

Reforming State Property Taxes

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Federal Relations Tax Workshop, Adelaide, August 2017

The Task

- Assess the comparative
 - Efficiency gains, and
 - Redistribution effects
- Of different options, or “devil in the details”, of a revenue neutral reform package to
 - Replace current state taxes on property with
 - A broad based property tax

Inevitably: A required trade-off between conflicting efficiency, equity and simplicity objectives

Some of the Tax Package “Devil in the Details” Options

- The current state taxes to replace
- Design details for the replacement tax
 - Choice of base
 - Land or property?
 - Disaggregate by use and by state?
 - Choice of tax rate schedule
 - Flat or progressive?
 - Transition options

Each replacement option has different efficiency, equity (both vertical and horizontal), and simplicity outcomes, and relative to the current taxes

Taxes to Replace: Current State General Revenue Property Taxes

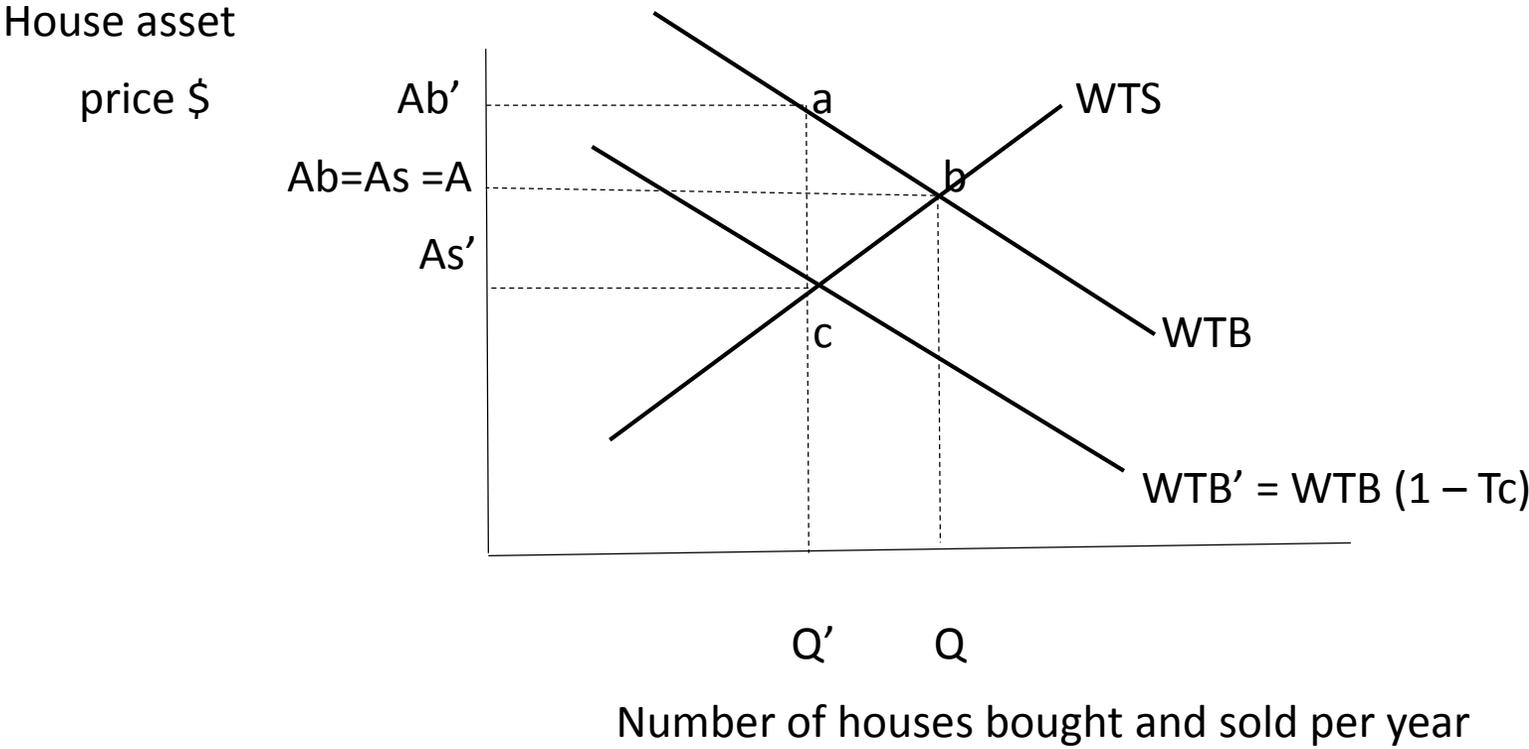
	Tax base	Rate schedule	2014-15 revenue, \$m
Conveyance duty	Unit property value	Progressive rate	18,422
Land tax	Entity holding. Exempt owner homes and primary production	Progressive rate	6,674
Insurance stamp duty	Gross premium on property	Flat rate	4,303

Each distorts decisions with efficiency costs, including

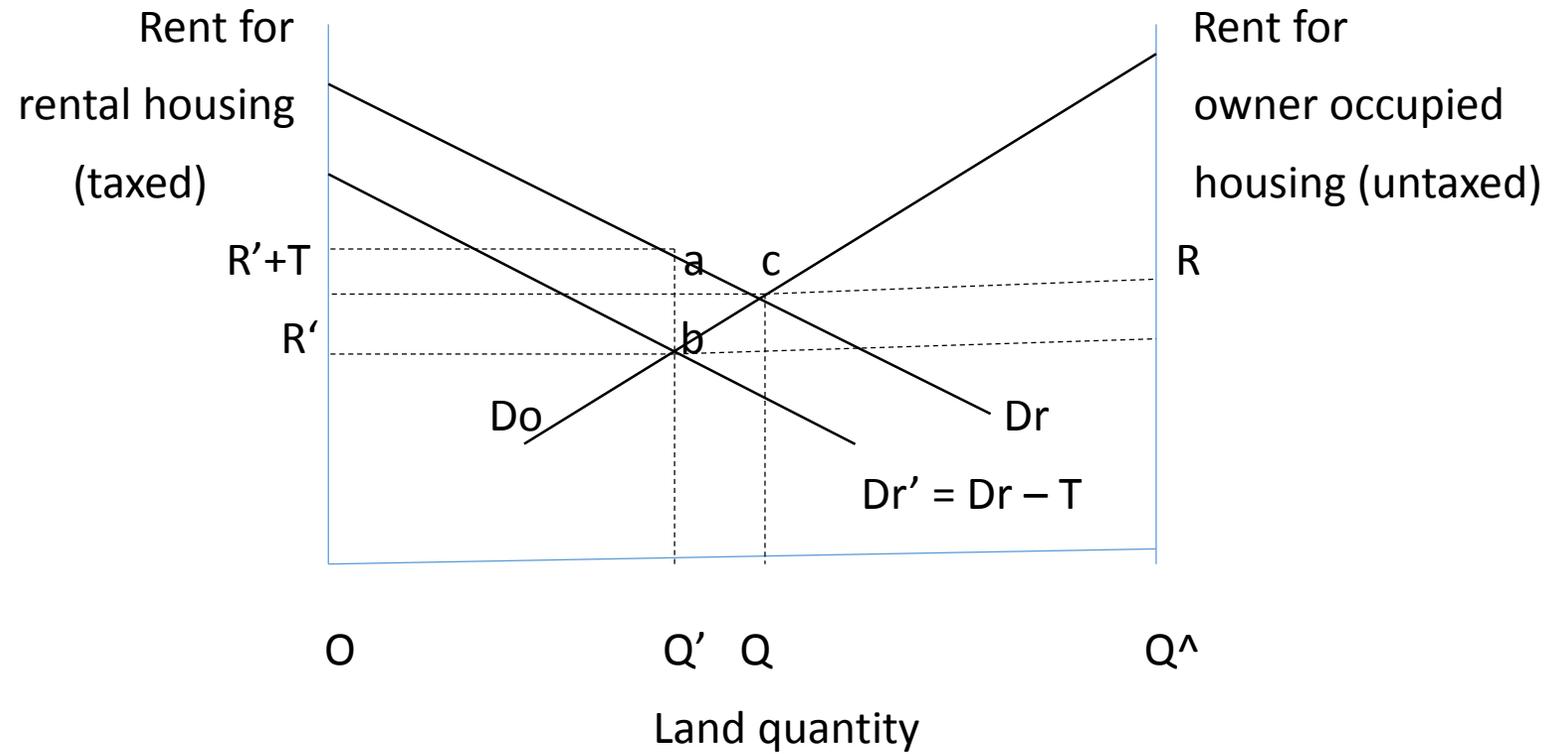
- Conveyance duty: reduces Pareto improving property transfers
- Land tax: distorts allocation of land
- Insurance stamp duty: distorts insurance choice and risk management

Overall mildly progressive incidence, but conveyance duty horizontal inequity

Effects of conveyance duty



Effects of narrow base land tax



Replacement Tax Base: Land or Property (=land + improvements + buildings) Base?

- Property about double in size, so half the rate
- Land Base
 - Wins on minimise decision distortions and efficiency gain
- Property base
 - Involves decision distortions on investment in improvements and buildings
 - Likely to reduce redistribution of the tax burden when compared with the current taxes
 - Uses readily available data

Replacement Tax Base: Single Comprehensive Base or Disaggregate?

- Potential disaggregates
 - By use of property, e.g. residential, and then by owner occupied and rental, commercial and primary production
 - By state
- Relative properties
 - Comprehensive base more efficient and simpler
 - But, comprehensive base involves larger redistribution effects relative to the status quo

Tax Rate Options: Flat or Progressive Rate?

- Then some options for progressive rate base
 - Base of value of assets held by taxpayer (current land)
 - Base of dollars per unit asset (Henry Review \$/square metre)
- Inevitable trade-off of equity and efficiency
 - For efficiency, flat rate wins
 - But, current taxes to be replaced have progressive rate schedules, except stamp duty on insurance, and they result in a more progressive distribution than a flat rate

Key Observations on Redistribution Effects of the Reform Package

- Minimal changes in property asset prices. With an aggregate revenue neutral package, the average tax burden across different taxpayers over time does not change, and market determined asset prices reflect this average
- Significant horizontal equity changes with replacement of conveyance duty.
 - With conveyance duty, those who buy and sell more (less) frequently than the average pay more (less) conveyance duty than the average tenured taxpayer
 - With replacement property tax, those with a similar property value pay the same tax every year regardless of frequency of property trades

Transition Path Options

- Cold turkey
 - Revenue neutral
 - Generates all efficiency gains from day one
 - “Double taxation” of recent traders, both new buyers and joint buyer and seller
- Grandfather introduction of replacement tax to new transferees
 - High revenue cost; approx. 5.5% properties sold each year
 - Long lag in gaining efficiency benefits, and adds a “lock-in” distortion
- ACT model of phased slow increase of new tax and slow reduction of current taxes
 - Revenue neutral
 - Long lag in generating efficiency gains
 - Reduces perceived “double taxation” inequity

Concluding Observations

- Replacing current property taxes with a broad based tax in an approximate revenue neutral package will
 - Generate significant efficiency gains
 - Involve considerable vertical and horizontal redistribution
- Trading-off efficiency for close maintenance of current vertical equity suggests
 - A property base rather than a land base
 - A progressive rate rather than a flat rate
 - Consideration of different rates for commercial, residential and primary production
- Careful explanation of the changes in economic as opposed to statutory incidence
- Explain and support the improved horizontal equity effects of the reform package