BCA
Business Council of Australia

NSW Property Tax Reform submission

January 2021

Overview

The BCA welcomes the opportunity to provide a submission to the NSW Property Tax Reform consultation paper. The BCA has long advocated for replacing stamp duties with a broad-based land tax and strongly supports this reform initiative.

The proposal has been put forward at a time the economy is recovering from an unprecedented economic crisis. There are further challenges on the road ahead, including from an ageing population, shifting global economic forces and increased digitisation. Australia's tax system must be fit-for-purpose to tackle these challenges, which means addressing several issues, including the volatile and inefficient state tax base – notably stamp duties.

Australia's tax system relies too heavily on taxes that impose high costs, particularly stamp duties. The Commonwealth Treasury estimates that each dollar of revenue raised through stamp duties on property costs the economy an additional 72 cents. A shift to a broad-based annual property tax, done the right way, could raise the same amount of revenue with a lower cost to society. It will help to boost home ownership, improve mobility and support the economic recovery.

NSW is leading the way for all other states through this reform. The consultation process, policy framework and administration could present a model for other states to emulate. This is a reform that is very much in the national interest and should be considered by all jurisdictions.

Key recommendations

- The BCA supports in-principle the proposal to replace stamp duty with an annual property tax on an opt-in basis. The proposed policy framework provides a solid foundation for reform.
- BCA member companies have identified several issues that should be further considered through the consultation process. They include the interim effects of the policy, how to identify the status of properties, the treatment of amalgamated/subdivided properties, and the treatment of apartments and mixed-use properties.

Additional information

Stamp duty is ripe for reform

Stamp duties increase the cost of buying a house and discourage people from moving, for example, to a house that is better suited to their family size or to a new job. Stamp duty can discourage new housing development as stamp duty is paid twice: once by the developer when the land is acquired and again when the final owner buys the new house.

While stamp duties increase with property values, they do not pass one of the important measures of equity: treating people in similar circumstances in a similar manner. They place a higher tax burden on people who move more frequently, regardless of their wealth or income. Stamp duties are also highly inefficient, with the Commonwealth Treasury estimating that each dollar of revenue raised through stamp duties on property costs the economy an additional 72 cents.[1]

With respect to budgeting, stamp duties are a volatile source of revenue. To illustrate, stamp duties on properties made up around a quarter of NSW tax revenue the past decade, but were the main driver of volatility in revenue collections. This is because the tax take follows the fluctuations in the housing market, in both volume and price

[1] Cao, Liangyue, Amanda Hosking, Michael Kouparitsas, Damian Mullaly, Xavier Rimmer, Qun Shi, Wallace Stark, and Sebastian Wende. 2015. *Understanding the economy-wide efficiency and incidence of major Australian taxes*. Working Paper 1. Canberra: Commonwealth of Australia.

of houses sold. Heavy reliance on a volatile revenue base may result in ad hoc policy changes to shore up budget positions – be they tax increases or spending cuts. This may mean business and the community begin to expect constant change in their financial affairs. It will also set an unstable platform for making decisions to work, save, invest and innovate.

The proposed framework is a solid foundation for reform

The reform framework proposed in the consultation paper is a solid foundation from which to reform stamp duty and property tax. The phased transition and opt-in nature of the reforms will reduce disruption to the property market and help smooth the budget impacts over time. The reforms are difficult by nature, but the balanced approach taken will also reduce distortions and inequities between current and future property owners.

The BCA supports the principle of revenue neutrality over the long term. The short-term impact on government revenue should be considered an investment. Indeed, the initial modelling suggests the NSW economy will be $11 billion larger over the first four years and 1.7 per cent larger in the long run – in the context of a revenue neutral reform. The BCA also strongly supports the consultation paper's commitment that "the overarching goal is neither to increase nor decrease the amount of tax collected from broad groups of property owners".

The proposal to apply property tax to the unimproved value of land is also critical, as it ensures there is no disincentive to improve the land. The existing processes around land valuation provide a useful benchmark against which to design this element of the reform. Of course, to ensure the process remains fair and enticing for taxpayers to opt in, there is a need for these valuations (and rates) to balance the revenue needs of government against stability and ability to pay for taxpayers.

The Commonwealth government also has an important role to play in ensuring that funding formulas for distributing GST revenue do not punish states such as NSW that pursue economy growing reforms. Without such action, the equalisation formula administered by the Commonwealth Grants Commission can negate the benefits for states that go it alone on tax reform.

Issues for further consideration

- What are the proposed transitional arrangements under which purchasers will be entitled to opt in to the regime and what are the key considerations for design of this?
  - Policy uncertainty has the general impact of causing households and companies to delay decisions that are costly to reverse (such as major investments or purchases). This may particularly be the case with this reform proposal as some investors delay purchases to better understand their impact or to maximise the benefits. The issue may be further exacerbated by the uncertainty around when any changes may be introduced. A transitional rule that allows people to opt in retrospectively and receive a refund of stamp duty could be a solution to minimise this distortion and provide certainty to prospective home buyers, property developers and investors. It is suggested that any transitional arrangements should:
    - be developed and implemented as a matter of priority and as early as possible in the process as the reality is that the announcement of the proposed tax reform may have already contributed to purchaser's investment decisions. The concern is that the longer it takes to provide clear guidance on this point, the more likely purchasers are to delay their investment decisions and this may be counterproductive to the key policy objective to stimulate more property transactions;
    - provide more detail on the price thresholds as they apply to different classes of properties and expected timetable for increasing the thresholds. It would be helpful to understand key assumptions applied in the modelling undertaken to date on this;
    - accurately define classes of property which would be covered by the tax election and consider how this applies to mixed-use properties;

  - identify and define the relevant phases for the rollout of the tax election for different types of purchasers. For example, if it is intended that the program will initially be limited to individual home buyers/investors and for developers (i.e. creators of the housing stock) to be given the choice at a later point in time, this should be clarified and consideration should be given to approximate timeframes for later phases in light of modelling undertaken;
  - clarify the timing for the tax election to be made in respect of non-residential property – whether this is to be done in parallel with residential implementation or at a later phase. Industry will need to understand this to determine whether this impacts investment decisions over the short, medium or longer term. It may also inform capital allocation strategies and prioritisation of investment in different asset classes; and
  - include further clarity around the operation of the 20 per cent property threshold.
- How can investors confirm whether a property has opted into the property tax regime?
  - Prospective investors should be able to readily and reliably confirm whether a property has opted into the property tax regime. A property's tax status will impact investment decisions, and likely prices, as properties that offer buyers the choice between stamp duty or property tax are likely to trade at a premium – particularly as the system matures.
- Which tax system will be applied where properties are amalgamated or subdivided?
  - Where investors amalgamate properties that are a mix of old and new regimes, the simplest and fairest option is to apply the principle that this is a new property and should be given the option to opt in to the property tax system. Similarly, a subdivided property – regardless of its existing property tax status – should give prospective buyers the opportunity to choose whether to opt in to the regime.
- How will the policy be applied to apartment buildings where a mix of investors may choose different regimes? Similarly, how will the reform apply in scenarios such as build-to-rent or where a building has a mix of residential and commercial properties?
  - The reforms should be neutral to build-to-sell and build-to-rent, and preserve incentives to invest. Similarly, investors should be given the choice independent of other buyers e.g. if one investor buys off the plan and opts in, this should not compel all to opt in. However, consideration should be given as to how this applies in practice.
- How will the proposal apply to emerging asset classes such as build-to-rent and how it will balance the main goal of boosting home ownership while supporting build-to-rent's objective of providing an alternative housing choice for consumers? It is noted that NSW has recently introduced a 50 per cent land tax discount for build-to-rent projects so the question will be whether an equivalent concession is to be introduced for property tax?
- Whether any equivalent tax-free threshold and exemptions (e.g. charities, retirement living, primary production land) are expected to be provided as with the existing land tax? Property owners who would otherwise qualify for such concessions under the existing regime are less likely to opt in to the tax if there is no equivalent concession which would then prolong the broader implementation of the tax.
- How will the property tax regime apply alongside existing duty and land tax regimes? Some technical and design points to consider include:
  - How will the property tax apply to co-owned properties? For example, if there are two owners that each own 50 per cent of the property and each owner sells its 50 per cent interest to different purchasers, could each purchaser apply a different choice of tax on its 50 per cent interest or do they have to adopt the same choice?
  - How the property tax would apply if there is an internal transfer of property to entities within a corporate group before sale to a third party? Typically, such transactions would be exempt from stamp

duty under the corporate reconstruction exemption. Would the choice to opt in to property tax be preserved notwithstanding that stamp duty is not paid on the prior internal transfer?

 – What property interests will be eligible to opt in? Is it only freehold land that is eligible to opt in, and if so, does a lease over the same land (and other lesser interests) remain within existing duty and land tax regimes? For example, property tax could apply to freehold land, and once the freehold is opted in, lesser interests relating to the same land (such as a lease) fall outside the existing duty and land tax regimes. Special consideration could be given to certain long-term leases which are equivalent to freehold.

 – Similarly, once a property is opted in, landholder duty under the existing duty regime should not apply to that property. Details would need to be considered to ensure no unintended consequences. For example, if a company buys freehold land and:

   i. opts in to the property tax, no duty is payable on the land purchase, but property tax will be payable on an ongoing basis;

   ii. does not opt in, duty is payable on the land purchase.

 – If an investor then buys all the shares in the landholder company, is the intention that no landholder duty is payable under i, but payable under ii? If the investor buys 49 per cent of the shares in the company (and in the absence of aggregation), no duty would be payable in either case, but the investor would be faced with an indirect impact of the property tax under i only, and not under ii.

- How will the property tax interact with the current surcharge purchaser duty to ensure policy objectives are met including revenue neutrality? Is the intention that once opted in, duty including surcharge purchaser duty ceases to apply? Is it intended that equivalent foreign investor charges will also apply for the property tax and if so, how would this be re-assessed if there is a change in the owner's status at a later point in time?

- When will liability to property tax arise e.g. pay property tax only on land owned as at 31 December, similar to the current land tax regime?

- Measures to ensure clarity around property tax and tenants will be critical, as existing documents have been signed without contemplation of the new property tax. Existing definitions of recovery for land tax may be sufficiently broad to include property tax. This is particularly problematic for longer term leases which span the implementation period.

 – For example, in the case of GST, landlords were provided with a statutory recovery right after 5 years (i.e. 30 June 2005) where the terms of the lease did not provide an appropriate mechanism to adjust the amounts payable under the lease to take account of the new tax.

- The consultation paper notes the changes will provide protections for tenants and people facing financial hardship, and this should be extended to both residential and commercial tenants. The reforms could support lower rents in the long term, but consideration could be given for measures to address short-term impacts of property tax changes on tenants and to achieve neutrality for both tenants and landlords.

 – For example, where a landlord opts in to property tax, they would not pay stamp duty up front and their annual property payments may likely be larger than they were under land tax. This will have flow on implications for the amount paid by tenants (i.e. it will impact rents and taxes paid). The reforms should look to deliver a neutral outcome over time for both landlords and tenants, and there should be scope for negotiation between parties.

- How will the broader transition to property tax evolve over time e.g. will land tax rates converge to property tax rates, will property tax be compulsory etc?

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