

## **Submission on Consultation Paper – Buying in NSW, Building a Better Future**

Thank you for the opportunity afforded to comment on the Consultation Paper. I will start by making some general comments before turning my attention to the particular questions posed in the paper.

### **General Comments**

Despite what is stated on page 17 of the Consultation Paper, it is far from clear as to the real purpose or intent of the paper/reform being proposed. More particularly, is it to:

- Give Stamp Duty relief to first home buyers; or
- To give relief to all Stamp Duty payers along with non-residential Land Tax payers; or
- To develop a more efficient tax; or
- To broaden the tax base and thereby make more people pay individually a lower rate of tax.

Until the problem is more clearly defined it is not possible to find the most appropriate solution.

The Consultation Paper makes a number of claims in support of the changes proposed. For instance it is claimed that:

- Changing from stamp duty to an annual property tax payment based on Land Value will increase home ownership;
- The change could inject \$11B into the NSW economy over 4 years;
- The amount of stamp duty homeowners pay has grown faster than house prices or incomes. For example, since 1990 NSW average earnings have increased threefold, while house prices have increased fivefold, and average stamp duty imposts have increased by more than 7 times;
- Stamp duty is a major barrier to anyone saving for their first home or wanting to upgrade;
- Home ownership rates have fallen from 70% in the 1990s to 64% today;
- Land Tax places a larger burden on a small number of tax payers;
- The changes being proposed will place downward pressure on home prices over the longer term.

In response to these and other arguments advanced to justify the change, I offer the following comments:

1. Stamp duty on an average property in Sydney valued at about \$1.1M (with a Land Value of about \$700,000) amounts to approximately 4% of the purchase price. This is not considered a major burden or a major cost driver impacting housing affordability.

House prices in Sydney are expected to increase by between 5% and 10% this year if the economic pundits are to be believed<sup>1</sup>. For the average Sydney house currently valued at \$1.1M this translates into a price of between \$1.155M and \$1.21M by year's end. This represents an increase of between \$55,000 and \$110,000.

Stamp duty on a \$1.1M property purchased at the beginning of the year would have been \$45,505. This is less than the price escalation expected in one year.

2. In any event it is always open to the Government to allow home buyers to pay their stamp duty liabilities off over time, say 10 to 15 years. This will then have the same impact on family incomes as the Property Tax being proposed.
3. It needs to be always remembered that Stamp Duty along with Land Taxes are levied by Government. It is within the province of Government to vary the rates of taxation every year to meet its various policy objectives. However, a little look at history shows that successive Governments have shown little concern about the impact of stamp duty rates on first or any home buyers. As shown in the following tables stamp duty rates have barely changed since 1986.

**Table 1. Stamp Duty Rates 1986-2003<sup>2</sup>**

<b>Value of Property</b>	<b>Stamp Duty Rate</b>
\$0 to \$14,000	\$1.25 for every \$100
\$14,001 to \$30,000	\$175 plus \$1.50 for every \$100 over \$14,000
\$30,001 to \$80,000	\$415 plus \$1.75 for every \$100 over \$30,000
\$80,001 to \$300,000	\$1,290 plus \$3.50 for every \$100 over \$80,000
\$300,001 to \$1,000,000	\$8,990 plus \$4.50 for every \$100 over \$300,000
Over \$1,000,000	\$40,490 plus \$5.50 for every \$100 over \$1,000,000

<sup>1</sup> The Australian January 23-24 2021.

<sup>2</sup> Office of State Revenue, NSW Treasury taken from "Submission To the Productivity Commission Inquiry Into First Home Ownership" by Professor Frank Stilwell, University of Sydney.

**Table 2. Stamp duty Rates now<sup>3</sup>**

<b>Value of Property</b>	<b>Stamp Duty Rate</b>
\$0 to \$14,000	\$1.25 for every \$100
\$14,001 to \$31,000	\$175 plus \$1.50 for every \$100 over \$14,000
\$31,001 to \$83,000	\$430 plus \$1.75 for every \$100 over \$31,000
\$83,001 to \$310,000	\$1,340 plus \$3.50 for every \$100 over \$83,000
\$300,001 to \$1,033,000	\$9,285 plus \$4.50 for every \$100 over \$310,000
Over \$1,033,000	\$41,820 plus \$5.50 for every \$100 over \$1,033,000

As can be seen from an inspection of the above Tables, there has been very little adjustment over time to stamp duty rates despite significant escalation in property values in Sydney and other metropolitan areas. Regional areas have also experienced price rises but to a lesser extent.

If we go back to our median Sydney house with a value of \$1.1M and assume no increase in value over time, stamp duty in 1986 would have been \$45,990 compared with \$45,505 today. This is hardly a dramatic concession.

If we consider our average house had a value of around \$95,000 in 1986 stamp duty upon its sale would have been \$1,815.

The increase in the value of the property over the years has been 11.6 times the initial purchase price. However, stamp duty has risen 25 times, or more than double, the rate of increase in the value of the property.

If the Government is concerned about the level of stamp duty on first homes buyers or downsizers, it already has the means to mitigate this impact. In short, if there is a problem with stamp duty affordability it is a problem of the making of successive governments over time. It is disingenuous to then use this argument to argue for change to the taxation regime.

4. Much concern is expressed about the efficiency of Stamp Duty relative to a broad based Property Tax. If the great advantages of a Property Tax is that it cannot be avoided then exactly the same should apply to Stamp Duty. Stamp Duty must be paid, or arrangements made to pay it, before the property ownership is transferred.

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<sup>3</sup> NSW Treasury

The only difference between Stamp Duty and a Property Tax is that one (Stamp Duty) is levied on transfer of a property based on the purchase price. It therefore includes the value of improvements. A Property Tax, as proposed, is to be levied annually based on the Land Value of the property.

It could be argued that there is greater progressivity and vertical equity in a Stamp Duty regime as it reflects the value of improvements as well as the value of the land. If Stamp Duty could be paid over time it would resemble a Property Tax operating for a defined period, and therein lie some primary advantages of a Stamp Duty regime over a Property Tax. Those advantages are that the value of the Stamp Duty is known at the time of purchase and if paid over-time, payments are made for a finite, rather than an indefinite period as would be the case with a Property Tax.

5. The paper indicates that it is the Government's intention to keep revenue from Property Tax and Stamp Duty revenue neutral. However, this term is not defined. Does it mean neutrality in any year or does it mean neutrality over time such that the:

$$PV^4 \text{ of a Property Tax over time} = \text{Stamp Duty paid in year 1}$$

for each property transferred. This is what would be required to achieve revenue neutrality for each property purchaser but would mean a multiplicity of different tax rates over time unless Stamp Duty and Property Tax rates were held constant.

In any event, it is important to recognise that while the current Government intends that its Property Tax proposal will be revenue neutral, the present Government cannot bind all, or any future government. In short, these intentions, no matter how honourable, are worthless.

6. Page 22 of the Consultation Paper contains an interesting admission. It introduces a discussion on how to grow "the annual property tax revenue target" and discusses various growth factors that could be used to grow annual property tax revenue.

At no stage was an increase in State Government revenue mentioned before pages 22-23, but perhaps this is the real reason for the proposed change from a Stamp Duty regime to a Property Tax regime – to grow the revenue and the base on which the impost falls – rather than concerns for the impact of Stamp Duties on first home buyers.

We were told when the GST was introduced that a principle reason was to give the States a revenue stream that would grow as household incomes and expenditures grow i.e. as the economy grows. The States Government therefore has a growth tax already.

If a primary aim of the introduction of a Property Tax is to broaden the tax base and to increase State revenues over time, the Government should be upfront about it. It is a shame that if this is the case and the primary reason for the proposed change, that other tax options were not considered.

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<sup>4</sup> Present Value

More particularly, the paper could have canvassed replacing, Stamp Duty, in all or part, by a State supplement on Federal Government Income Tax rates. This would be a genuine tax on income derived from economic activity in each year. It should be remembered that no country has got rich from taxing away accumulated wealth.

If taxation revenues were derived from income taxes there would be no need to worry about whether surrogates, such as a Property Tax, are affordable.

In any event, while a swap from Stamp Duty to Property Tax may seem attractive in the short term, such a change will just lay the foundations for future political agitation to reduce the Property Tax rates. Such a change could sow the seeds of its own demise. This is particularly likely to be the case as the number of people paying the Property Tax approach 50% and these people, forgetting the past, become disenchanted with having to pay this annual impost while a large portion of the population is excluded from it.

This will be exacerbated as the first Property Tax payers reach retirement age and realise that a property tax bill will take a large proportion of their disposable income to pay. This then has consequences for housing affordability for the aged and also the ability to downsize and move where past tax liabilities have been deferred but are subject to payment on the sale of the property.

I would also mention that I have no recollection of a Property Tax proposal based on Land Values having been raised by either of the main political parties prior to the last State election. It follows that the Government has no mandate to make such a change before the next election, and before it forms part of its election manifesto.

## **The Questions Posed**

### ***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 abroad-based annual property tax?***

I do not agree that Stamp Duty is out of date. It is also far from clear that it represents a handbrake on the economy any greater than would the cumulative effect of a Property Tax over time. I do not see any merit in replacing the existing Stamp Duty regime with an annual Property Tax.

If there is a problem with affordability for first home buyers then allow them to pay their Stamp Duty obligation over 10-15 years.

### ***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?***

Land value based rating should be left to local government were it enjoys some level of support. Land values in any local government area are likely to vary between properties to a lesser extent than property land values across the State. This greater variability will give rise

to much greater variability in Property Tax imposts depending on where in the State a property is located.

At least with local government rates there is a nexus, however tenuous, between paying the rate and the provision of services by the local council and the betterment in properties due to the provision of local infrastructure.

It is a real concern that the Government's proposed Property Tax, which is likely to be multiples of local government rates, will not only sow the seeds of its own eventual demise but also undermine confidence in Councils' use of land value based rates as a revenue source.

**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 purchase and, for investors, the current annual land tax?**

There should be no greater attraction to paying a property tax as there would be to being able to pay Stamp Duty in 10-15 annual instalments. In fact, the instalment option would, prima facie, be more attractive as it would be for a defined period for a known amount of money.

A Property Tax would be more advantageous for someone who turns over residential property greater than once every 10 years. It would be a major disadvantage for anyone who intends to hold and live in a property for a greater length of time. When young people decide to settle and start a family it is not uncommon for them to stay in an area for considerably more than 10 years, particularly during the schooling years. These are also the years in which communities form and grow.

As far as investors are concerned, they are only likely to prefer a board based Property Tax over the present tax if the present value of the Property Tax is less than the Stamp Duty and Land Tax nett of Income Tax concessions. It needs to be remembered that Stamp Duty costs are included in the cost base for the calculation of capital gains tax when an investment property is sold. Land tax is able to be offset against income in the year in which it is paid.

The only other scenario in which an investor may prefer a Property Tax regime, is if the total impost on the investor from Stamp Duty and land tax, taken together, is greater than a Property Tax. This could come about by the Government reducing the amount that investors currently pay and smearing this over all other properties, that is residential owner occupiers. The Consultation Paper makes no mention of this occurring and if this is part of the Government's agenda then it should be more forthcoming with information about its proposals and changes in the incidence of where the tax impost falls.

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

The opt-in strategy is a good way of ensuring a fair transition. However, it would be enhanced if it were an opt-in, opt-out proposition. As the proposal stands once a property owner is caught within the web of the Property Tax regime it is stuck in that regime. A better proposition would be to allow each successive property owner to make a choice of whether to pay the Property Tax or a lump sum Stamp Duty. If, as the Government contents the two

taxation propositions are to be revenue neutral then the Government should be indifferent as to whether people pay Stamp Duty or the Property Tax.

One concern with the Government's proposal is that it cannot bind future governments. While the current government may have the intention of having the two taxation systems running in parallel what is to stop a government in 10 years time saying it is too difficult and costly to have two taxation systems and to unilaterally declare that it will be placing everyone on the Property Tax system subject to a phase-in period of 10 years.

**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.***

No and No.

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

Certainly there should be different rates between owner-occupied properties and the other classes of property for no other reason than the other classes of property will be able to offset their Property Tax liabilities against income earned in the calculation of their Commonwealth Income/Company tax liabilities in any year. This concession is not available to residential property owner-occupiers and they will confront what is effectively double taxation i.e. paying the Property Tax from income earned in any year and also paying Federal government income tax on the same income.

The only effective way of overcoming this double taxation is to allow owner-occupiers to deduct their Property Tax payments from their gross income for the purpose of calculating their taxable income. This will effectively mean shifting the tax burden to the Federal government, not something they are likely to be enamoured with.

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

Given that the proposed Property Tax is supposed to be revenue neutral with the existing Stamp Duty regime (and Land Tax for non-residential properties) it is difficult to see how it represents a net investment in anything greater than what takes place now.

Moreover, there is no guarantee that any additional revenue raised by the change is invested in anything as it is more likely that it will be progressively used for recurrent expenditure. This is, in short, introducing a tax on accumulated wealth (albeit one form of wealth) to pay for recurrent expenditure.

This comment raises an additional issue with the Government proposal. That is while it is a tax on wealth it is a tax limited to a particular class of wealth, that being land. All other forms of wealth such as shares, bonds, bank deposits, diamonds, gold and other precious metals, and even land held in other States is exempt from the tax. This will hardly encourage investment in NSW.

In summary, is it worth the cost – the answer is an unequivocal no, and this is before the political cost to Government is factored in.

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

Given the Government's enthusiasm for its Property Tax proposal this question seems misplaced. It can only be assumed that the Government desires to retain the revenue that it obtains in the form of Stamp Duty from high valued properties. If this is the case there is no point including the discussion on the most valued properties i.e. commercial properties, in the Discussion Paper at all.

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

Currently Stamp Duty forms part of the cost base for an investment property and is therefore deductible before assessing the level of any capital gain on disposal. Any investor would normally seek a return, in the form of rent and expected capital appreciation, on the whole of a property's cost, including Stamp Duty paid. Tenants would therefore be already paying a return on the value of Stamp Duty in their rent.

There would be no difference if a new owner decides to pay the Property Tax. This would seek to recover all annual outgoings in rent or lease payment. In some cases lessees are already paying such items as Council rates where the lease agreement makes provision for this (i.e. rates paying lessees). I would be surprised if things change much. One thing is clear and that is it is not the place of governments to intervene in arms-length commercial negotiations between parties.

In any event, it must be remembered that costs and outgoings of the owner are only one consideration in the rent equation. Market conditions have a much bigger influence on rents, and if a prospective tenant does not like the rent being sought they can seek to negotiate a lower outcome or walk away and seek an alternative property.

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

This is going to be a major dilemma for future governments if the proposed change is introduced.

From my own experience I would suggest that there are two periods in a family's life when an annual property tax is going to be problematic. The first is during the family's child bearing and child rearing years. Mortgages are high, requiring two incomes to service. Parents have yet to reach their maximum earning potential (this comes in the forty's and early fifty's). I remember these days as those of sausages and mince. For the Property Tax paying cohort finding between three and five thousand dollars each year, on top of other bills (and kids themselves are not cheap) will be a large ask. For them even sausages and mince may be a luxury. They may turn vegetarian out of necessity rather than choice.

The second cohort of people who could experience difficulties paying are those moving from employment to retirement. Their income will be reduced and they will face difficult decisions if they wish to stay in their family home. How to pay a large Property Tax impost will be one

of these. Even if they are able to defer payment and have the debt accumulate against the property, this will limit other choices later in life. The debt will have to be paid if they choose to move to a smaller place giving them less money to spend on that smaller place. It will also limit their capacity to make choices about nursing homes should the need arise as just about all these require a substantial bond, usually derived from the sale of the family home.

Government needs to think carefully about all the consequences of its proposed tax changes, including changes that normally take place over a lifetime. There would seem to be little point in taxing people through their working life only to see a greater and greater proportion becoming reliant on governments, both federal and state, at a younger and younger age because they have been unable to make adequate provision for themselves during their working lives.

***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 best way of doing this is to continue with the existing Stamp Duty and Land Tax mechanisms. Despite the criticisms from vested interests, they have worked reasonably well over time. I hear no loud clamour in the streets for change. This should be a signal to Government that things are not broken. It would be wiser not to meddle in something that doesn't seem to need it.

The fact that this question was posed at all is concerning. The fact that the Government has concerns about the affordability of a Property Tax regime before it has even been introduced points to real issues about the new regimes' overall viability and the benefits the Government claims the changes will bring forth.

If there are concerns about affordability at this early stage, the proposal needs a rethink.

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

There are a number of changes I would make; including:

- ❖ Considering a wider range of tax reform options than just a switch from Stamp Duty (and Land Tax) to a Property Tax, particularly consideration of a State based supplement on existing income tax rates.
- ❖ The opt-out to Stamp Duty/opt-in to Property Tax should be available each time a property is transferred. If the Government's stated intention to keep the two tax regimes revenue neutral is honoured, it should make no difference to the overall revenue position over time.
- ❖ Instead of introducing a Property Tax consider allowing all parties the option of paying Stamp Duty over a lengthy period of time, say 10-15 years (with any outstanding balance payable upon sale of the property). This would ease the burden for all home buyers, including first home buyers, and in the initial years would have the same boost to the economy as introducing an annual Property Tax.

- ❖ Exempt pensioners and self-funded retirees from the payment of the Property Tax on their principle place of residence. This will encourage, rather than discourage, elderly people to downsize from property that is too large for them.<sup>5</sup> It will also help ensure that they are not further condemned to a life of penary.

Thank you again for the opportunity to comment on the Consultation Paper.

Yours Faithfully,



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<sup>5</sup> The issue of downsizing is much more complex than just home maintenance costs and transaction and transfer costs. People stay in their homes for a wide variety of reasons including: being part of a community, established friendships, support and family networks, local amenity and locality, and relationships with health workers to name just a few.