NSW PROPERTY TAX PROPOSAL

Response to *Buying in NSW, Building a Future*

MARCH 2021

BUSINESS NSW

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1. PREFACE

Business NSW welcomes the opportunity to provide a submission in response to *Buying in NSW, Building a Future*, the Consultation Paper on the NSW Property Tax Proposal.

As NSW's peak business organisation, *Business NSW* has more than 30,000 member businesses across the state. We work with businesses spanning all industry sectors including small, medium and large enterprises.

Operating throughout a network in metropolitan and regional NSW, *Business NSW* represents the needs of business at a local, state and federal level.

Business NSW has long called for the NSW Government to replace conveyancing stamp duty with a broad-based land tax. The NSW Property Tax Proposal is a significant and welcome step towards needed reform.

In this submission, *Business NSW*:

- describes why we support the objective of the NSW Property Tax Proposal
- presents findings from a survey and a series of focus groups with member businesses, outlining their understanding of the proposal
- highlight some areas of concern with the proposal
- offers recommendations for how the proposal could be strengthened.

2. THE NEED TO REFORM STAMP DUTY

Conveyancing stamp duties (CSD) are a bad tax that reduce the economic welfare of NSW. Stamp duty reduces housing affordability and the efficiency of NSW's tax system. The dependence of the NSW Budget on CSD revenues is unsustainable.

A property boom has resulted in spectacular growth in CSD revenues in NSW. In 2019, prior to the COVID-19 pandemic, the State Government projected that CSD would yield just over $9 billion in 2022-23. The growth in CSD revenues saw them become the largest source of tax revenue for the NSW Government by 2015-16. This rapid growth in CSD revenues appears to have been unplanned, with CSD revenues collected in recent years being significantly higher than successive governments had expected. Growth in stamp duty has vastly outpaced growth in incomes or house prices. Allowing this situation to persist will continue to hold back the NSW economy and make tax reform in the future more difficult.

The economic benefits of reform are significant, including when compared to alternative tax reform proposals. *Business NSW* recommends that stamp duty reform be put at the top of the NSW Government's tax reform to-do list.

Stamp duty reform is an important part of addressing housing affordability. Changing from stamp duty to a land tax (or giving purchasers the option to do so) would improve housing affordability by making it easier for households to move as their needs change over time. This enables better use of existing housing stock and reduces the upfront costs of home ownership. However, it is only part of the solution. Reforms in other areas of policy, including land-use planning and social housing, should be considered part of a wider package of measures aimed at addressing NSW's housing challenges.

It should be noted that the bulk of economic benefits come from reducing conveyancing stamp duty rather than implementing a 'textbook perfect' land tax. This gives the NSW Government flexibility to design a land tax that meets the needs of the community without compromising the shared benefits of changing from stamp duty to land tax.

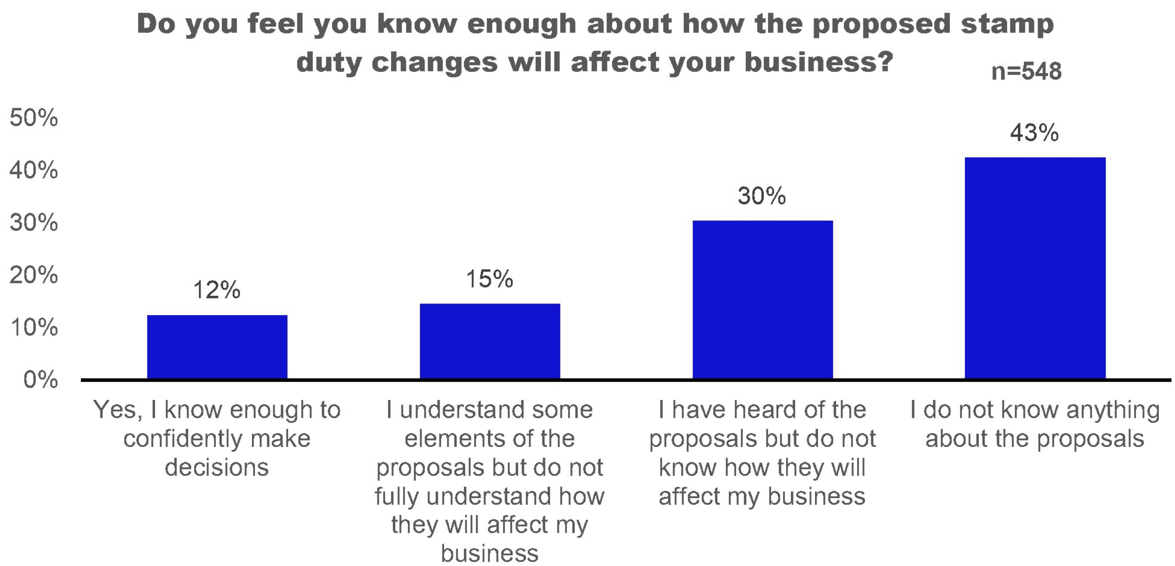
3. BUSINESSES' UNDERSTANDING OF THE PROPERTY TAX PROPOSAL

Business NSW sought feedback from NSW businesses to determine their understanding of the Property Tax Proposal. This included asking businesses a series of questions about the Property Tax Proposal in our *March 2021 Business Conditions Survey* and holding a series of focus group sessions with our regional advisory committees. The survey findings are presented below and the focus group feedback is included in Section 4.

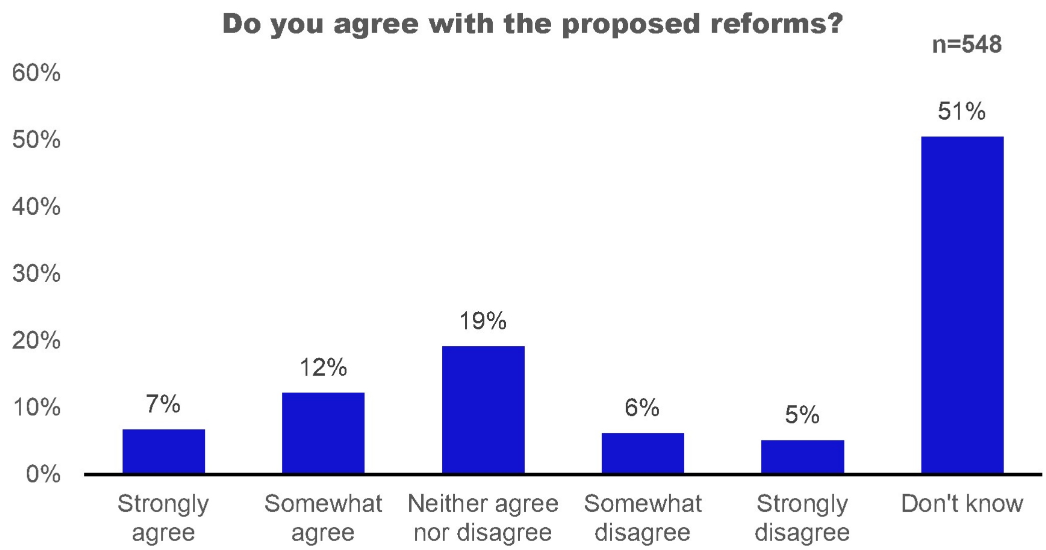
Business survey findings

Of the 548 business respondents to our *March 2021 Business Conditions Survey*, almost 90 per cent of respondents reported that, at most, they only understood some elements of the proposals but not the full potential impacts on their business.

,A significant proportion (43 per cent of respondents) reported that they did not know anything about the stamp duty proposal, with only 12 per cent reporting that they knew enough about the proposed reforms to make a confidently informed decision whether to support the proposals or not.



This lack of understanding was further evident when we asked businesses whether they agreed with the proposed reforms. More than half of respondents reported that they 'didn't know' whether they supported the proposals or not. The remaining 49 per cent expressed a broad range of support, with support split across the spectrum between 'strongly agree' and 'strongly disagree'.



Respondents to the survey were also given an opportunity to provide free-text feedback to the question "What will these reforms mean for your business?". The following sample demonstrates the range of different perspectives received from business.

> *"I don't think they will affect our business, as long as my understanding is correct and it will only be "new" buyers and they have a choice to either pay stamp duty or land tax. It would be extremely unfair if we would have to pay land tax after having paid a huge amount of stamp duty when we purchased the property."*
>
> *"It depends. I have not heard enough about it to understand the long-term impact."*
>
> *"I do not know enough about it to know if it means we would be better off or worse off. It lessens the blow upfront, but over the life of the asset???? Not sure it is going to be better."*
>
> *"I will need to check the small print before knowing what the reforms could mean for my business."*
>
> *"Nothing really. Might help with some businesses [to] have increased cashflow but not likely to be significant for small business. More helpful for large companies who would be able to seek finance for property and land purchases."*
>
> *"Landlords would most likely pass on additional costs in the form of increased rent."*
>
> *"We are stamp duty exempt. If we had to pay land tax annually instead, I guess that means another cost to our struggling business."*

4. BUSINESS FEEDBACK

The NSW Property Tax Proposal naturally focuses considerably on the residential property market. The proposal generates its most significant benefits by freeing up the housing market, and the majority of CSD-eligible transactions each year are for housing. However, the proposal also affects commercial property.

To achieve the considerable benefits that can be gained through stamp duty reform, it is crucial that the proposal address areas of concern and attract support from across the community. *Business NSW* supports the objectives of the proposal but has identified areas where it lacks detail on how particular businesses' circumstances will be addressed. Business structures and circumstances across the state are varied and complex, and for the proposal to succeed it will need to accommodate these different experiences.

Payback period

One of the simplest ways to make the decision whether to opt into the new property tax arrangement or pay stamp duty is to calculate how long it would take to pay as much in property tax as stamp duty (plus land tax where applicable). Due to the diversity of property types across the state, and the different composition of unimproved land value to sale price making up those properties, the 'payback period' varies significantly.

Using a small dataset of sample property transactions from across NSW, *Business NSW* calculated indicative 'payback periods' for stamp duty (plus land tax where applicable) compared to the new property tax (see Table 1). The dataset is limited in size but does show indicative ranges for the payback period on different types of property.

Table 1: Payback period for stamp duty compared to property tax

Property type	Payback period
Residential owner-occupied	9 to 45 years
Residential investor	3 to 12 years
Commercial	2 to 16 years

For businesses where unimproved land makes up a bigger share of their property requirements, the new property tax structure appears unattractive. Given the choice not to opt-in to the new property tax arrangements, most would likely choose to remain in the current arrangements. It is unclear whether the significant variation in the payback period, both within and between different property types, is a deliberate design choice or an oversight.

For commercial property buyers and investors in residential property, property tax will be more cost-effective for fairly short tenure lengths. For the three examples from our dataset, this tenure would be less than three years. For owner-occupied property, the rates are set at levels that make the property tax more attractive over longer expected tenures. (The dataset only included one agricultural property, which indicated a payback period of 57 years, suggesting that property tax would appear more attractive. For family farms where owners expected to be able to pass property through multiple generations, calculating the payback period is not so clear cut).

Businesses' expectations at the time of a property purchase decision will influence whether these payback periods are attractive or not. For a rapidly growing business which expects to outgrow the property being purchased in a short number of years, those payback periods may still accommodate the choice to opt-in to property tax. However, businesses more focused on becoming established and stable with a consistent community presence were less likely to see property tax as attractive.

Depending on NSW Treasury's intention for the Property Tax Proposal, these findings may or may not prove to be a problem. The opt-in nature of the proposal means that businesses will not be forced into less cost-effective arrangements. These findings suggest a much larger share of commercial property than residential property would remain in the stamp duty regime. The consequences of that for NSW Treasury's revenue projections is not clear. Alternatively, should NSW Treasury's priority be to pull more commercial property into the new property tax structure, the property tax rate on commercial property would need to be lowered.

Impact in regions

Property markets and property characteristics vary considerably across NSW. The proportion of the value of a property accounted for by the value of the underlying land differs considerably between densely occupied areas, particularly in Sydney, and low density areas across regional and rural NSW.

As an example, a flat fee portion of the property tax will on average mean those in regional areas pay a higher rate of property tax. For owner occupied residential, the amount is $500 +0.3% of the unimproved value and for investors it's $1,500 + 1%. Since property prices are lower in regional areas, $500 or $1,500 of a $300,000 land component is a higher proportional impost relative to land worth $1 million in a metropolitan area.

As a consequence, there is concern in some regions that the Property Tax Proposal will be detrimental to development of regional communities. This is to some extent ameliorated by the option not to enter into the new property tax arrangement.

Business NSW recommends that future development of the proposal should include further analysis of its anticipated impacts on the different property markets and types across the state.

Complex situations

Recurring feedback from businesses was that the simplicity of the proposal presented in the consultation paper and the media did not adequately reflect the complexity of many business circumstances. Some of the more complex circumstances raised included mixed use properties, changing property use (or zoning) and merged properties (see below). *Business NSW* assumes that work has been conducted to address these situations.

Business NSW recommends that given businesses' generally low level of awareness and understanding of the Property Tax Proposal, more detail is provided.

Mixed use property

It is not uncommon to have mixed uses over a single land footprint, such as a unit above a retail shop on a suburban high street or a new mixed-use tower block in a metropolitan area. It was unclear to our focus group participants how property tax shares would be allocated in those situations, particularly given the differences in rates between commercial, residential owner-occupied and residential investor properties.

Some businesses were concerned that this could lead to 'gaming' of different rate types, although how this would occur in practice was unclear. Others raised concerns that complexity of tax treatment could become a barrier to mixed use development where mixed use had generally been seen as a desirable neighbourhood design option.

Changing use of property

Businesses also raised questions about whether the new property tax arrangements would become an impediment to changing the usage type (and where, relevant zoning) of property to ensure its highest and best use (see also Integration with Planning and Zoning Reform below). The differentials between different rates for different usage types was seen as one way this could occur. That is, the lower rate for residential property could incentivise keeping property as residential even if a higher and better commercial use had been identified.

The other theorised obstacle was that the one-way opt-in to property tax could deter transactions to higher and better commercial uses where the new owner would prefer an upfront stamp duty payment to an ongoing property tax charge. Again, the exact mechanics of this scenario were vague due to the low degree of awareness and understanding of the Property Tax Proposal. More generally, concerns remain among businesses that as the one-way ratchet of property moving into the new arrangements progresses, the proposal will in practice become less flexible than the initial description makes out.

Merging properties

A number of participants asked what will happen if an owner tries to merge lands previously subjected to a stamp duty payment with lands on which they are paying property tax. Specifically:

- would the owner have the choice of which arrangement the new combined holdings would fall in
- would the owner be required to bring the consolidated property into the property tax system
- if so, how would that be assessed given stamp duty would already have been paid on a proportion of the lands
- how would that affect the consolidated property when it was next sold
- would that act as a deterrent to efficient land consolidation?

While not all the complex scenarios participants described were ones that affected them directly, there was a widespread view that business property arrangements are usually more complex than residential arrangements. As a result, the new system would need to be able to manage that complexity effectively and without burdensome bureaucratic compliance.

There was also concern that the degree of complexity of business property arrangements would impede informed decision making about whether to opt-in to the new property tax if the potential financial liability was unclear or potential constraints on future property choices could arise. Some participants expressed a "better the devil you know" attitude, suggesting they would rather stick with stamp duty if they were to make a future purchase.

Integration with planning and zoning reform

Reforming stamp duty is an important step to help accomplish the proposal's objective that 'more people be able to own their own home'. However, on its own stamp duty reform will not be enough to make a serious difference to housing affordability. It is important, therefore, that stamp duty reform be seen as part of a government-wide effort to increase housing affordability. Improvements to the planning system and increasing flexibility for land use zoning are also critical parts of that effort. Stamp duty reform must not become an excuse for complacency on these other fronts.

In 2019, *Business NSW* recommended to the NSW Productivity Commissioner some steps that could be taken to improve planning and zoning issues.

> "Reform of the planning system offers significant opportunities to enhance productivity in NSW. It will be important to focus on making the system more flexible and adaptable going forward, to avoid replacing one set of locked-in, hard-to-change systems with one that can respond as our needs change over time. Grievances with NSW planning and approval processes are well-known. As noted in the [Productivity Commission White Paper], approval processes in NSW take far longer than those in other jurisdictions. The typical experience in NSW involves more red tape, approval periods and

> ultimately delays in delivering new projects (if they are approved at all). This adds to the cost and uncertainty of projects which improve and build capacity within our communities.
>
> "[*Business NSW*] notes proposals by other stakeholders to improve the NSW planning system, including by adopting practices which streamline processes in other jurisdictions. This includes more consistent and streamlined approval processes across councils; expanding and maximising the benefit of 'complying development' processes; and improved DA workflows to minimise delays.
>
> "The [Productivity Commission White Paper] identifies the complexity and prescriptiveness of zoning in NSW as a potential barrier to business establishment and expansion. "[*Business NSW*] shares this concern and supports the identified option of reducing the number of commercial and business-related zoning categories. This would allow for a more demand-driven focus for development. It also potentially reduces the burden on local councils to carry out reviews of zoning of existing lots – an activity that has failed to keep pace with changing patterns of demand from businesses of all types. The specificity of current zoning categories means councils would need to carry out frequent updates to plans to ensure continued matching of demand for business property of different types with the land or buildings available. Councils have struggled to do this in practice, and it may be unrealistic to expect them to. Removing many of the distinctions between different zoning classes will allow councils to focus on the differences that matter but remove the need for constant 'fine-tuning' of zoning."

While some planning processes have seen temporary streamlining measures introduced during the pandemic, *Business NSW* encourages the NSW Government to make those improvements permanent.

Business NSW also notes recent proposals in the NSW Design and Place SEPP with the potential to undo any housing affordability improvements made through stamp duty reform. Increasing minimum dwelling size standards and imposing additional design rules on an already regimented and costly planning regime will inevitably reduce housing affordability. As *Business NSW* submitted to the Productivity Commissioner:

> "Minimum dwelling sizes increase the cost of affordable housing in NSW. The housing stock needs to adjust to changing demographics and household structures. Single resident households are on the rise. By limiting dwelling sizes, individuals are unable to make their own decisions about housing that is most suitable to their needs. This ultimately makes it harder for individuals to access economic opportunities available closer to economic centres and restricts upward labour mobility and productivity."

Cross-subsidy from business to residential property

A few businesses in the focus groups raised concerns that higher rates on commercial property taxes than on residential property taxes was an attempt to cross-subsidise the housing market "on the backs of businesses". As a result, views were mixed on whether the current proposed rates for different sectors of the economy were appropriate.

An alternative proposal was to have an escalating rate based on the underlying value of the property (either land or sale price) but equal across different types of use. As an illustrative example:

- any property under $1 million would incur a land tax rate of X%
- $1 million to $2 million would incur X+Y%
- $2 million to $3 million would incur X+Y+Z%

and so on, up to the threshold where property tax is not available.

For some businesses at least, an escalating rate based on expense, not on economic sector, was considered fairer and less likely to negatively affect regional development. However, as business views were mixed on this approach, *Business NSW* has put this forward for consideration and not as a firm recommendation at this stage.

Other stamp duties

While the Government is contemplating reform of CSD, it should use the opportunity to re-examine other forms of stamp duty enacted in NSW. *Business NSW* has particular concerns about insurance stamp duty.

Insurance costs have risen in prominence over the last two years to become one of the most commonly raised cost-pressures affecting our members. The combination of stamp duty, Emergency Services Levy (ESL) and GST on top of already-high insurance premiums contributes to making insurance difficult for businesses to afford, leaving them underinsured. The small business stamp duty exemption is helpful but is limited in application to commercial vehicle insurance, commercial aviation insurance, occupational indemnity insurance, product and public liability insurance. Property insurances, where some of the most severe cost escalation has occurred, is not subject to the exemption.

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