefit from an increase in land value, would pay a slightly higher annual land tax bill. Thus making an additional contribution towards the infrastructure delivering them a handsome personal windfall.

FIGURE 7 HOW VALUE CAPTURE COULD WORK IN SYDNEY



6.5 Impact on state government revenue

A transition away from stamp duty to a broad based land tax would have a number of impacts on the state government's fiscal position. Revenue sourced from land tax would be far more stable than volatile stamp duty revenue. As discussed, an additional source of revenue could be introduced to fund infrastructure through value capture financing. Finally, the state's VFI would at worst be halted, but more likely reduced, as land tax and value capture revenue increases over time.

Fiscal impact of transition

The Lambert Report modelled the fiscal impact of abolishing stamp duty and extending land tax under the assumptions proposed in Table 2, namely: opt-in when you purchase a property, rates assessed on a square metre basis and a progressive rate of taxation.

The modelling showed that the NSW Budget would face an initial reduction in revenue as stamp duty is immediately abolished and land tax begins to extend. Transitional debt would peak in the tenth year at \$15.4 billion and would be completely paid off in the twenty third year.

Importantly, the Lambert Report stressed that New South Wales would retain its Triple A credit rating due to the replacement revenue stream of a broad based land tax.

The rates modelled by the Lambert Report and proposed in this paper, are calculated to ensure when fully applied, the extended land tax would deliver similar levels of revenue as the current annual average stamp duty revenue.

These marginal rates of 0.75 per cent and 1 per cent are a significant reduction to the current land tax rates of 1.6 per cent and 2 per cent which are consistent with lowering tax levels when the tax base is broadened.

A stable revenue source

The Lambert Report confirmed that while stamp duty is the most volatile form of state taxation, land tax is a stable form of taxation as illustrated in Figure 5.

Value capture financing

As addressed in Section 6.4, value capture financing would make a significant contribution towards the funding of infrastructure. Unlike other infrastructure proposals such as the privatisation of government assets which deliver a 'one off' source of capital, value capture delivers a recurrent stream of revenue. This allows governments to borrow against this revenue stream, further increasing the potential finance available for infrastructure funding.

Halting and reducing VFI

Unlike proposals to abolish stamp duty and replace its revenue with federal taxation, replacing stamp duty revenue with land tax revenue will have no impact on the state's VFI as both are state administered taxes.

The introduction of value capture financing would allow for additional revenue to finance infrastructure projects which currently require federal funds. It is therefore likely that this proposal would slow or halt VFI in the short-term, while reducing it in the long-term through the expansion of value capture financing.

Summary

The proposal to abolish stamp duty and extend land tax will improve the lives of New South Wales residents by making housing more affordable, reducing unemployment and helping to fund infrastructure.

Instead of facing the often prohibitive up-front cost of stamp duty, homeowners will pay a small annual land tax rate. Homeowners who cannot afford these payments due to special circumstances will have the opportunity to defer their payments.



Through the abolition of stamp duty, up-front housing costs will be reduced, thereby helping all homebuyers. Further, the financial impediment to mobility that stamp duty creates will be removed: allowing workers to move more easily for employment, and homeowners to move to a home that suits their needs.

The extension of land tax will help to balance house prices when stamp duty is abolished, and will assist

in the optimal allocation of housing stock, further improving housing affordability. A broad based land tax will allow for value capture financing to be used to fund infrastructure projects in New South Wales, while providing a stable form of state government revenue.

It is clear that the people of New South Wales will greatly benefit from this important reform to property taxation.



7. How could the proposal be communicated?

“By virtue of being a very transparent tax on an immobile base - the very features that make it a good tax - could be held also to be its greatest weakness, since it as noted earlier has contributed in making it a politically very unpopular tax.”⁴⁴

International Monetary Fund, 2013

The economic and social case for abolishing stamp duty and extending land tax is irrefutable. It would be a fairer, simpler and more efficient way to tax property in New South Wales.

The answer to Nobel Prize recipient Professor Sir James Mirrlees' question "Why, then, do we not have one already?" is simple: such a reform is politically difficult.

Tax reform is not a simple task. The minority who find themselves adversely affected complain loudly, while the majority that benefit are often not immediately aware that they have benefited.

A reform such as is proposed would face additional political difficulties as it is a form of tax associated with the family home, making it particularly vulnerable to scare campaigns from political parties, peak bodies or interest groups that oppose the reform.

This is why the proposal has not been implemented, despite two decades of expert reports, commissions, inquiries and reviews explicitly recommending it.

However, as has been demonstrated in this paper, the current taxation arrangements surrounding property are economically and socially harmful, as well as grossly inequitable.

We have reached the point in New South Wales where political difficulty is no longer a satisfactory excuse for policy inaction.

Despite this, it would be naive to expect New South Wales parliamentarians to act on this proposal in isolation. The conditions for its introduction must be created: the case must be made beyond the pages of reports and economic journals.

Most importantly, the people of New South Wales must be a part of this discussion.

7.1 The case for change

This paper has examined the vast body of evidence in support of abolishing stamp duty and extending land tax, as well as chronicling the range of benefits such a reform would deliver.

However, for such a reform to be successfully communicated to the people of New South Wales, advocacy of the proposal must move beyond discussion of excess burdens and tax incidence.

Below are five clear and simple reasons that this reform should be introduced to benefit the people of New South Wales.

1 IT WILL HELP FIRST HOME BUYERS

Stamp duty represents the largest up-front cost when buying a home. In many cases, the up-front cost of stamp duty prohibits New South Wales residents from buying a home. Abolishing stamp duty will assist a generation to achieve the Australian dream of home ownership.

2 IT WILL IMPROVE HOUSING AFFORDABILITY

In addition to abolishing stamp duty, housing affordability will be improved through a better allocation of housing stock. A broad land tax will encourage homeowners to live in homes that best suit their needs, ensuring a better allocation of housing which will improve affordability.

3 IT WILL REDUCE UNEMPLOYMENT AND SKILLS SHORTAGES

Abolishing stamp duty will remove the most significant cost of moving for workers seeking new employment opportunities. As workers move to accept jobs, New South Wales is likely to see a reduction in unemployment and skills shortages.

4 IT WILL PROVIDE ADDITIONAL FUNDING FOR INFRASTRUCTURE

A broad based land tax will allow for the introduction of value capture financing. Value capture financing will provide a new stream of revenue to help fund much needed transport infrastructure in New South Wales.

5 IT IS A FAIR WAY TO TAX PROPERTY

Taxing property when a home is purchased is fundamentally unfair. It places the taxation burden on people who move homes regularly or are seeking to enter the property market. Replacing this form of taxation with a small annual payment is a fairer way to tax property in New South Wales.

A CAUTIONARY TALE

A SUPER PROFITS TAX PROPOSAL THAT SNATCHED DEFEAT FROM THE JAWS OF VICTORY

The Resource Super Profits Tax (RSPT) was announced by Prime Minister Kevin Rudd and Treasurer Wayne Swan one week before the 2010 Federal Budget in conjunction with the public release of the Henry Tax Review which proposed it.

The RSPT was to be applied at a rate of 40 per cent of profits made from Australia's non-renewable resources such as iron ore mining. The proceeds were to fund an increase in superannuation for all Australians, a cut in the company tax rate and infrastructure investment. Simply put, every Australian taxpayer and business would benefit while only a small number of very profitable mining companies would be liable to pay the tax.

Such a tax proposal had not been publicly canvassed by the Federal Government. It had not been discussed with the Australian people. No coalitions or alliances of the plethora of beneficiaries including representative bodies of Australian businesses, superannuants and workers had been established. While Australians began to digest and understand the proposed tax, the mining industry swung into action with a multi-million dollar advertising blitz opposing the tax.

One week following the announcement, opinion polls showed that 47 per cent of

Australians opposed the RSPT while 44 per cent supported it.

In the coming months as Australians learnt more about the tax, support for it would increase, but throughout May and June 2010 a ferocious campaign continued against the RSPT. Prime Minister Kevin Rudd was deposed in late June 2010, in part due to this ferocious campaign.

His successor, Prime Minister Julia Gillard, immediately reduced the scope of the RSPT in order to neutralise the issue in the lead up to an election. This significantly altered mining tax measure was introduced in July 2012. Former Prime Minister Tony Abbott succeeded in repealing the mining tax in 2014.

Despite being a tax proposal that would benefit all Australians, adversely impacting only a handful of highly profitable mining companies, the RSPT was scaled back two months after its announcement, and abolished two years after its introduction.

It serves as a cautionary tale for policy makers that reforms must be discussed and advocated in public, not simply announced without notice. To successfully introduce reform requires careful consideration and extensive dialogue with the community.

7.2 The case must be made for change

The public generally don't react well to significant public policy changes being foisted upon them without prior consultation and discussion. This is particularly the case with tax reform. Such a strategy will inevitably result in either an outright rejection of the proposal, or significant changes and exemptions to the original proposal.

Poor communication and policy processes can result in popular reforms being rejected, as was the case with the Rudd Government's Resource Super Profit Tax (see previous page).

In order for this proposal to be successfully introduced it must be publicly debated. This improves the likelihood of success for a number of reasons including:

- Allowing for public advocacy of the proposal and its benefits;
- Allowing for public discussion and debate surrounding the proposal;
- Providing experts and opinion leaders with the opportunity to lend their support to the proposal;
- Establishing alliances of peak bodies to advocate for the proposal; and
- Refuting misrepresentations, falsehoods and scare campaigns launched against the proposal.

In the 2012 ACT Budget, the ACT Government proposed to abolish stamp duty and increase land tax as part of a comprehensive tax reform plan informed by the recommendations from an independent tax review the government had commissioned in 2010.

The ACT Government made the case for change throughout 2012 and was re-elected later that year with a mandate to introduce the reform.

The ACT case study is detailed on the following page. This case study provides key insights which should inform any communications approach in

New South Wales, specifically:

- The commissioning of an independent panel to review taxation and consult with members of the public;
- Public discussion and debate regarding the need for tax reform generally and property tax reform specifically; and
- Strong public advocacy of the benefits of the tax reform.

A FAIRER, SIMPLER AND MORE EFFICIENT TAXATION SYSTEM

The ACT Government's ***A fairer, simpler and more efficient taxation system*** plan will see inefficient taxes such as stamp duty and insurance taxes removed with their revenue replaced by increases in land tax. The plan is revenue neutral. It seeks to remove inefficient, unfair and distortionary taxes with the more efficient and fairer land tax.

As residents of the ACT have only two levels of government, they currently pay land tax to the ACT Government through its general rates system.

While New South Wales residents also pay general rates on their primary residence, this is paid to local municipal councils. For this reason the Henry Tax Review recommended that broad based land taxes be merged with council rates to provide a single, easy and efficient point of billing for all landowners.

CASE STUDY

The ACT removing stamp duty and extending land tax

The ACT Government is currently in the process of abolishing stamp duty and increasing land tax revenue. The policy was announced in the ACT 2012-13 Budget in May 2012 by ACT Treasurer Andrew Barr. The ACT Government was successfully re-elected as a minority government six months later in October 2012.

As the ACT is governed by only two levels of government, the ACT reform proposal involves increasing general rates currently paid. The ACT general rates system levies a broad based land tax on the unimproved value of land.

While this undoubtedly makes the ACT reform administratively simpler than the proposal in this paper, the ACT reform is in other respects more challenging. For instance, the ACT Government needs to continually invest in ensuring the long term support of the policy to cover the lengthy transition period of 20 years. Generous transition arrangements of exempting existing homes, which are proposed in this paper, are not provided in the ACT.

The ACT Government undertook what policy professionals would regard as an impressive example of a good policy process.

Following the release of the Henry Tax Review in May 2010, the ACT Government announced the establishment in August 2010 of the ACT Taxation Review (Quinlan Tax Review), the first review of the Territory's taxation arrangements since it achieved self-government in 1989.

The Quinlan Tax Review panel was headed by Ted Quinlan, a former ACT Treasurer, with the objective of assessing the ACT's taxation arrangements against

the principles of stability, efficiency, equity and simplicity. The panel called for submissions and undertook public consultations before delivering their report to the ACT Government in August 2011.

The ACT Government considered the report and publicly released both the review and the ACT Government's response in May 2012. The response included a detailed five year reform plan which explained the reasons for the tax reform package and effectively put the case for reform.

The ACT Treasurer subsequently discussed and promoted the policy announcement throughout Canberra. Despite a scare campaign waged by the ACT Opposition during the Territory's general election in October 2012, the ACT Government received a swing towards them and was returned to minority government.

A key reason for the success of this reform was the extensive consultation and discussion that occurred during the period from August 2010 until May 2012. While the ACT Government did not reveal its intended reform plan until May 2012, property tax reform was extensively canvassed. It was understood that reforms would be made in this area of taxation by the public and key stakeholders.

While there are significant differences between the ACT and New South Wales, including governance arrangements and population, the successful implementation of tax reform abolishing stamp duty and replacing it with land tax revenue provides some key insights for consideration.

Such reforms must involve significant consultation, be discussed publicly, and clearly explained and advocated.

7.3 A strategy to communicate this proposal

In order to successfully communicate this proposal to the people of New South Wales, public awareness of the need for tax reform must be raised, while the benefits of this proposal are also promoted.

Successfully communicating and advocating a tax reform proposal takes time. Informed by successful and unsuccessful tax reform communication, this paper recommends four components inform any strategy to communicate this proposal:

- 1 Raising public awareness of the need for taxation reform in New South Wales;
- 2 Public advocacy of the proposal and the benefits it will deliver;
- 3 Ensuring those that stand to benefit immediately are aware of the proposal; and
- 4 Addressing concerns and debunking scare campaigns and misrepresentations.

Raising public awareness of the need for reform: an independent tax review

This paper has focused on the urgent need for property taxation reform.

A detailed review of New South Wales property taxes, undertaken by an independent expert panel, would provide a strong foundation for the communication of this proposal in New South Wales.

As every significant review of taxation over the last two decades has recommended abolishing stamp duty and extending land tax, it is almost certain that such a review would also endorse the proposal. Crucially, the review could consider this model put forward in this paper, and other models, in order to discuss them with the public and stakeholders.

Perhaps of greater importance, the review would

assist in raising public awareness of the need for property tax reform. A tax summit, information sessions, and public consultations would provide an opportunity for the public to both learn about tax reform proposals and contribute to discussion.

An independent tax review panel consulting widely with the community and making a series of recommendations for reform would be an invaluable first step in communicating this proposal.

Public advocacy of the proposal: alliance building for reform

It is important for a trusted expert panel, that has consulted widely with key stakeholders and the public, to recommend the abolition of stamp duty and extension of land tax in New South Wales.

However, this proposal has been recommended by expert tax reviews in the past without any action from government.

The second essential step to communicate this proposal is the establishment of an alliance of businesses, community organisations, trade unions and peak bodies to endorse and advocate reform.

Organisations that have an interest in improving housing affordability, reducing unemployment and skills shortages, boosting productivity and financing transport infrastructure all have an interest in endorsing and advocating this proposal.

The formation of such a representative alliance would assist in creating public momentum for reform and further raising awareness of the benefits of the proposal.

In 2012, such an alliance was formed with the goal of publicly advocating for a second Sydney airport at Badgerys Creek in Western Sydney. The Western Sydney Airport Alliance's membership includes Unions NSW, New South Wales' peak trade union body; and the NSW Business Chamber, the peak representative body of businesses in the state. This bi-partisan alliance spent two years promoting the social and

economic benefits of building a second Sydney airport in Western Sydney. In no small part due to this strong public advocacy, in April 2014, the Federal Government announced that a second Sydney airport at Badgerys Creek would proceed.

Ensuring those that benefit are aware: anyone buying a home soon

Perhaps the greatest challenge of tax reform is engaging with those who stand to benefit.

Those who believe that they will be adversely affected will be vocal in their objection. It is therefore crucial that the majority who will benefit from reform are informed.

While this paper has detailed how the overwhelming majority of New South Wales residents will benefit, a key group that stands to immediately benefit from such a reform are future homebuyers.

Anyone in New South Wales that plans to, hopes to, or needs to, purchase a home in the near future will benefit immensely and immediately from this reform, saving tens of thousands of dollars.

All potential homebuyers in New South Wales must be made aware of this proposal and how they stand to benefit. This can be communicated by peak bodies informing their membership, promotion through the housing and property sector, and advocacy through the media.

Addressing concerns and

debunking scare campaigns

Scare campaigns motivated by self-interest or ignorance can easily be mounted against a tax reform proposal, and if left unanswered destroy the reform, as illustrated on pages 43 and 48.

Such campaigns rely on emotive catchcries and often misrepresentations or mistruths surrounding the proposed reform. They can be extremely successful in the application of intense, short-term, political pressure.

However, if tax reform is debated and discussed over a long-period of time, scare campaigns generally wither and fade. Misrepresentations or mistruths are corrected or exposed.

Slogans such as 'A tax on the family home' give way to more thoughtful consideration of the benefits extensively canvassed in this paper.

It is crucial that no scare campaign or mistruth go unanswered.

For this to be achieved, the communication process cannot be rushed. Advocates of the proposal (whether economists, civic or business leaders) must correct mistruths. By setting the public record straight scare campaigns can be refuted and dismissed.

A GETUP! SCARE CAMPAIGN ON LAND TAX

A CUT AND PASTE SCARE CAMPAIGN – WHICH CAN BE DISMISSED WITH FACTS

The perennial challenge facing any government embarking upon tax reform are vocal interest groups opposing reform. These can include self-interested individuals or groups that believe they will be worse off under the reform, fellow politicians that believe they will gain votes from opposing reform, or partisan third parties that oppose reform purely based on who proposes it.

It is extremely easy to run an effective scare campaign. While advocates of tax reform must explain complex details, opponents can simply rely on slogans and glib one line attacks. Furthermore, with the proliferation of online advocacy organisations whose *raison d'être* is to run campaigns, we are witnessing the emergence of scare campaigns for the sake of scare campaigns.

In July 2013 the Business Council of Australia called for the introduction of a broad based land tax, among other recommendations, in its pre-election *Action Plan for Enduring Prosperity*. Immediately, online advocacy organisation Getup! launched an aggressive scare campaign against the land tax proposal stating that “Homebuyers would be invited to pay even more, by introducing a new land tax on home owner-occupiers”, and called

for donations to run advertisements opposing the move.

Getup! states that its aim is to build an “accountable and progressive Australia - an Australia which values economic fairness, social justice and environmental sustainability at its core.”

If this mission statement is accurate, then opposing the introduction of a broad based land tax contradicts the core objectives of the organisation. It is unknown whether the organisations’ staff choose advocacy positions without understanding a policy or simply oppose policy based on who proposes it. Regardless, following this intervention independent commentators and economists ridiculed *Getup!*’s irresponsible intervention. *Getup!* has been silent on the issue since.

This example illustrates how easily a scare campaign can be run opposing land tax, and the importance of ensuring vocal, but uninformed bodies, are not permitted to dominate public discussion. This is why it is vital that the proposal be extensively, discussed in public, so that innocent or wilful ignorance can be exposed and dismissed calmly and methodically.



Summary

The proposal to abolish stamp duty and extend land tax can be effectively communicated to the New South Wales public if the case is made for change and the proposal is discussed over a period of time in a calm and methodical manner.

The communication of this proposal cannot be rushed. As illustrated in the ACT case study, successful tax reform requires time to raise public awareness of the need for reform and debate potential solutions.

Forming advocacy alliances of groups that stand to benefit from the reform will assist in both promoting the reforms' benefits and correcting inaccuracies and mistruths.

Conclusion

If one was tasked to design a system of property taxation in New South Wales, it is hard to imagine that anyone would advocate the creation of the current system.

Stamp duty creates a significant financial obstacle for first home buyers, while punishing those that move homes regularly, regardless of their means. By inhibiting homeowner mobility, New South Wales experiences unnecessary unemployment in some regions, and skills shortages in other regions, as workers cannot afford to move homes.

An extended land tax on the other hand would not restrict mobility, places no up-front costs when purchasing a home, and would be fairly applied across all land in New South Wales.

In addition to removing the harmful effects that stamp duty currently inflicts, land tax would bring a range of benefits in its own right. A stable and simple form of revenue that cannot be avoided, land tax would improve housing affordability through incentivising a better allocation of housing, while also allowing for transport infrastructure to be financed through value capture financing.

Despite transition arrangements which would ensure few homeowners are disadvantaged, the proposal must be effectively communicated to the public in order for it to be successfully introduced.

This paper has chronicled key arguments in support of this proposal and outlined a suggested process of public consultation and advocacy in order to create the political environment for such a reform.

As the ACT Government has shown, this reform can be successfully introduced in order to make property taxation fairer and more efficient.

If adopted, this reform will improve the lives of the majority of New South Wales' residents, and this, after all, should always be the objective of policy makers and governments.

Recommendations

While the economic and social case for abolishing stamp duty and extending land tax is extremely strong, the political challenges associated with such a reform are formidable.

Thus, if such a reform is to be realised, an incremental approach is recommended.

This paper makes three recommendations to begin to communicate this proposal to the New South Wales people so that the political environment for this reform can be created.

RECOMMENDATION 1

The New South Wales Government commission an independent expert panel to review property taxation in New South Wales.

RECOMMENDATION 2

New South Wales community leaders and representatives of peak bodies publicly advocate the abolition of stamp duty and extension of land tax.

Our community leaders can play a crucial role in generating momentum to create a fairer property taxation system through promoting the benefits of this reform to the people of New South Wales.

RECOMMENDATION 3

New South Wales advocacy groups who represent individuals and organisations that will benefit from this reform, communicate the benefits to their members.

Ensuring that those who will benefit are aware of the proposal, will help to create public support for property taxation reform in New South Wales.

Abbreviations

The NSW Financial Audit 2011	=	Lambert Report
Australia's Future Tax System Review (AFTSR)	=	Henry Tax Review
Office of State Revenue	=	OSR
Australian Bureau of Statistics	=	ABS
ACT Taxation Review	=	Quinlan Tax Review
Resource Super Profit Tax	=	RSPT

Glossary

AVERAGE EXCESS BURDEN

Average excess burden measures the economic harm of the entire tax, expressed in cents per dollar of additional revenue. Average excess burden is useful in considering the overall impact of the tax. For example, if a tax were abolished, the amount of revenue that would be 'returned' to the community could be calculated based on the amount the tax raised and the cents per dollar of excess burden. See also 'Excess burden' and 'Marginal excess burden'.

CAPITAL LAND TAX

Tax levied on the improved value of selected categories of land held at a particular date. See also 'Land tax' and 'Rates'.

DISTORTION

Any action that reduces economic efficiency. Distortions generally arise when private action (such as price-fixing by a cartel), or public action (such as a tax imposed by government), changes an individual's or businesses' behaviour. See also 'Economic efficiency'.

DOWNSIZE

To move to a smaller home. See also 'Upsize' and 'Rightsize'.

EFFICIENCY

Efficiency means making the best use of resources. 'Technical' or 'productive' efficiency means producing as many goods or services as possible from a given set of inputs. 'Allocative' or 'economic' efficiency means putting productive resources (like labour, land or capital), to their highest value use and distributing goods and services to consumers in a way that best satisfies consumer needs and wants. See also 'Distortion'.

EXCESS BURDEN (OR DEADWEIGHT LOSS)

Excess burden is a calculation of the economic loss society suffers as a result of the distortionary impact of taxation. Excess burden is generally calculated in two manners: marginal excess burden and average excess burden. See also 'Marginal excess burden' and 'Average excess burden'.

EXEMPTION

Part of the tax base not subject to taxation.

EXTERNALITY

The impact of an activity that confers costs (a 'negative externality') or benefits (a 'positive externality') on a third party that are not fully reflected in prices. Externalities can arise during the production or consumption phases of the activity and may be of an environmental, social or financial nature.

HORIZONTAL EQUITY

Similar treatment of individuals in similar circumstances. See also 'Vertical equity'.

IMPROVED LAND VALUE

The assessed market value of land and any improvements made to it (such as buildings on the land) under normal sales conditions. See also 'Unimproved land value'.

LAND TAX

Tax levied on the unimproved value of selected categories of land held at a particular date. See also 'Rates' and 'Capital land tax'.

LEGAL INCIDENCE

The individual or entity legally liable to pay a tax or receive a transfer bears the legal incidence of the tax or transfer. It often differs from the tax incidence. See also 'Tax incidence'.

MARGINAL EXCESS BURDEN

Marginal excess burden measures the economic harm from an increase in the tax, expressed in cents per dollar of additional revenue. It is useful in considering the impact of a small rise in a tax. See also 'Excess burden' and 'Average excess burden'.

PROGRESSIVE TAX

Where the average rate of taxation increases as income or wealth increases. See also 'Regressive tax'.

RATES (COUNCIL, MUNICIPAL OR GENERAL)

Tax levied by a local or territory government on the unimproved value of land. See also 'Land tax' and 'Capital land tax'.

REGRESSIVE TAX

Where the average rate of taxation falls as income or wealth increases. See also 'Progressive tax'.

RIGHTSIZE

To move to a home which is the optimal size for your needs. See also 'Upsize' and 'Downsize'.

STAMP DUTY

In New South Wales, the term stamp duty can be used to describe government taxes applied to property transfers, motor vehicle stamp duty and insurance stamp duty. However, the term is commonly used to refer solely to stamp duty on property transfers and not incorporate other forms of stamp duty. This common usage is replicated in this paper, using the term stamp duty to refer solely to stamp duty levied on property transactions.

TAX INCIDENCE (ALSO ECONOMIC INCIDENCE)

The individual or entity which bears the final burden of a tax. This is distinct from the legal incidence of the tax or transfer. For example, the legal incidence of a consumption tax is often the supplier of goods and services who are legally required to pay the tax. However, the supplier may be able to factor in the tax they pay into the price of their products or services that they charge to consumers. This results in the consumer paying a higher price for the good or service. In such cases, the consumer bears the economic incidence of the tax through paying higher prices even though it is the supplier that is legally liable to pay all of the tax. See also 'Legal incidence'.

UNIMPROVED LAND VALUE

The assessed market value of land, under normal sales conditions, disregarding any structural improvements made to the land (buildings on the land). The unimproved value of land is determined in New South Wales by the NSW Valuer General as of the 31st December each year. See also 'Improved land value'.

UPSIZING

To move to a larger home. See also 'Downsize' and 'Rightsize'.

VERTICAL EQUITY

Different treatment of individuals in different circumstances, with those better off bearing a greater tax burden than those less well off. See also 'Horizontal equity'.

VERTICAL FISCAL IMBALANCE (VFI)

The imbalance between the spending responsibilities but limited revenue raising options of Australia's states and territories and the federal government's ability to raise more revenue than is required for its own expenditure needs. This imbalance creates a need for large financial transfers from the federal government to each state and territory government annually.

Appendix

Full details of New South Wales current land tax arrangements are available here:

www.osr.nsw.gov.au/taxes/land/about

TABLES AND GRAPHS

Figure 1 – The proposal in short

Figure 2 – How stamp duty operates

Figure 3 – Stamp Duty as a proportion of New South Wales' tax revenue

Figure 4 – Stamp Duty and land tax in operation over 20 years

Figure 5 – Stamp duty and land tax as a proportion of New South Wales tax revenue

Figure 6 – The proposed scheme's impact on homeowners

Figure 7 – How value capture could work in Sydney



Table 1 – Key problems with stamp duty

Table 2 – Notable reports advocating the abolition of stamp duty and extension of land tax

Table 3 - A proposal to abolish stamp duty and extend land tax in New South Wales

Table 4 – Current land tax thresholds in New South Wales

Table 5 – Key principles of good tax design

Table 6 – Marginal and average excess burdens of selected taxes

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