Council Reference: Tax Reform

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26 February 2021

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To Whom It May Concern

Submission -Property Transfer and Land Tax System in NSW

Thank you for the opportunity to make a submission on the proposed changes to property transfer and land tax system in NSW.

Having read the consultation paper and related information I have a number of concerns regarding the ability of the reforms to achieve the intended results and other unintended impacts it may have.

The consultation paper claims the removal of stamp duty will boost home ownership, household mobility and housing transactions, and place downward pressure on home prices. For the government, it will mean replacing an unpopular, unfair and volatile tax with one that is more stable and equitable.

While the need for further tax reform in Australia is well documented, it appears that this proposal has settled for what is better rather than what is best. Despite numerous tax reviews concluding that the best form of funding for state responsibilities is a more efficient use of income and consumption taxes, this has resulted in little positive changes and states continue to be forced into inappropriate forms of revenue raising.

The claim that the proposal would place downward pressure on home prices appears to be solely based on the removal of the upfront duty cost and is perhaps at odds with the claim of increased housing transactions and other potential demand consequences.

My main concerns with the proposal are based on the potential;

- Negative affect on housing affordability;
- Downward pressure on local government rating revenue;
- Added complexity and stress for the housing market; and
- Inappropriate use of the property taxation base

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Housing Affordability

While removal of the stamp duty will reduce the upfront cost of a property purchase, in reality this cost would normally be included in the borrowings required and repaid over the life of the loan. Under the proposal the purchaser will simply be paying a property tax instead of higher loan repayments, making no difference to the weekly disposable income, the real test of affordability.

There is a real risk that increased demand from the perceived improved affordability will see sale prices rise and take up the void left by the stamp duty removal.

The consultation paper focuses on the fact that the beneficiaries will be property owners who transfer property at least every ten years and that this would include most owner/occupiers.

While the frequent transfers of owner/occupiers may have a neutral effect on demand, the paper makes no mention that potentially the main beneficiaries from removing the market entry barrier are not owner/occupiers but investors and speculators. This would make investment in new land releases and spec homes in particular more attractive which would create a greater demand/supply imbalance and place an upward pressure on prices.

The current and previous property booms show that demand shifts have a far greater impact on housing affordability then stamp duty ever has.

There would however be many people who do not need or are not able to move that frequently, who will all be worse off under the proposal. The paper clearly shows that the empty nester/ retiree transferring to their final residence will be significantly worse off, at a time when they could least afford an additional annual burden.

Downward pressure on local government rating revenue

The proposal for an annual property tax on the Unimproved Land Value (ULV) puts it in direct competition with local government rating for the property ownership budget.

Rates have always had to compete with property utility services in this space, usually coming last in terms of debt recovery (with no threat of supply cut available) and price setting. The latter being due to general rates having no clear cost base and subsequently being subjected to the harshest rate pegging.

It would appear the property tax would commence at about the same amount as the general rate for properties, immediately doubling the tax burden on owners. While the paper suggests the government may impose a rate capping facility to ensure the impact of ULV increases does not outstrip ability to pay, there is no guarantee of if or to what extent this would be applied. There has been no equivalent applied to the stamp duty which has moved directly with property sale prices.

Ratepayers would therefore undoubtedly be acutely more sensitive to rate increases regardless of merit.

Special Rate Variation applications are required where council finds it needs to increase rates above the rate peg due to historical shortfalls or new initiatives. The main two hurdles to this being successful are:

- General community support for the increase; and
- IPART's assessment of the affordability.

Both these would clearly be adversely affected by the property tax making efforts by councils to improve financial sustainability even more difficult.

Added complexity and stress for the housing market

The proposal assumes that most property owners buy and sell regularly until they are ready for their forever home and the choice between Stamp Duty and Property Tax will always be clear.

For most people the process to purchase property is difficult enough without adding another element of stress in deciding:
- How long will I hold property for;
- How to do cost comparisons allowing for the other cost variables; and
- What would the implications be for the future resale of the property.

The latter consideration has the potential to cause a significant split in the housing market and result in the government losing revenue from buyers who clearly benefit from the property tax option with very little compensatory uptake from other sectors of the market.

One specific area where the government is likely to lose revenue is that of strata properties where land is a lesser component of the property value. The option comparisons provided in the proposal documents assume an Unimproved Value: Purchase Price ratio of 65%. For most strata properties this will be significantly less and more in the order of 10-15%, making the property tax option significantly favourable regardless of expected terms of ownership. This is a large and growing market which will be difficult to offset if there is reasonable reluctance in the freehold market to commit to the property tax.

Inappropriate use of the property tax base

Property as a tax base meets most administrative requirements in terms of being simple, efficient and difficult to avoid.

Even so, local government rating has still been the subject of many reviews over the years to assess its suitability. These have all concluded that a property based rate is the most appropriate for the local government services it funds and the rating system has endured with only minor changes.

This is largely due to land values being a reasonable approximation for the ability to pay and the benefit principle, in regards to local government services, with the benefit principle having the strongest relevance. This is due to local government services having a close correlation to property values and resident needs and the ULV being a weak indication of ability to pay. The ULV shortcomings as a measure of ability to pay is evidenced by a number of measures provided in the rating system such as; pension rebates, postponed rates and differential rating.

As stamp duty principally provides general revenue for the state government, there appears to be no argument for its replacement to be based on the benefit principle. The consultation paper mentions it could be used for funding infrastructure as justification for a property tax, but there appears to be no intention to hypothecate the tax and state government services are much broader than local governments.

There is also the potential for this proposal being just an entry to the property tax base for the state government to replace other revenue sources. The recent attempt to transfer the Emergency Services Levy from insurance premiums to property had more merit than the current proposal and whatever the reason for its demise, must still be under consideration.

The proposal will be duplicating an existing tax base, is inappropriate for the purpose and will take at least twenty years to phase in.

Conclusion

Rather than pursuing this less than ideal solution, the state government should be pushing for the reforms to federal/state funding from the more appropriate income and broad based tax bases, that all reviews show will provide the best long term tax solutions for Australia.

Yours faithfully

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