

The Real Estate Institute of New South Wales Limited

Submission

The NSW Budget 2020/2021 Buying in NSW Building a Future Consultation Paper

5 March 2021

To: Tax Reform Task Force
NSW Treasury
GPO Box 5469
Sydney NSW 2001

By email: [REDACTED]

Introduction

This Submission has been prepared by The Real Estate Institute of New South Wales Limited (**REINSW**) in response to the document published by the NSW Government titled *The NSW Budget 2020/2021 Buying in NSW, Building A Future Consultation Paper* ("Consultation Paper").

REINSW is the largest professional association of real estate agents and other property professionals in New South Wales. REINSW represents over 10,000 individual members and seeks to promote their interests and the property sector on property-related issues. In doing so, REINSW plays a substantial role in formulating property policy matters in New South Wales.

The REINSW has been a vocal advocate for a review of property taxes in NSW for many years. However, given all levels of Government tax property, a solution to the disproportionate tax burden shouldered by real property, logically requires all levels of Government involved in the process.

The information that the REINSW have at its disposal to prepare this submission lacks the granular detail to properly examine and comment on the proposed tax reform. Accordingly, REINSW may lodge a further submission if those details become available.

1. Questions for Consultation

2.1 Do you agree that stamp duty is out of date and is a handbrake on the economy?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?

The REINSW agrees that stamp duty is out of date, the applicable rates and brackets have not been adjusted to reflect increases in property prices since 1983. The decision to not amend the rates of tax to CPI or some other appropriate review has adversely affected property transactions.

The current narrow based property transactional model needs attention, everything should be on the table including a broad-based annual property tax. The REINSW is aware that some property consumers are electing to not transact property to avoid paying the tax.

Tax should be a consequence of a transaction not a consideration as it currently is.

The REINSW would be grateful for the opportunity to review draft legislation should the proposal proceed.

2.2 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 REINSW agrees that it is appropriate to base any annual property tax on the unimproved land value as this is an established concept within existing state taxation and valuation systems.

The consultation paper at page 17 identifies one issue attaching to employing improved capital value. As discussed above, discouraging people from transacting property needs to be addressed, similarly creating a disincentive to renovate one's property must also be avoided.

The REINSW assumes that property owners will take a far greater interest in the unimproved land value of their property than is the case now. That is likely to increase the requests for a review of the determined value. Accordingly, the Valuer General may need additional resources.

Whether or not the detail we seek will address the REINSW's concerns for an equitable distribution of tax across the various property types is not yet available. On the face of it, free standing properties will have a higher land value than a unit.

2.3 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?

From the information provide to us, it is clear that the choice exists until a purchaser elects to pay the property tax. In subsequent transactions of that particular there is no choice, the purchaser will pay the property tax. It would be misleading to promote this aspect of the proposed reforms as being a choice.

There is no one size fits all, accordingly, allowing a purchaser to exercise a choice should be considered. A purchaser who is buying their forever home may want to cap their tax contribution with stamp duty while a person purchasing a property as a short-term accommodation solution may choose to pay the property tax.

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

Again, we lack details of the reform, however it is usual that the transitional phase of a reform process is where the majority of the difficulties arise. Accordingly, and subject to the additional detail, we consider a gradual roll out to be the best approach to limit the adverse market disruption and unjust outcomes for purchasers.

No doubt Government is also mindful of the revenue it enjoys from property taxes. A gradual approach will also protect Government from a reduction in revenue.

2.5 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?

Our response to question 2.3 second paragraph is relevant in the context of this question. Additionally, as identified in our response to question 2.4 the transitional phase will be the most challenging. We are aware from our meetings that it is Government's intention to apply the "no detriment" test. As part of that philosophy, allowing a person(s) who purchased a property prior to the introduction of the property tax, will in part achieve that.

The REINSW is concerned about the impact on the market from public statements coming from Government. In these statements, Government seeks to promote the benefits of the property tax for consumers. We are aware that some purchasers are taking these comments into consideration when determining to purchase now or wait until the property tax is implemented. To address this issue, Government should consider promoting the "no detriment" provisions of the proposed reforms. This will go along way to address uncertainty currently in the market. If this suggestion is adopted, it is imperative that this is clearly communicated to purchasers.

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

The REINSW considers the most important consideration for the proposed reforms is the taxation costs of acquiring and holding a home. If that means applying different property tax rates to different categories of purchasers, then that in the REINSW's view is appropriate. The REINSW accepts that differential rates will add to the complexity of the property tax, which is undesirable.

It should also be recognised that businesses paying the property tax will include that as part of its accommodation costs when the calculation of its income tax is calculated. On the face of it this will reduce the net cost of the property tax to business.

Consideration also needs to be given to the stamp duty/land tax exemptions that currently apply. Will those exemptions from a cost perspective be replicated in the proposed property tax? Without similar exemptions it is likely people who currently enjoy these taxation benefits will not opt-in to the property tax.

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

It is difficult to view the paying of tax as an “investment”. We accept that Government must source revenue to provide services to the community and undertake the functions of Government. However, it is incumbent on Government to share the burden equitably and with minimal market disruption. It is not in dispute that property bears a disproportionate tax burden. Whilst the proposed property tax is promoted as a “broad base tax” however, it applies only to property and therefore cannot be described as broad base tax. The GST by comparison is a broad based tax.

Government imposing taxes on the community is by no means new. Jean Baptiste Colbert said in the 17th Century:

The art of taxation consists in so plucking the goose as to obtain the largest possible amount of feathers with the smallest possible amount of hissing.

The REINSW suggests that the benefits of a genuine broad based tax has been known for centuries.

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

As discussed above there needs to be transitional processes for a variety of reasons. This proposal needs active consideration as part of that transitional strategy.

However, before we can properly respond to this question, we will need to know the price at which the threshold will be set. If the proposal proceeds then the REINSW is of the view that ultimately all taxpayers should have the ability to opt-in to the property tax.

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

There are a number of legislative instruments that will need consideration. We have set out below some pertinent examples. We ask that you note that this is not an exhaustive list.

In relation to residential tenants – sub-section 40(1) of the *Residential Tenancies Act 2010* states that:

- (1) *A landlord must pay the following charges for the residential premises—*
 - (a) *rates, taxes or charges payable under any Act (other than charges payable by the tenant under this Division),...*

Then sub-section 40(2) of the Residential Tenancies Act 2010 states:

(2) *This section is a term of every residential tenancy agreement.*

It is difficult to see how a property tax would not be captured by Section 40, therefore the Tenant cannot be asked to the tax on top of the rent.

For Landlords who are subject to the property tax, this will be an additional cost impacting the profitability of the investment. Whilst the Landlord would obviously like to increase the rent to off-set this cost, the rent is set by the market and not by the Landlord's costs.

For retail tenants, sub-section 12A (1) of the *Retail Leases Act 1994* prohibits a landlord from collecting an outgoing, if the landlord has not made the necessary disclosure in the mandatory Disclosure Statement provided by the landlord to the tenant. This could be problematic for a sale of a retail property with an existing Tenant. Legislative intervention to address this issue should be considered.

Despite the above sub-section 12A (3) of the *Retail Leases Act 1994* provides an exception to the usual requirement for disclosure where a new tax is introduced. This may resolve the matter, nonetheless, given the property tax was not contemplated when this sub-section became law, legislative intervention to provide certainty in respect of this issue should be considered.

The REINSW has not fully considered the issue of the landlord recovering the property tax in the circumstances of a shopping centre and the like. The current market procedure for recovering land tax may provide the answer.

With respect to commercial tenants, the question of who pays the property tax would be resolved by the parties during broader negotiation between the Landlord and Tenant.

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

Whilst it is true that the REINSW does not support the current stamp duty regime, the payment of stamp duty is part of the acquisition costs, once paid it is no longer a budgetary issue for the purchaser. The lure of avoiding stamp duty in favour of the property tax may saddle the purchaser with expenses they cannot service. We know that people regularly find themselves in difficulty paying their council rates. It appears to the REINSW that the experiences of Councils would be a valuable source of data that should be considered.

We support the development of a hardship scheme. In our experience it is often difficult for people find it difficult to satisfy the requirements of existing hardship schemes. Accordingly, it will be important that those taxpayers who genuinely require assistance can access the scheme. Another failure of some existing hardship schemes is bureaucratic nature of the applications. The majority of people who currently seek assistance, come from the more vulnerable section of the community, therefore accessing the system should be designed with the needs of those people. The ability to waive interest should be part of the hardship scheme, with clear guidelines as to who may exercise such a discretion and indicative grounds.

Page 21 of Consultation Paper states that a landowner facing financial difficulty would not be required to sell their principal place of residence to meet property tax liabilities. The REINSW supports this approach in principle, however the definition of “financial difficulty” will ultimately determine our position.

Page 21 also notes the potential for landowners in hardship to defer liabilities until the property is sold or transferred. This seems an appropriate option under a hardship scheme.

2.11 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?

This is clearly a very difficult question. However, what we do know is failing to address bracket creep with stamp duty demonstrates the problem that needs to be avoided. For the community to have confidence, the legislation must deal with this as part of the reforms. From a very simplistic position, adjusting the tax in accordance with CPI appears worthy as a starting point for further investigation.

It is likely that a purchaser will be mindful of the likely increase in the property tax when deciding to opt-in or not. Accordingly, providing some certainty for tax calculation purposes in subsequent years would be of considerable value. Government should explore the option to cap the property tax if the land value or other factors cause the tax to increase beyond what is reasonable. The key to confidence in the system is predictability.

Finally, the property tax is designed to replace stamp duty and land tax. There is no land tax payable for a person’s principal place of residence. The REINSW would not support the current land tax collections being distributed across the community. That would adversely affect affordability and have the effect of home owners paying the tax of business as it sits today.

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

Please see below.

2. Additional Comments

3.1 Increase in Transaction

Government expressed the opinion in the Australian Financial Review that property transaction will increase as a direct consequence of the property tax. This, if accurate, will obviously have a significant impact on the market, including the resources required within the property services industry to respond. There is within the market significant scepticism

in regards this opinion. The REINSW suggests that Government provide the data and analysis behind such claims, to do otherwise risks damaging its credibility.

3.2 Reduction in the Existing Stamp Duty Rates of Tax

When the REINSW has argued for a reduction in stamp duty, Government has responded saying that it would not improve affordability because would simply push the price of the property up by the savings enjoyed from a reduction in stamp duty. If that remains Government's position, then it follows that the price of the property will be inflated by the purchaser who elects to pay the property tax.

There is empirical evidence demonstrating that a reduction in stamp duty with increase transactions. Has Government explored this avenue of reform?

3.3 Other Dealings in Land

There are, as you know other dealings in land that attract stamp duty. Will these dealings provide the parties involved in the transaction with the opportunity to opt-in to the property tax?

3.4 Agents and Auctioneers

The REINSW is concerned that the duty to inform prospective purchasers of the tax status of the property will become the responsibility of the Agent and or Auctioneer. The REINSW considers the discharging of this obligation as constituting legal and tax advice, for which Agents are not qualified nor competent.

The REINSW is of the view that the contract for sale of land include a tick box providing this information. Additionally, Government provides a public register of a property's tax status for prospect purchasers to search free of charge.

3.5 Auctions

The REINSW understands that during the transitional phase not all properties will be eligible to opt-in to the property tax. The opportunity to opt-in will be lost if the property is sold above the threshold. In the auction environment this has the potential to be very problematic. The REINSW requests the opportunity to work with Government to develop a procedure that informs prospective purchasers without interfering with the flow of the auction.

3.6 Retirees

Currently retirees who are colloquially referred to as “*empty nesters*” elect to remain in a property that does not respond to their current accommodation needs. This decision is largely driven by the stamp duty implication of a sale and purchase of another property. This has a significant adverse impact on the supply of property for people with an expanding family.

The REINSW is concerned that the property tax option does not remove this disincentive.

3.7 Premium Stamp Duty

Under the current stamp duty regime there exists a premium stamp duty rate of tax when a property exceeds a prescribed sale price. Will Government replicate this, albeit through the property tax?

3.8 Federal Government Revenue

Stamp duty is treated as part of the capital costs of acquiring a property. When the property is sold stamp duty and the cost of the property are applied to a formula to determine the capital gain if any on the sale of the property. The property tax, as an annual tax like land tax would presumably be deductible in the year it is paid. That will reduce the tax revenue of the Federal Government. It would be useful to know if the Federal Government will accept that or move to protect its revenue.

3.9 IPART

The REINSW has often referred to IPART’s analysis and findings as part of its arguments to reform the current property taxes. We suggest that Government review those findings as part of the reform process.

3.10 Stamp Duty -v- Property Tax

It is likely that properties that offer purchasers the option to pay stamp duty or the property tax will attract more market attention than the properties that can only offer the property tax only. The greater attention of the former will logically achieve a greater sale price. This market outcome needs to be considered to determine the impact it may have on the roll out of the proposed property tax.

3.11 Mandatory Participation

The REINSW can see a possibility of Government requiring all property owners to pay the property tax regardless of whether or not the purchaser paid stamp duty. The rationale for this approach could be justified on the basis that a purchaser paying the stamp duty has after a number years been fully amortised and that it is now equitable for that purchaser to pay the property tax. For example a purchaser pays stamp duty,

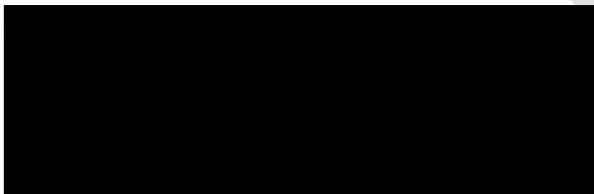
after 10 years that tax payment equates to what a purchaser would have paid if that purchaser had elected the property tax. If this is being contemplated, Government has an obligation to make that clear, as this knowledge will clearly impact the decisions of purchasers from the introduction of the proposed property tax.

Conclusion

The REINSW supports a review and evidence-based reform to the current market distorting property taxes regime.

It is incumbent upon Government to not only collect tax equitable, but also make the tax system understandable without the assistance of legal and the cost to community collecting the tax and generally administering the system as simple and efficient as possible.

We look forward to continued engagement and contribution to the discussion.



**Chief Executive Officer
Real Estate Institute of New South Wales**