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James Hunter, Rachel Garcia and Kirsty Bennet
Tax Reform Taskforce
NSW Treasury

By email: **TaxReformTaskforce@treasury.nsw.gov.au**

Dear James, Rachel and Kirsty

NSW Treasury property tax proposal – consultation paper

CPA Australia represents the diverse interests of more than 168,000 members working in over 100 countries and regions supported by 19 offices around the world. We make this submission on behalf of our members and in the broader public interest.

The **Buying in NSW, Building a Future Consultation Paper** (**the Consultation Paper**) presents the New South Wales Government's (**the Government**) case for a shift in the New South Wales tax base from stamp duty to property tax.

As an external member of the ATO National Tax Liaison Group, we thank you for speaking with us during the consultation period. This submission provides our further views on the proposal for your consideration.

While presented as a home ownership policy, we consider that the proposed property tax (**the proposal**) is fundamentally about shifting the Government's tax base from the property market to New South Wales land via property owners. The replacement of the volatile and inefficient transaction-based stamp duty will change to a more stable revenue stream for government through annual tax levied on all owners of property in New South Wales.

We are supportive of reforms that increase the wellbeing and prosperity of New South Wales residents but are mindful of the potential long-term tax burden on property owners. We believe that even with its cautious approach, the Government should carefully monitor and manage the transition to ensure that the market can sustain the property tax and that financially vulnerable or distressed property owners, or their tenants, are not unduly impacted.

We note that the price threshold and opt-in components of the proposed tax do not have timeframes, nor is modelling available to assess the results of alternative approaches. Further details on the expected path to a full transition should be published to inform consultation on the appropriate settings.

Our responses to the Consultation Paper questions are in the Attachment.

If you have any queries about this submission, contact Elinor Kasapidis, Senior Manager Tax Policy on 03 9606 9666 or **elinor.kasapidis@cpaaustralia.com.au**.

Yours sincerely,

Dr Gary Pflugrath
Executive General Manager
Policy and Advocacy

1. Do you agree that stamp duty is out of date and is a handbrake on the economy? Is there merit in replacing it with a broad-based annual property tax?

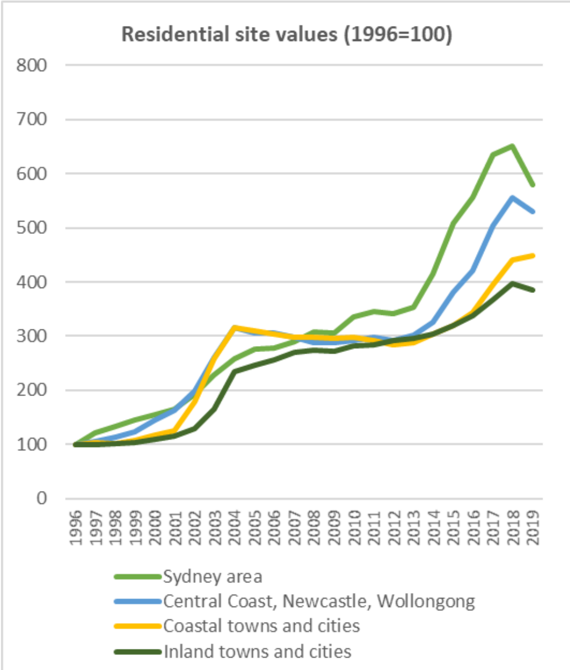
There is significant recognition amongst economists and the profession that stamp duty is an inefficient tax and therefore the Government is to be commended for considering its removal. We support the removal of stamp duty on both policy design and economic grounds.

However, in terms of an alternative revenue source for the Government, we have previously expressed our preference for GST reform, in the form of changes to the base and potentially the rate, to be the mechanism used to support state government budgets, rather than new state-based taxes. We remain of the view that reforming the GST should be the priority.

A property tax shifts the burden onto every New South Wales resident, directly or indirectly, and uses the unimproved land value of the land that they occupy as a proxy for income and wealth. This reflects the principle that residents should regularly contribute towards the goods and services provided by the Government for their collective benefit, not just when they purchase a property in the state. Property taxes also form a more stable revenue base for government, as opposed to stamp duty revenues which fluctuate according to the volume and value of property market activity.

We note the mixed results from various economic models seeking to estimate the direct and indirect price impacts on property purchases and rents. This suggests that the policy goal that houses will become more affordable, or that renters will have more affordable lease costs, may not necessarily be realised.

The comparison of residential property prices and earnings in the Consultation Paper[1] highlights the rapid growth in average property prices compared to slow earnings growth. Similarly, New South Wales land value data[2] reflects similarly rapid increases (*see graph, right*) raising the concern that property taxes will increase at a rate faster than earnings if current trends continue.



Source: NSW Valuer General, 2020.

Therefore, the affordability issues related to stamp duty are not necessarily resolved by the shift to a property tax. To the extent that the opt-in property tax does not reduce or dampen property price and land value growth, the potential for property taxes to become burdensome over time on owners, their tenants and the market is high. This has an effect similar to bracket creep for income tax as the value of the taxed asset increases disproportionately to income, leading to higher tax liabilities without a commensurate increase in income.

Therefore, we recommend that the Government also consider how the property tax rate will be adjusted when land values and measures such as earnings significantly diverge. The Consultation Paper proposal to set a total revenue cap or target and adjust rates accordingly is a reasonable suggestion. The choice of growth factor should be informed by its correlation or nexus with the taxpayer's capacity to pay – for example, residential property might use household income even when it's held by an investor to protect tenants, commercial properties might use Gross State Product, while farmland might require a more tailored growth factor.

2. The annual property tax would be based on unimproved land value, much like the way council rates are currently calculated – what do you think of this approach?

The use of unimproved land value, as opposed to capital improved land value, is sensible as it does not disincentivise capital improvements. It is also progressive in that owners of high-value property will pay more than owners of low-value property.

The valuation methodologies and results of the New South Wales Valuer General, and the basis of assessment by Revenue NSW, will become increasingly important. The Government should ensure that there is an appropriate mechanism by which to challenge property tax assessments in a timely manner and that there is total transparency of the valuation process.

[1] NSW Treasury, 2019. *Buyers will be given the choice of which tax to pay*, Buying in NSW, Building a Future Consultation Paper, p.12

[2] NSW Valuer General, *Land values (1996 to present)*, **Long term land value trends**, downloaded 5 January 2021

3. Do you agree that it would be attractive to be able to choose an annual property tax rather than paying a large lump-sum stamp duty on a purchase and, for investors, the current annual land tax?

Not necessarily. Where there is choice, the decision between stamp duty and property tax will be determined by the overall cost to the purchaser. If the property tax provides a net benefit greater than the stamp duty, it is more likely that a purchaser will opt in.

For those intending to hold property for a longer term (i.e. more than 12 to 18 years depending on the type of property), stamp duty remains the cheaper option. The certainty of a lump-sum amount may also be preferable to the property tax which will increase over time due to growth in unimproved land value and, potentially, changes to the tax rates. In addition, some purchasers currently benefit from reduced stamp duty or land tax liabilities due to concessions, exemptions and grants, and they may be worse off under the property tax.

The choice to opt in also means that a dual market may exist for some time with prices for properties subject to land tax being different from those that retain the option to pay stamp duty.

4. Is an opt-in and gradual approach the best way of ensuring a fair transition to the property tax?

Because the choice to opt in is irrevocable, it is assumed that the opportunities to pay stamp duty will decrease over time as properties move to the property tax regime. The Consultation Paper states that "*after twenty years the option to pay stamp duty would remain for more than half of all properties*"[3].

As a result, the Consultation Paper does not set out a clear path to a full transition to property tax, leaving the issues of potentially removing the opt-in choice and changing the price threshold to future governments.

A gradual introduction can minimise impacts on prices, allow the design to be improved and maintain continuity of government finances. It also enables the Government to identify and address potentially unfair or inequitable outcomes as they emerge. However, the potential risks with a policy implemented over decades include purchaser uncertainty, pricing distortions, dilution of the tax base and even failure, if low numbers of purchasers opt in.

Arguably, there may also be differing views about the fairness of the proposals in terms of:

- properties above a price threshold not being subject to the property tax
- the relative contribution to state revenues by property owners over time depending on whether they pay stamp duty or property tax
- the relative contribution to total property tax revenues by type of property (e.g. residential, commercial, industrial, farming), and
- whether the rates of property tax are appropriate.

The Government may also need to assess the costs, inefficiencies and potential market distortions of levying and administering three separate taxes[4] on the same tax base over the longer-term. If the Government seeks a faster transition to a property tax base, reductions to the property tax rates or the introduction of concessions may need to be considered to encourage take up of the property tax.

Given the broadening of the tax base, the potential impacts on financially vulnerable groups must be considered. The introduction of property taxes should not harm low income earners, or those receiving government support, particularly in the form of increased cost of living.

5. Would you delay a home purchase if it meant you could opt-in to the property tax? Should there be a limited window for retrospective opt-in to the property tax, after it commences?

To the extent that a time-limited retrospective opt-in results in improved choices for purchasers, a reduction in market uncertainty and an increase in the number of properties opted into the tax, it should be considered.

We also recommend that the timing of making the opt-in election should be made clear. Consideration should be given to allowing purchasers to amend their choice shortly after settlement as they may receive further advice or reassess their financial options after purchase.

[3] NSW Treasury, 2019. *Buyers will be given the choice of which tax to pay*, Buying in NSW, Building a Future Consultation Paper, p.18

[4] Property tax, stamp duty and land tax.

6. Should there be different property tax rates for residential owner-occupied properties, residential investment properties, farmland, and commercial properties?

Given the different markets and uses of residential, farmland and commercial properties, different property tax rates are appropriate. The Government should consider whether industrial and commercial land should be taxed at different rates.

For residential housing, there is an argument that there should be no distinction between the type of purchaser as the property tax differential generates different revenues to government from the same property and may lead to price distortions in the market. While the Consultation Paper proposes different rates for investors due to the tax deductibility of the property tax for investors and the removal of land tax, we note that owner-occupiers benefit from the capital gains tax main residence exemption upon disposal. Also, many investors in the residential property market are currently exempt from land tax.

Further, the greater the complexity of the tax, the greater the administrative and compliance costs for both government and taxpayers. Consideration should be given to the benefits of a simpler tax based solely on the type of land use, rather than the owners' purpose, and the likelihood that this may be more efficient over the longer-term.

If two residential property tax rates are chosen, the Government should ensure that the higher taxes on investment properties do not create significant additional costs for renters, particularly those who are financially vulnerable.

We also note that the purpose and zoning of land can change over time, such as shifting from commercial or rural land to residential land. Clarity will be required about the rules and timing of changes to the type of property tax levied and any changes to the unimproved land value as a result of the zoning change. Planning policies such as Precinct Structure Plans can alter the zoning and therefore the unimproved land value of a property, generating large property tax increases which are entirely outside of the control of the taxpayer.

For example, a purchaser who opts into the property tax regime on the basis that the land is zoned and will be used as farmland, may then find the land is later designated and subsequently valued as unimproved residential land. It is unlikely that they will be able to afford the commensurate increase in property taxes and may be forced to sell.

7. Given this tax reform is an investment into our future, do you think it is worth the cost?

The Government has been clear in its intention that the proposed changes will be revenue neutral over the long term. As such, on balance and subject to the suggested changes in this submission, we believe that the change to a more stable tax base and the removal of stamp duty is a positive reform.

The 2020-21 New South Wales Budget shows that taxes of $29.9 billion contributed to 37 per cent of revenue from transactions ($81.4 billion), of which 39 per cent ($11.6 billion) came from stamp duty on transfers and land tax[5]. The Consultation Paper estimates that, based on the proposed settings, revenue forgone would be limited to $2 billion in any given year. This is less than 3 per cent of government revenue from transactions. Also, we note that future property tax receipts can be securitised to maintain budget stability.

We recommend that the Government monitor the impact of the change to property tax to ensure that cost is not only measured in terms of Government revenue and budget position, but also the direct and indirect cost impacts on New South Wales residents and businesses across all social, geographic and economic strata. This will provide some comfort that the tax burden is appropriately distributed.

8. Should price thresholds be used to exclude people buying the most expensive properties from being able to choose the property tax?

No. The Consultation Paper indicates that the basis of the price threshold is to protect the Government's budget during transition. As receipts from property taxes can be securitised, concerns about budgetary impacts may be alleviated by the government accessing appropriate and interested investors.

Further, the Government may benefit from progressing without a price threshold as properties with high unimproved land values will generate higher revenues over time. We also note that, given the Government estimates that only 50 per cent of properties would opt into the property tax over the next twenty years, there may be capacity in the budget to raise or remove price thresholds at a future date.

If the property tax proceeds, the Government should be clear in its intention to raise or remove the price threshold over time and should work actively to transition all properties across to the property tax.

[5] NSW Government, 2020. *Chapter 4: Revenue*, **Budget Papers**, The NSW Budget 2020-21, November.

9. What arrangements should be made for residential and commercial tenants if their landlord chooses to pay the property tax?

Ultimately, the market will determine the level of rent charged for any given property as costs are passed on, either directly or indirectly, to the extent possible. Given the relatively slow predicted uptake of the property tax, there will be ongoing opportunity to observe and address unintended or negative impacts on tenants.

The Consultation Paper suggests that rents could fall in the longer term as a result of the shift to property taxes, but market intervention may be required to protect tenants. We agree that the Government should proactively monitor the market and undertake continuous evaluation of the impact of the property tax on prices and activity. Where residents or investors are being disproportionately or inappropriately impacted, the policy settings should be adjusted.

10. What should happen for people who have chosen the property tax, but then can't afford it?

During transition, we would hope that purchasers will consider the risks of opting into the property tax and will make an informed decision to choose in favour of annual taxes. However, as the stamp duty tax base diminishes, future purchasers will have limited or no choice but to pay property taxes. Their ability to pay can be significantly affected by events including unemployment, having a family, ill health or economic shocks.

The interest rate charged on tax debts should be carefully chosen as commercial interest rates may be potentially punitive, especially for owner-occupiers. Payment arrangements, like those provided by the ATO, should be available to all taxpayers.

The Government must take a reasonable approach to those suffering financial distress or who are financially vulnerable. This could include providing payment waivers or deferrals for financial hardship and concessions, credits or rebates to residents in receipt of other government benefits, or those who lease premises to them.

Consideration should also be given to those of pension age whose income may be insufficient to afford the annual property tax. While those in receipt of government pensions could be given concessions, there will be many self-funded retirees in the coming decades who may still experience difficulty paying the tax. The Government approach should align with broader policy reforms in relation to **retirement income** and **aged care**, consider the subsequent impacts of forcing a sale of the main residence (e.g. effect on the Age Pension Asset Test) and provide financial security to elderly Australians.

The Government should also consider approaches taken by local councils in managing unpaid rates, including defined periods of time before commencing recovery action, waivers of interest and charges on late payments and policies for those suffering financial hardship.

We note that although property can be secured to protect the revenue generated by the property tax, recovery of stamp duty is relatively efficient in that it must be paid before a transfer can be processed through PEXA (i.e. for property transfers that require a transfer on title). There may be additional compliance costs for the recovery of property taxes that will need to be factored into Government cost estimates.

We reiterate our concern that sustained divergence between growth in unimproved land value and income or earnings will create affordability issues for a growing number of property owners. The Government should develop measures to monitor affordability and consider including safeguards in the legislation to ensure that the property tax burden does not become onerous.

11. What is the best way of ensuring that the property tax remains affordable for taxpayers, while generating the same amount of long-run revenue as stamp duty and land tax?

The issue is not necessarily about revenue neutrality between the current and future tax regime, but rather the composition, stability and size of state government revenues. A broader conversation about GST and Commonwealth funding to the States is required to identify reform opportunities and efficiencies which may present greater benefits for New South Wales and Australia, than the introduction of a new state-based tax that will eventually replace existing ones.

Australian state governments have experienced windfall stamp duty revenues, driven by rapidly increasing property prices, in the past few decades. Evidence over recent months suggests that even COVID-19 has had little impact on residential property prices with growth exceeding expectations. We observe that permanently setting property taxes at a rate intended to maintain the current level of stamp duty revenues may be unsustainable. Stamp duty is being generated from an extremely high growth asset class in a high turnover environment with significant concerns about the 'bubble' nature of the current market. It is not unreasonable to expect that stamp duty revenues will fall should there be a negative shock to the property market (e.g. rapid rise in interest rates, changes to bank lending criteria).

The property tax should therefore not necessarily be set by reference to current revenues, but rather be driven by estimated long-term government expenditures. In addition to the proposed total revenue cap, consideration could also be given to establishing a macro-economic threshold for the state-based tax burden (e.g. total state revenues to gross state product), similar to the Federal Government's policy that tax revenues comprise no more than 23.9 per cent of gross domestic product (GDP). The government could then further adjust specific taxes, fees, levies and charges as required and appropriate.

We believe that increases in unimproved land value above growth in wages and income creates the biggest issue for the proposed property tax. In designing the tax, the Government should evaluate the efficacy of similar land tax regimes, such as the previous capping that applied to Victorian land tax.

12. Is there a specific aspect of our proposed reform you would change to help make the proposal better?

We note that there is a need for legislation, or at least guidance, to address the tax treatment of:

- Mixed use land
- Vacant land, including where its use is changing (e.g. from farmland to residential) or where it can't be developed due to circumstances outside the taxpayer's control (e.g. planning process)
- Property transfers arising upon death, relationship breakdowns or inter-generational asset transfers
- Unimproved land intended for residential development
- Partial renting of property by the resident owner, such as AirBnB, granny flats and share houses
- Student accommodation and serviced apartments
- The ownership of land by charitable organisations and similar entities, and
- The interaction between land tax and the property tax where a taxpayers' total land holdings exceed the threshold, and future purchases are opted into the property tax.

Clarity should be provided by the Government regarding the treatment of current duty exemptions and the extent to which there will be alignment or replication in the property tax regime. While a broader base and simpler design are preferable, we recognise that existing exemptions are often included in order to achieve equity and fairness of outcomes. These may need to be considered for the property tax regime. The Government should also clarify if purchasers are able to not opt into the new property tax and still qualify for an existing exemption or concession (e.g. in specie distributions or changes of trustees).

The timing of the assessment of the property tax should also be considered. Issues include whether the value will be assessed based on ownership and use as at midnight 31 December of the previous year as such factors may put additional pressure on settlements of sales prior to the end of the year if there are different rates for homeowners and investors.

Tax agents registered with the Tax Practitioners Board and regulated by the *Tax Agent Services Act 2009* are permitted to provide advice on federal taxation laws, but this permission does not extend to state taxes. While most purchasers will tend to engage a lawyer or conveyancer to assist with their purchase, many will seek the advice and input on which option is best from their tax agent who is usually their accountant. The profession would appreciate a legislative provision stating that registered tax agents are permitted to provide advice to their clients on the property tax, as this provides certainty to both the adviser and their client.