The Property Owners Association of New South Wales Submission

NSW Property Tax Reform Proposal

The NSW Budget 2020/21

MARCH 2021

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Introduction

Since 1951, The Property Owners Association of NSW (POANSW) has been the peak industry body acting as the voice of property owners across the state.

The POANSW is an independent organisation that relies on the support of our volunteer members and does not benefit from any Government funding. Since its inception some 70 years ago, POANSW has been a key participant in the development of policies that protect small to medium sized property owners and businesses, along with the residential accommodation market in NSW more generally.

The 2020/21 NSW Budget included a significant property tax reform agenda that has the potential to re-shape the property market in NSW for generations to come. The proposal includes the introduction of a new opt-in system of property tax, and a reimaging of the existing regime. The broad brush and wide-reaching changes proposed would have significant impacts, well beyond the stated goals of the state Government.

The stated aim of the NSW Government is to improve housing affordability for the people of NSW, and to remove barriers for first home buyers. However, the suggested changes as currently presented are unlikely to achieve these goals. Research undertaken by Core Logic suggests that *"replacing Stamp Duty with a Land Tax may not reduce the cost of housing, or increase affordability."*

The sphere of impact of the proposed changes is likely to reach into the following areas:

- Future levels of housing stock;
- The range of uses to which properties are put;
- The availability of rental accommodation in both urban and regional areas;
- The appetite for investment into the residential property market;
- The appetite for investment from businesses for owner occupied business premises;
- The appetite for investment into the commercial property market;
- Accessibility of the market to homebuyers;
- Property values; and
- Real estate transaction volumes.

The above issues provide a high-level snapshot of some of the more obvious impacts, and by no means is an exhaustive list.

Public submissions have been invited by the state Government, with submissions due by 15 March 2021.

This document is the POANSW submission in relation to the proposed property tax changes.

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Summary of Recommendations

The recommendations set out within this submission are summarised below.

ONE

POANSW recommends that, if any new proposed property tax is introduced that shifts taxation toward land values, the objection system of the Valuer General be reviewed simultaneously. POANSW recommends the following:

1. The Valuer General introduce a consultative process such as mediation as part of the system of review when objections to land values are made.

2. The introduction of an independent tribunal to hear land value objections, or an expansion of the jurisdiction of NCAT to hear land value objections.

Without these changes, there is a significant risk that property owners in NSW would be incorrectly taxed under the proposed system.

TWO

POANSW recommends that a system of thresholds and aggregations be retained in some form, in order to limit consequential shortage of residential rental housing stock in more vulnerable markets and increases in rent.

THREE

POANSW is opposed to an opt-in tax system, and recommends that a consistent system of property tax be retained across the market. The proposed opt in system has the potential to cause confusion, poor housing stock allocation, a two-tiered property market, and distort property prices. POANSW also recommends that current land tax exemptions for particular sectors of the market such as low cost housing and childcare be retained in any new system, so as to continue their positive impact for the people of NSW.

FOUR

POANSW recommends that the NSW Government commit to a moratorium on increases in the rate of land tax for current owners of properties who have already paid stamp duty under the old system. This commitment would ensure that double taxation of current property owners was avoided.

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FIVE

POANSW is highly concerned about taxation rates being contingent on land use. POANSW recommends that a standardised rate be introduced regardless of land use.

SIX

POANSW is opposed to a staggered introduction based on property values and recommends that any proposed property tax is introduced uniformly across the market.

SEVEN

POANSW recommends that proposed protections not be implemented. In their proposed form, they will lead to legal and administrative problems within the commercial property market, and largely be redundant an ineffective in the residential market.

EIGHT

POANSW is supportive of financial assistance for first homebuyers but is opposed to cash grants being paid to home buyers. POANSW recommends that first home buyers be given a choice of:

- Stamp duty grant; or
- Relief from the proposed property tax to the value of the stamp duty that would be required to be paid; or
- Stamp Duty liability be split over 3-5 years, with nominal interest, in the same way that current land tax liability can be paid over 3 instalments.

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Summary of Proposed Reform Framework

The NSW Government is proposing a new framework for property tax across the state. In general, the essence of the proposal is to introduce a new property tax that buyers can opt-in to when they purchase a property. The new property tax would replace existing property taxes.

The pertinent elements of the proposal are summarised below.

- An annual tax on land value for each individual property.
- Buyers to be given the choice of which tax to pay.
- There is no change until a property transacts.
- Rates based on property use.
- Limited initial participation, with staggered application.
- Protections for tenants from rent increases.
- Revenue neutrality with the state Government collecting the same total revenue.
- Existing stamp duty concession for first home buyers to be replaced by a $25,000 grant.

The proposed rates for the new property tax are outlined below.

Property Type	Currently Liable for Stamp Duty	Currently Liable for Land Tax	Potential Property Tax Rate
Owner Occupied Residential Property	Yes	No	$500 + 0.3% of unimproved land value
Investment Residential Property	Yes	Yes	$1,500 + 1.0% of unimproved land value
Primary Production Land (farmland)	Yes	No	0.3% of unimproved land value
Commercial Property	Yes	Yes	2.6% of unimproved land value

This submission addresses each element of the proposed property tax reform framework separately.

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1. An annual tax on land value for each individual property

Land Value VS Market Value

Under the current system, stamp duty is levied on the market value of a property. Land tax is levied on the unimproved land value. The proposed property tax would be levied on the unimproved land value only.

Market Value	*The price that a willing but not anxious buyer would pay a willing but not anxious seller for an asset including the land and all improvements, as at the relevant date, having acted prudently, without compulsion, and with full knowledge of market factors that may impact the property.*
Unimproved Land Value	Assessed by the NSW Valuer General each year pursuant to the Valuation of Land Act 1916. Defined as: *The capital sum which the fee-simple of the land might be expected to realise if offered for sale on such reasonable terms and conditions as a bona-fide seller would require, assuming that the improvements, if any, thereon or appertaining thereto, other than land improvements, and made or acquired by the owner or the owner's predecessor in title had not been made.*

POANSW is generally supportive of the use of unimproved land values rather than market value. Property taxes that are levied on market value tend to discourage capital investment as owners are aware that they will be taxed on capital improvements to land.

The Valuer General undertakes bulk valuations of land each year. The Valuer General regularly makes errors and incorrectly assess land values. Property owners can object to the Valuer General's assessment; however, the objection process is cumbersome and expensive. The process for objection does not include accessible opportunities for dispute resolution, mediation, negotiation or review by a tribunal, and ultimately requires an application to the Land & Environment Court – an expensive and complex legal process.

The process is summarised in the flowchart overleaf.

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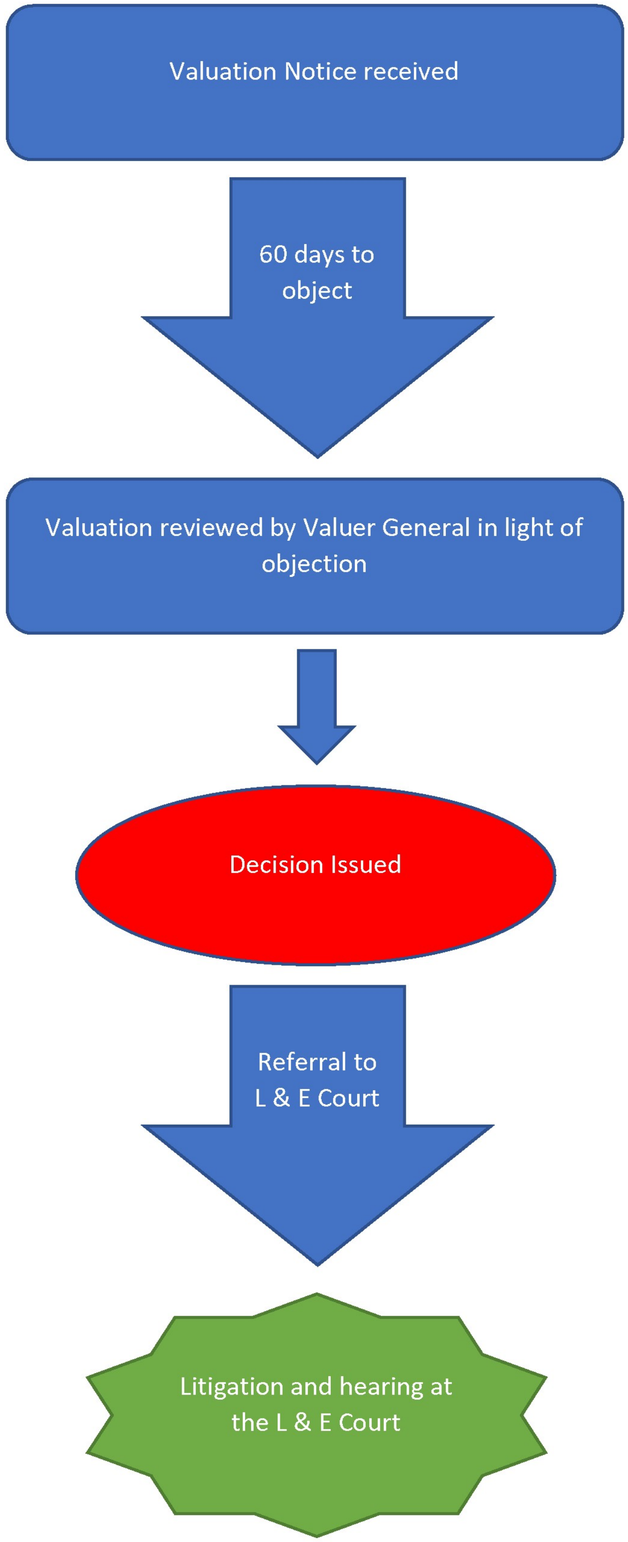
Valuation Notice received
60 days to object
Valuation reviewed by Valuer General in light of objection
Decision Issued
Referral to L & E Court
Litigation and hearing at the L & E Court

Under the current system, it is uneconomic for property owners to continue to the Land and Environment Court.

The Valuer General currently receives thousands of objections each year.

POANSW is concerned that a broadening of the use of unimproved land values as proposed in the proposed property tax system, with no corresponding review of the objection process, will cause the exacerbation of errors. The Valuer General is likely to see a significant increase in objection activity given the larger number property owners that would face a new proposed property tax.

RECCOMMENDATION:

POANSW recommends that, if any new proposed property tax is introduced, the objection system of the Valuer General be reviewed simultaneously. POANSW recommends the following:

1. **The Valuer General introduce a consultative process such as mediation as part of the system of review when objections to land values are made.**

2. **The introduction of an independent tribunal to hear land value objections, or an expansion of the jurisdiction of NCAT to hear land value objections.**

Without addressing these issues, there is a significant risk that a large number of property owners in NSW would be incorrectly taxed under the proposed system.

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Individual Property Assessments

Under the current system of stamp duty and land tax, stamp duty is paid for all property transactions other than those that are deemed to be exempt. Land tax is levied based on the aggregated value of all assets owned by an entity.

Under the current system, owners of property in NSW do not pay land tax on a property until the aggregate land value of their land tax liable assets reaches the threshold, which is reviewed each year. For 2020 the threshold is $734,000.

The proposed new property tax system is a step away from this and is based on a property tax that is levied on each property in the state, regardless of ownership. It does not include adjustments for the aggregation of assets.

This system would be simpler to administer. However, we note that the brunt of this change will be most felt by smaller investors who own one or two residential rental properties – particularly residential units.

To illustrate, we provide an example below.

Jane owns a single residential investment property. It is a 4-bedroom house located in Newcastle. The house has a market value of $800,000 and an unimproved land value of $650,000. Jane's liability under the current system and proposed system is illustrated in the following table.

	Current System	Proposed System
Purchase Price	$800,000	$800,000
Stamp Duty	$31,335	Nil
Total Cost of Acquisition	$831,335	$800,000
Market Rent	$650/week ($33,800 pa)	$650/week ($33,800 pa)
Estimated Property Outgoings	$7,500	$7,500
Land Tax / Property Tax*	Nil	$8,000
Net Annual Rent	$26,300	$18,300
Investment Yield on Acquisition^	3.16%	2.28%

*rate based on 2020/21 NSW Budget proposed rates
^includes stamp duty cost in calculations

With approximately three quarters of investors in residential property in NSW owning 1 or 2 properties, the above example is representative of a common theme that will emerge. It is plain to see the erosion of the return on investment. Annual net rental income is reduced by approximately 30% following the introduction of the proposed new property tax system.

A natural and expected consequence of that erosion is a decline in the demand for such investments as investors choose alternate assets providing superior returns such as shares.

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The longer-term impact of this change will be a corresponding reduction in rental housing stock over time along with an increase in rents. The proposed tax regime penalises detached free-standing housing, where land values are usually higher in relation to market values, and this impact is likely to be particularly pronounced in markets where detached housing makes up a larger proportion of housing stock. This is likely to include regional cities, rural areas and large parts of western Sydney.

RECCOMMENDATION:

POANSW recommends that a system of thresholds and aggregations be retained in some form, in order to limit consequential shortage of residential rental housing stock in more vulnerable markets and increases in rent.

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2. Buyers to be given the choice of which tax to pay

Part of the proposed property tax framework is the option for buyers of properties to choose whether they opt-in to the new proposed property tax system. The proposal is that the 'opting-in' remains with a property, and once a property has been 'opted-in' by one purchaser, it will remain permanently a part of the new proposed property tax system.

An opt-in system is likely to create several structural problems within the property market, and POANSW is strongly opposed to the proposition of any opt-in system.

Housing Stock Allocation

One key issue with an opt-in system is an exacerbation of the housing stock allocation issues that currently plague the housing market. In the current system, property owners are reluctant to sell their homes due to high cost barriers created by the current stamp duty system. The net result is a lethargic reallocation of stock, with older couples retaining large family homes that are too big for them, and growing families retaining smaller, inappropriately sized homes.

In practice, by allowing people to opt-in to this system, it is likely that when purchasers are buying a family home that they intend to retain long term (more than 10 years), they will not opt-in, and will choose to pay the stamp duty at the time of purchase. In due course, that same person would likely delay the sale of that property more aggressively that they currently would, feeling that they have 'pre-paid' a lifetime of property tax through stamp duty when they purchased it.

This is likely to exacerbate the existing housing stock allocation issues within the property market.

Two Tier Market

Another likely impact of an opt-in system is the creation of a two-tier market. Initially, it is likely that in markets where buyers tend to hold for shorter periods of time such as inner-city units, and entry level housing, many buyers will opt-in. As properties are opted-in to the proposed property tax regime, it is likely that a pricing premium would develop for properties that are not opted-in.

This is particularly true in markets where typical hold times are longer such as large family homes, prestige housing, agricultural assets, and larger commercial premises.

The development of a two-tier market is likely to further distort market pricing for houses. In addition, it will create artificial economic inefficiencies that would likely be leveraged by market participants.

Who opts in?

POANSW is concerned about who can opt-in which properties. The proposed new tax regime is clear for a single residential house; however, it is unclear for many other situations. Some of these include:

- Two adjacent properties are purchased over time by one buyer with one ‘opted-in’ and one not. They are amalgamated and sold to a developer. Is the developer able to ‘opt in’?
- The same developer the demolishes the buildings and constructs a block of apartments which is then strata subdivided. When the resulting units are sold can the buyers opt-in or not?
- A unit within a block of 100 company title apartment is sold and the buyer opts-in. Seeing as there is only a single title, is the whole property opted in or not?
- Two adjacent properties agree to a boundary adjustment, which results in them undertaking a small subdivision, and relocating a fence, and selling each other 1 square metre of land for $1.00. One property is opted in and one is not. The larger portions are amalgamated with the smaller portions. Are the properties now opted-in or not?

If an opt-in system were to be introduced, there would need to be clarity surrounding who can opt in and for what properties.

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What exemptions persist?

The current land tax system includes many exemptions that have been developed by the NSW Government over decades. They are each designed to address part of the property market and encourage particular types of development. Some of the key land tax exemptions include:

- Low cost housing exemption
- Childcare exemption
- Aged care exemption
- Religious/place of worship exemption
- Exemptions for workers unions

The wholesale removal of these exemptions would be problematic for those sectors of the market that are reliant on them for profitability.

For example, under the current system, if you were to purchase a childcare centre, you would pay stamp duty, however, there would be no ongoing land tax burden. The introduction of a property tax to this sector would likely be catastrophic.

Great consideration should be given to the structure of exemptions ands the desired impact on sensitive property market sectors.

RECCOMMENDATION:

POANSW is opposed to an opt-in system. POANSW recommends that a consistent system of property tax be retained across the market. POANSW also recommends that current land tax exemptions for particular sectors of the market such as low cost housing and childcare be retained in any new system, so as to continue their positive impact for the people of NSW.

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3. There is no change until a property transacts

The proposed property tax reform agenda includes a stated goal of avoiding double taxation. For this reason, it is proposed that current property owners, who have already paid stamp duty on their property, will not be forced to also pay the new property tax in addition. The property tax will only need to be paid following a transaction and 'oping-in'.

POANSW wholeheartedly agrees that double taxation should be avoided at all costs. However, based on the current proposal, property owners that have already paid stamp duty under the old system will continue to be liable for Land Tax after the introduction of the new property tax.

In order for the NSW government to show genuine efforts at alleviating the burden of paying double taxation, the NSW government should commit to a moratorium on future raises in the rate of land tax for property owners who have already paid stamp duty in full for properties that they currently own under the old system.

RECCOMMENDATION:

POANSW recommends that the NSW Government commit to a moratorium on increases in the rate of land tax for current owners of properties who have paid stamp duty under the old system. This commitment would ensure that double taxation of current property owners was avoided.

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4. Rates based on property use

The proposed property tax reform includes a major structural change in the way that property tax is calculated with varying rates applicable depending on the use of the property. Under the proposed framework, this is called 'Balanced Rates'. Under this proposal different rates would apply for:

- Owner occupied housing
- Residential investment properties
- Commercial properties
- Primary production land

Many properties in NSW are mixed use properties, with more than one use applying to a single property. This is a common arrangement that occurs in every part of NSW. Some examples of mixed use properties include:

- Farms (primary production land) where the farmer lives on a house on the land as their primary residence.
- Strip retail shops with a residential apartment on the first floor.
- Residential houses with a small office attached.
- Residential houses with a single bedroom that is rented out for part of the year via short term lettings.
- A vineyard where grapes are grown (primary production), the owner lives on the land (primary place of residence), there a cellar door and restaurant (commercial), and a second house that is rented to the farm manager (residential investment).

Property uses in NSW are governed by a complex system of land planning laws that incorporate dozens of local councils as well as state government departments and the Land & Environment Court – all of which may act as consent authorities.

The relevant legislation includes dozens of State Environmental Planning Policies (SEPPs), regional Environmental Planning Policies (REPs), Local Environmental Planning Policies (LEPs) as well as other more nuanced planning instruments.

Depending on the prevailing planning instruments, specific local councils, historic court orders, and other factors, property uses may change without notification to any government authority. Examples of this include:

- A strip retail shop with an apartment above, that may sometimes be used an office, and at other times a residence, being approved for both uses.
- A farm where onsite rental accommodation is provided to seasonal workers as needed.
- A residential house where some rooms are occasionally let out on short-term letting arrangements.

This is by no means an exhaustive list, but provides a flavour for some of the many issues that would arise if a property tax based on use were to be implemented in NSW. Keeping in mind that some uses may be temporary, or occasional and the proposed property tax would be annual, this is likely to add significant challenges to the way the tax would be calculated.

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Given the broad variety of circumstances where consent is not required for property owners to change or implement some aspect of their current use, it would be nearly impossible for this to be policed and enforced.

Beyond the complexities of implementing and enforcing this proposed system, POANSW notes that the value of land upon which the proposed property tax is likely to be charged already incorporates the value premium associated with higher order uses. For example, a block of land where a 10 storey office building is permitted to be built would be higher in value than an adjacent block of land where only a single storey dwelling may be built. Applying a single consistent rate to all properties, with differences in value captured by the land value properly assessed by the Valuer General, would adequately and fairly spread the burden of the proposed property tax.

Overall, POANSW is strongly opposed to property tax based on use, which would be difficult to administer, confusing and nearly impossible to enforce.

RECCOMMENDATION:

POANSW recommends that any proposed property tax rate be consistent regardless of land use. A single rate applied to land values would be the best outcome.

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5. Limited initial participation, with staggered application

The proposed property tax reforms include a limitation on initial participation. Ultimately, this is designed to exclude high value properties from opting in, and protect government stamp duty revenues.

POANSW is strongly opposed to any opt in system. POANSW is also strongly opposed to an initial staggered application based on property value.

There has been no guidance as to what a potential threshold may be, however, presumably, it would be at a level that would capture large commercial properties such as regional shopping centres and inner city office towers, as well as large residential houses in premium locations.

Large commercial properties generally already carry a large land tax burden. They do not transact frequently and the proposal of excluding them from the new property tax will likely lead to continuation of unpredictable stamp duty revenues.

Likewise, it is likely in the governments best interest that large premium residential properties that are currently primary places of residence and do not pay land tax, are included in any new proposed property tax system as quickly as possible.

From a market point of view, excluding some properties based on value, is likely to create a two tiered market and distort values in that market around the threshold value.

Overall, POANSW recommends a uniform application, rather than a staggered introduction based on property values.

RECCOMMENDATION:

POANSW recommends that any proposed property tax is introduced uniformly across the market, with no staggered introduction based on property values.

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6. Protections for tenants from rent increases

It is proposed that tenants would be protected from rent increases resulting from the introduction of a property tax. This concept needs to be carefully considered as the direct and secondary impacts of such policies are subtle and far reaching.

Commercial Properties

Leases over commercial properties vary in the way they treat outgoings. Payment of outgoings are negotiated along with rent and other terms at the commencement of lease. Common structures in NSW include:

- Gross lease – Base rent only, with the lessor required to pay outgoings.
- Net lease – Base rent paid by the tenant along with building outgoings.
- Semi-gross lease – Base rent paid by tenant with some agreed outgoings paid by tenant and some by lessor.
- Increases over base – Base rent paid by tenant, with outgoings paid by lessor, and annual increases outgoings over the level they were at commencement paid each year by the tenant.
- Percentage rent – Base rent paid by tenant, plus a percentage of gross revenue of the tenant.

The above treatment of outgoings are the most common in NSW, however, there are leases currently in place that address outgoings in other ways.

A wholesale ban on passing on increases in outgoings to tenants is likely to place some property owners and tenants in commercial buildings immediately into breech of their lease agreements.

We outline an example below.

John owns a single retail shop, which is rented to a retail tenant, being a local florist. The lease term is 10 years, and the lease is a semi-gross lease, whereby the tenant pays base rent of $25,000pa plus statutory outgoings only (water, council rates, land tax).

John had offered a gross lease with a base rent of $30,000pa, but the tenant rejected this and entered into the semi-gross lease at a lower rent.

John only owns one single investment property, and does not pay land tax, as the land value is below the threshold. The lease was agreed in 2019, prior to the announcement of any property tax reform.

In 2026, John sells the property to Sarah. Sarah opts-in to the new property tax system, which has subsequently been introduced and does not pay stamp duty. Based on the prevailing rates, her annual property tax liability is $13,000pa. Under the old system, Sarah would have been liable for $8,000pa in land tax, which would be paid by the tenant and is clearly captured by the lease.

The lease specifically addresses 'any future statutory outgoings levied by any government authority or statutory body'. The lease requires the tenant to pay the new property tax, however, Sarah is prohibited from charging the tenant for this.

In the above example, the lease requires the tenant to pay the new tax. However, if this were wholly prevented by legislation, the buyer may choose to buy under the old system, paying stamp duty, and charge the tenant the land tax, which would be permitted.

Overall, POANSW is of the view that restricting the charging of tenants for building outgoings is likely to cause significant disruption and unexpected consequences in the commercial property market.

Residential Properties

The proposed property tax would only apply to a property from the time of sale. This means that there will be no impact on existing tenancies unless a property is sold.

If a property is sold subject to a lease, the tenant would already benefit from protections under the Residential Tenancies Act 2010 in relation to rental increases.

Given this, it is questionable whether any further protections would be required.

However, the NSW government should be wary of secondary 'flow on' impacts. As outlined earlier in this submission, buyers under the new proposed property tax will face lower returns on their investments. This will naturally result in reduced demand for investment properties as investors chose to invest in other asset classes, and a corresponding reduction in rental stock over time.

A reduction in rental stock, would likely lead to upward pressure on rents, as more prospective tenants competed for limited housing stock.

The likely result of this circuitous path would be that rents would naturally increase until stock levels rise. This is likely to take several years before it is pronounced, as the increase would not be a direct result of the property tax, but rather a resultant secondary impact on stock levels over time.

As market rents rise, they will naturally incorporate typical building outgoings such as council rates, insurance, water rates and the proposed property tax.

Overall, given the profile of the introduction of the proposed property tax, with it applying at the date of sale of a property, it seems somewhat redundant to apply overarching rental protections.

RECCOMMENDATION:

POANSW notes that proposed tenancy protections will likely lead to legal and administrative problems within the commercial property market, and largely be redundant an ineffective in the residential market. Overall, POANSW recommends that proposed rental restrictions not be implemented.

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7. Revenue neutrality with the state Government collecting the same total revenue

We note that the proposed property tax is designed to maintain revenue neutrality, and while over initial years, there may be some loss of revenue, the long-term annual revenue from the current stamp duty and land tax system is proposed to be aligned with the revenue generated by the proposed property tax system.

POANSW is generally supportive of the concept of revenue neutrality. However, POANSW would like to see detailed projections reviewed by independent auditors in order to confirm that revenue neutrality will be achieved.

Furthermore, POANSW note that NSW property taxes are currently some of the highest in the country, and it is both the structure and the quantum of these taxes that warp and impact the property market. POANSW, would support a full review of overall property tax levels, and a strategic reduction of some taxes, to alleviate the current tax burden placed on a small group of tax payers, and thereby reduce the resultant warping of the property market.

8. First home buyers / stamp duty concession

Currently, most first home buyers in NSW are exempt from paying stamp duty. This system is designed to stimulate construction and demand from first home buyers. Under the proposed property tax reform package, first home buyers would instead receive a $25,000 cash grant that could be used for payment of stamp duty or kept by the buyer.

POANSW is generally supportive of encouraging property purchases through a system of grants, however, is opposed to cash grants.

RECCOMMENDATION:

POANSW recommends that first home buyers be given a choice of:

- **Stamp duty grant; or**
- **Relief from the proposed property tax to the value of the stamp duty that would be required to be paid; or**
- **Stamp Duty liability be split over 3-5 years, with nominal interest, in the same way that current land tax liability can be paid over 3 instalments.**