

## Buying in NSW: Building a Future

### Brief Comments on Consultation Paper

The following are some brief comments on the *Consultation Paper* which proposes replacing property transfer duties (stamp duty) with a land tax, often described in the *Paper* as a property tax.

I start with brief comments on efficiency and equity impacts of existing stamp duty, followed by some comments on the proposal, and suggest an alternative strategy. I am submitting separately a paper that I prepared on this issue in 2016, which provides more analysis and support for the main points made in this brief submission.

#### Impacts of stamp duty

1a Estimates of the marginal excess burden of stamp duty vary from about 0.30 to 1.00, i.e. from 30 cents per \$ of tax raised up to \$1.0 for each \$ of tax raised. Citing unpublished work, the *Consultation Paper* takes the view that the burden of stamp duty is at the very high end (a \$ per \$ of tax raised) of these estimates. As analysed in my paper being submitted separately, I believe that this substantially over-states the cost of stamp duty and that the accurate answer is closer to the bottom end of the range of estimates noted above. But it is agreed that stamp duty is still a significantly less efficient tax than a property or land tax and that this efficiency argument is a sound basis for change.

1b The *Consultation Paper* appears to imply that house buyers will benefit almost wholly from abolition of stamp duty. This is a fallacy. House prices will fall only by about a quarter of the stamp duty foregone.

A basic principle of public finance is that taxes are borne by the party less able to escape them (in technical terms with the lower price elasticity of demand or supply respectively). In a perfectly competitive market, a tax on producers is passed on fully to, and borne by consumers.

When I made an investment purchase a few years ago, I calculated the capital value based on the rate of return, subtracted the stamp duty payable, and offered the net price to the vendor. The vendor immediately accepted.

Analysis in the accompanying submission shows that most of the stamp duty is borne by the seller. Assuming, broadly but realistically, that housing demand elasticity ( $\eta_d$ ) = 1.0 and housing supply elasticity ( $\eta_s$ ) = 0.3, house vendors bear 77% of the cost of the tax (in a lower price than they would otherwise get) and house buyers bear 23%.<sup>1</sup>

In so far as the stamp duty is paid in effect mainly by existing homeowners (or by landowners with new housing), who tend to have above average net wealth, stamp duty is not as inequitable tax as it is widely perceived to be. However, it does discriminate against households who move home more often and first homeowners who bear around a quarter of the stamp duty (unless exempted or subsidized in some way).

---

<sup>1</sup> The impact on the consumer (buyer) =  $\Delta P^c/S = \eta_s / (\eta_d + \eta_s) = 0.30 / (1.0 + 0.30) = 0.23 = 23\%$   
The impact the seller =  $\Delta P^s/S = \eta_d / (\eta_d + \eta_s) = 1.0 / (1.0 + 0.30) = 0.77 = 77\%$

## Comments on proposed changes to stamp duty

2a The *Consultation Paper* proposes exchanging the one-off stamp duty on property values with a small flat annual tax plus an annual tax on “unimproved land values”.

This language in the *Paper* is unclear in two ways. First, it often describes this as a change to a Th, which it is not. Second, in practice it is a tax on improved land values, not unimproved land values.

In practice land tax is usually based on improved land values, not on unimproved land values. This form of land tax is less efficient than a tax on unimproved land values.

2b A basic problem arises because land values (improved or unimproved) are not well correlated to property values. For given property values, land values are usually higher for house owners than apartment owners. House owners generally pay a higher land tax than do owners of apartments of similar value. Thus, the proposal is not property neutral. Relative to stamp duty, it appears that the proposal is likely to provide a subsidy for apartment owners relative to an increased tax for homeowners.

House owners pay the same stamp duty as owners of apartments with similar prices. Equality of revenue could only be achieved under the proposal only if differential land taxes were applied to owners of apartments and owners of houses. This would seem to be problematic unless the aim is to tax homeowners more highly.

2c Under the proposal, the land tax would vary according to the use of the property, presumably at any point in time, with rented property attracting a higher land tax than owner-occupied property. This appears to be based on the federal tax deductibility for rented property. It is not clear how this is consistent with achieving revenue neutrality between stamp duty and the proposed land tax.

2d Under the proposal, after about 10 years, half of the residents of a street would be paying high annual land taxes and the other half (non-sellers) would not be paying any land tax other than council rates. This may be looked upon as very unfair and may not be politically sustainable.

## An alternative Strategy

This response supports a gradual move from stamp (transfer) duty to either annual land taxes or annual property taxes.

Land taxes (especially on unimproved land values) are more efficient: they have a lower marginal excess tax burden. But property taxes are arguably more equitable and not confused with council rates.

Whether land or property taxes are adopted, this strategy could be done by gradually increasing the applications of land tax and by gradually reducing stamp duty.

Importantly, this strategy could also *include applications to many privileged sporting, religious and other entities, sitting on billions of dollars of land, who are fully or largely exempt from both stamp duty and land taxes and are not included in the Consultation Paper proposal.*

This alternative strategy is a practical, efficient and fair reform option which would appear to create fewer anomalies than the present proposal.