



State property tax reform: balancing economic principle and political realism

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**Federal Relations and Tax Reform Workshop, Adelaide
28 August 2017**

State property tax reform

A stamp duty – property tax swap is the holy grail of state tax reform

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- Property taxes are efficient; generate stable revenues; and are fair

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A broad-based property tax would not impose unreasonable burdens

- A flat ~0.6% land tax could fund stamp duty abolition, whereas a 0.9% land tax could also replace progressive state land taxes

A gradual transition best balances the competing objectives

- Three main hurdles: revenue stability during transition; treatment of recent purchasers; asset-rich, income-poor households
- Three main options: ACT approach, compulsory switch on sale, opt-in model

Stamp duties discourage property transfers, producing large welfare losses

Stamp duties reduce housing turnover

Leigh and Davidoff (2013) – a 10% increase in stamp duty lowers Australian housing turnover by 3% in the first year, and by 6% over 3-years.

Dachis, Duranton and Turner (2012) – a 1.1% increase in Toronto's land transfer tax caused a 15% fall in housing sales.

Van Ommeren and Van Leuvensteijn (2005) – a 1% increase in transaction costs reduces residential mobility rates in the Netherlands by at least 8%.

Best and Kleven (2015) – a temporary 1% cut in the UK stamp duty rate led to a 20% increase in housing transactions.

Hilber and Lyytikainen (2017) – a 2% increase in the UK stamp duty rate reduces the propensity to move by 2.6 percentage points. Particularly strong **negative impact on housing-related and short distance moves**, leading to misallocation of dwellings in housing market.

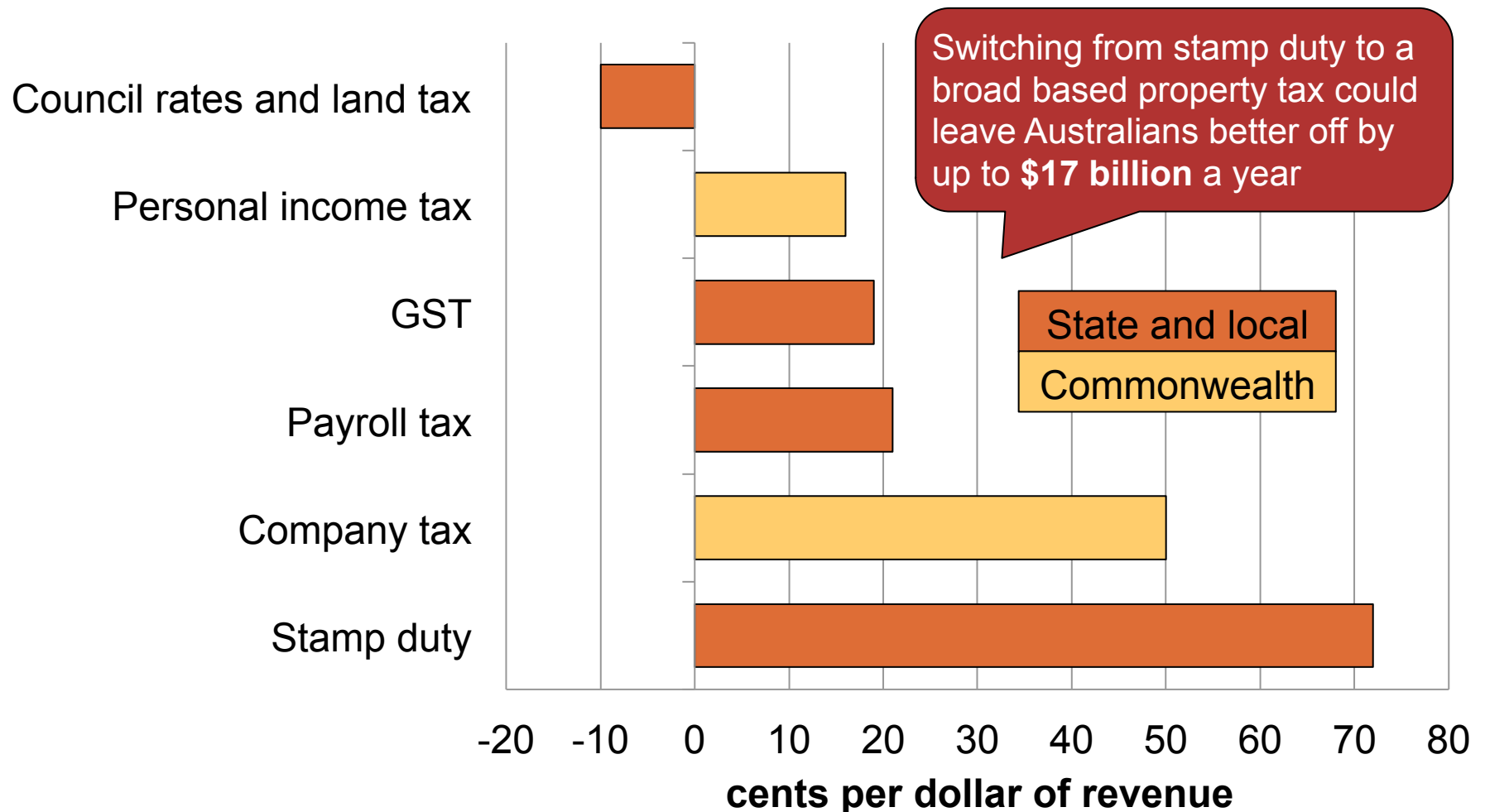
Stamp duties produce large dead weight losses

Hilber and Lyytikainen (2017) – average welfare loss of 84% of additional stamp duty revenues over marginal stamp duty tax range of 1-3%.

Dachis, Duranton and Turner (2012) – find a 13% deadweight loss relative to tax revenue.

Stamp duties are the most costly state taxes, re-current property taxes are the least damaging

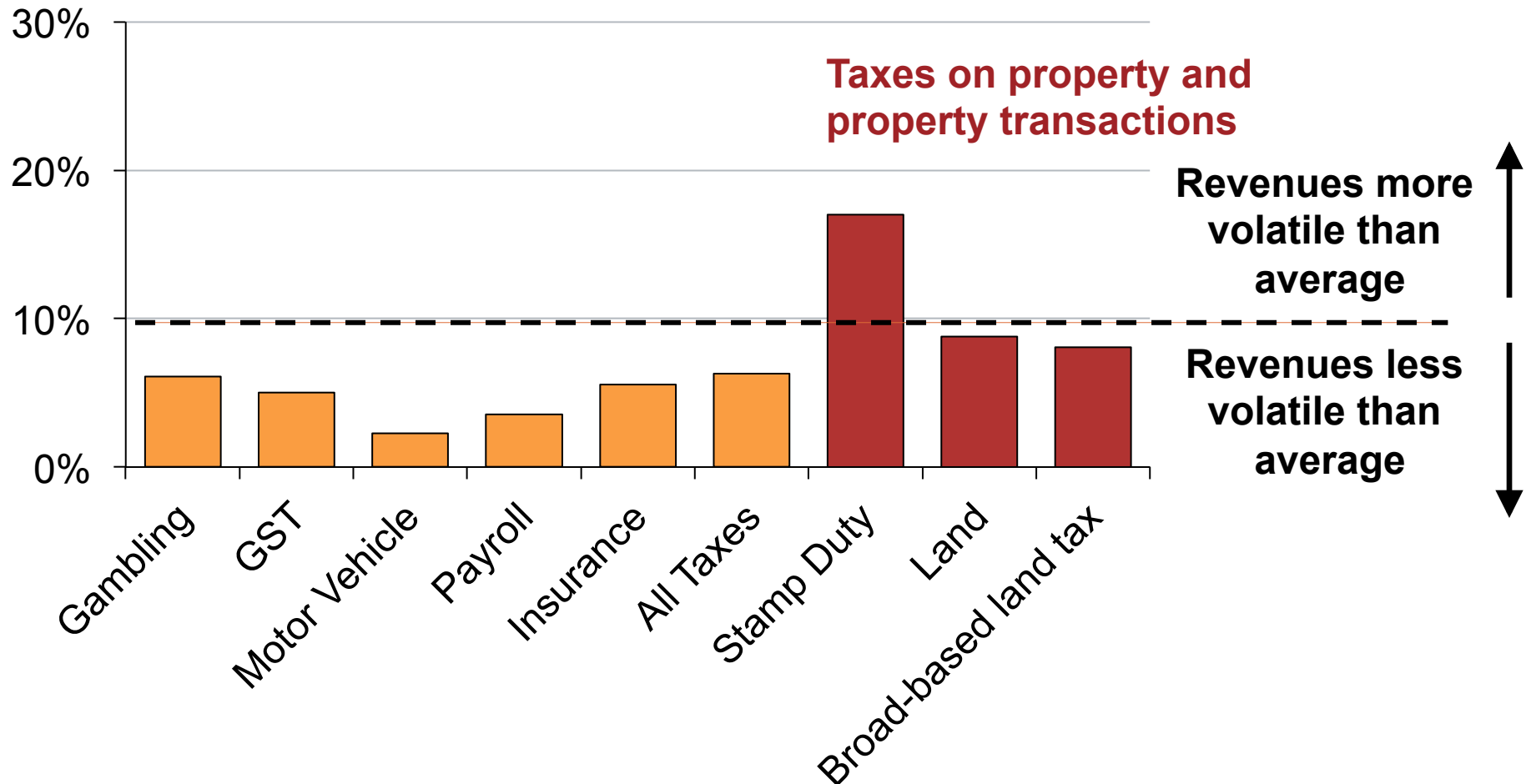
Loss of economic welfare (cents) for each \$ increase in tax



Re-current property taxes are also less volatile than stamp duties on property transactions

Revenue volatility, 2000-01 to 2015-16

Standard deviation between annual tax growth and long average growth

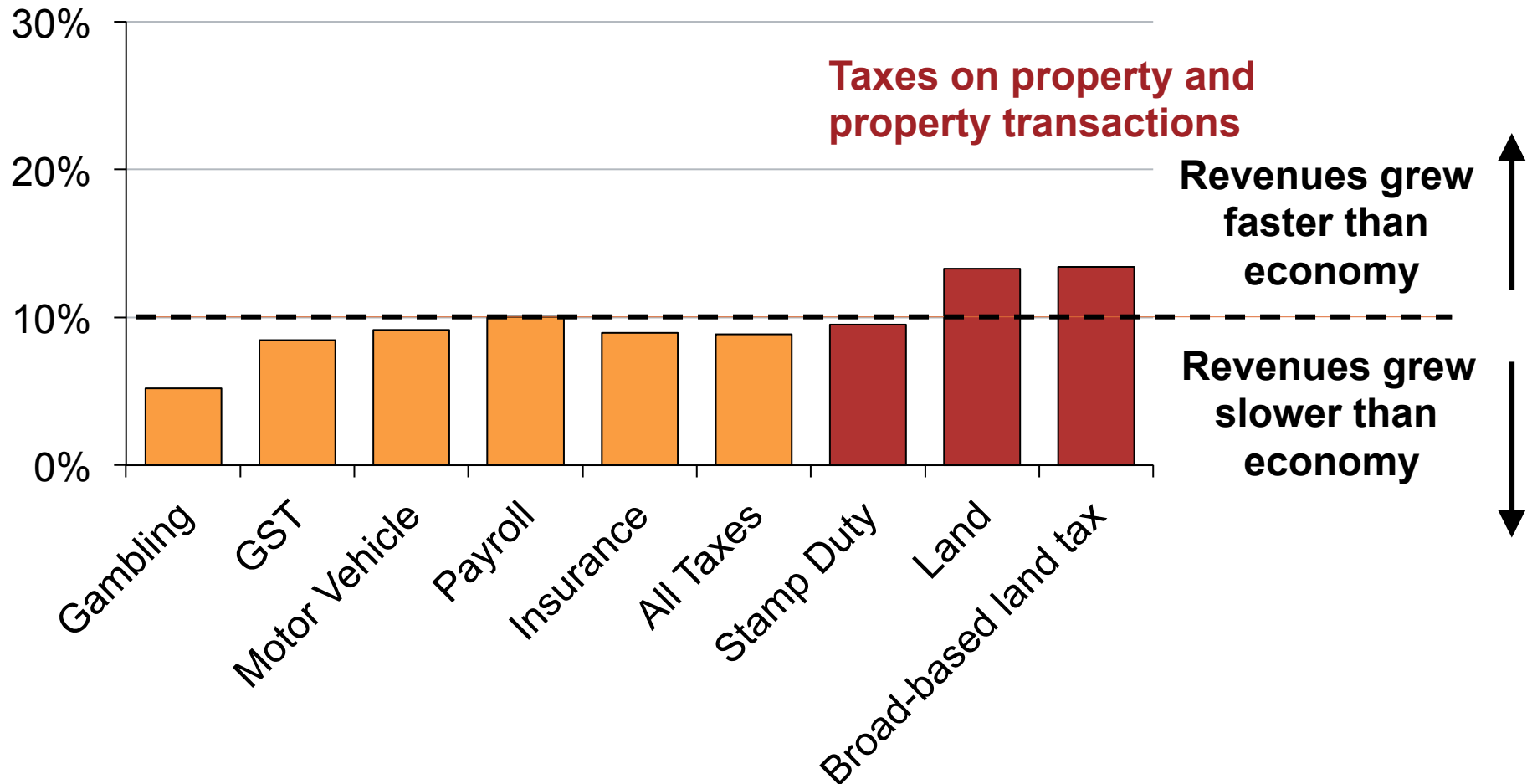


Source: ABS (multiple years); Grattan analysis.

Note: Note: 'Broad based land tax' shows the revenues that would have raised with a broad-based land tax had it been in place over the period.

And taxes on property have been the growth taxes over the last decade

Change in tax collection relative to 10% increase in Gross State Product
2000-01 to 2015-16



Source: ABS (multiple years); Grattan analysis.

Notes: Note: 'Broad based land tax' shows the revenues that would have raised with a broad-based land tax had it been in place over the period.

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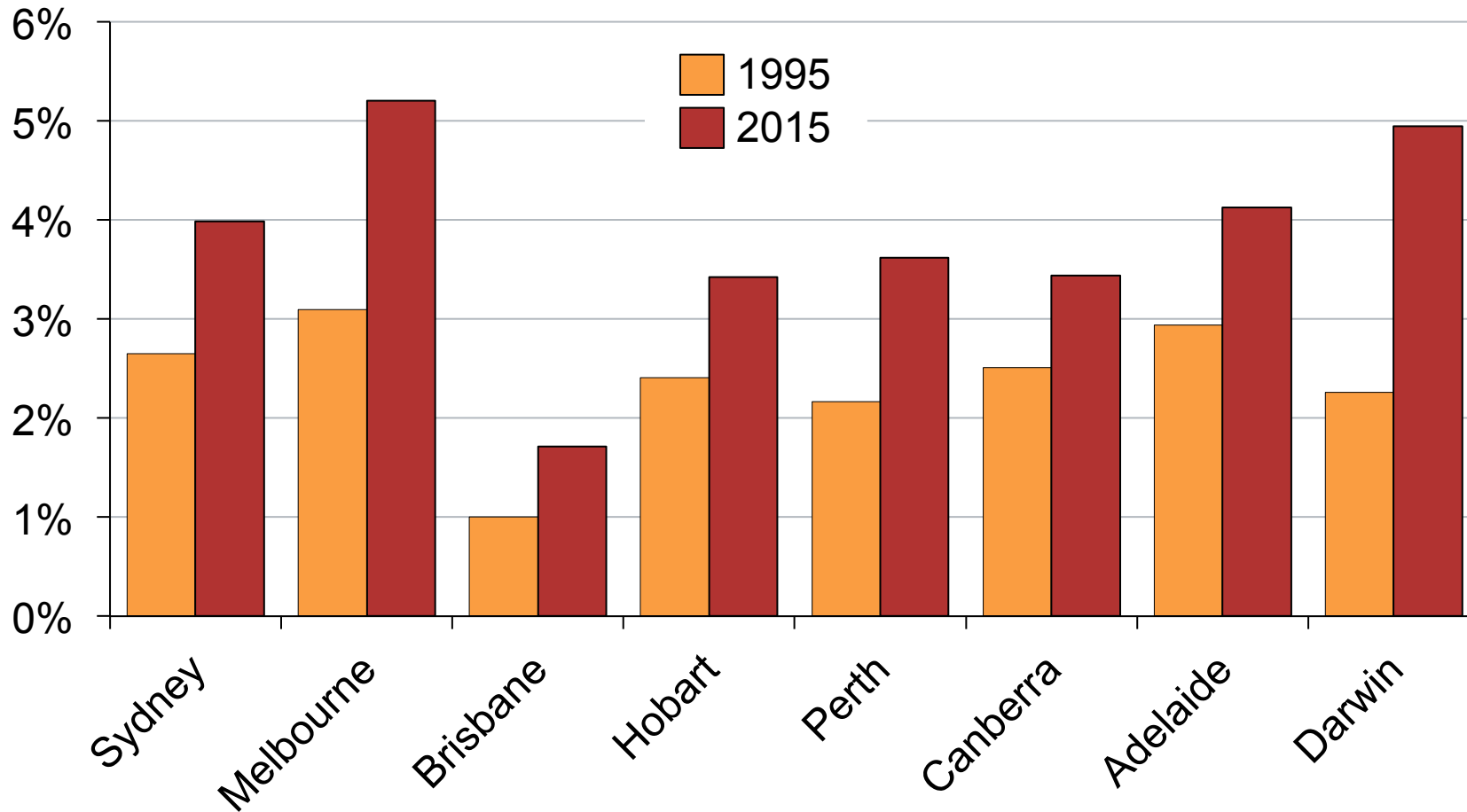
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Effective rates of stamp duty have risen sharply in all states in the past two decades

Stamp duty payable on median-priced house in each capital city

Per cent

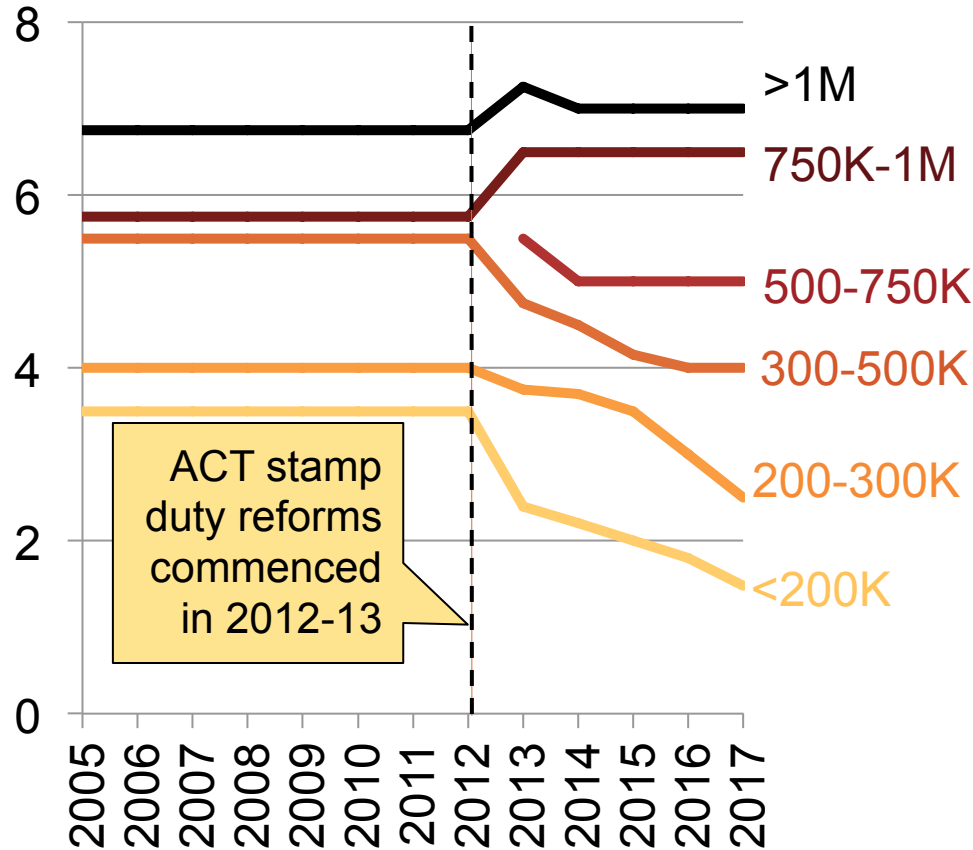


Notes: Median prices are for a detached house. Darwin median price is for 2000. Assumes residential property and that the purchaser is not eligible for a concessional rate of stamp duty.

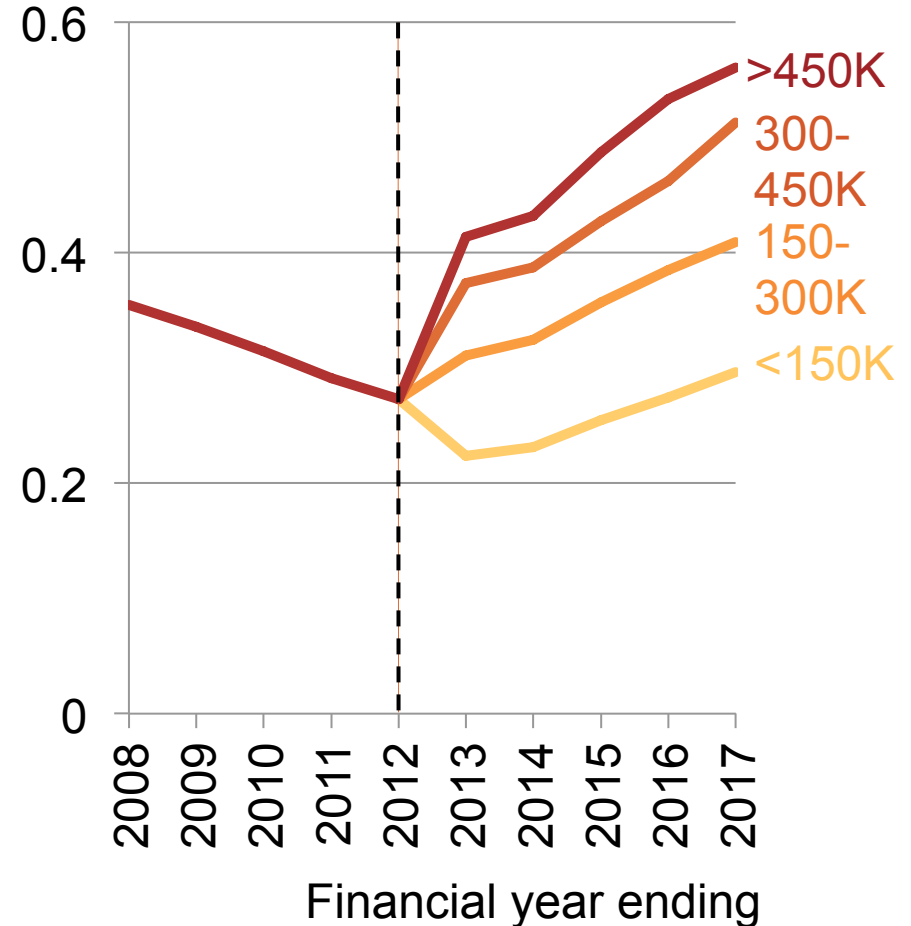
Source: Property Council; Core logic; Grattan analysis.

So far only the ACT has begun the switch from stamp duty to a re-current property tax

Marginal stamp duty rates on residential property, per cent



ACT municipal rates on residential land, per cent



Source: Prosper (2016); ACT Revenue Office (2017)

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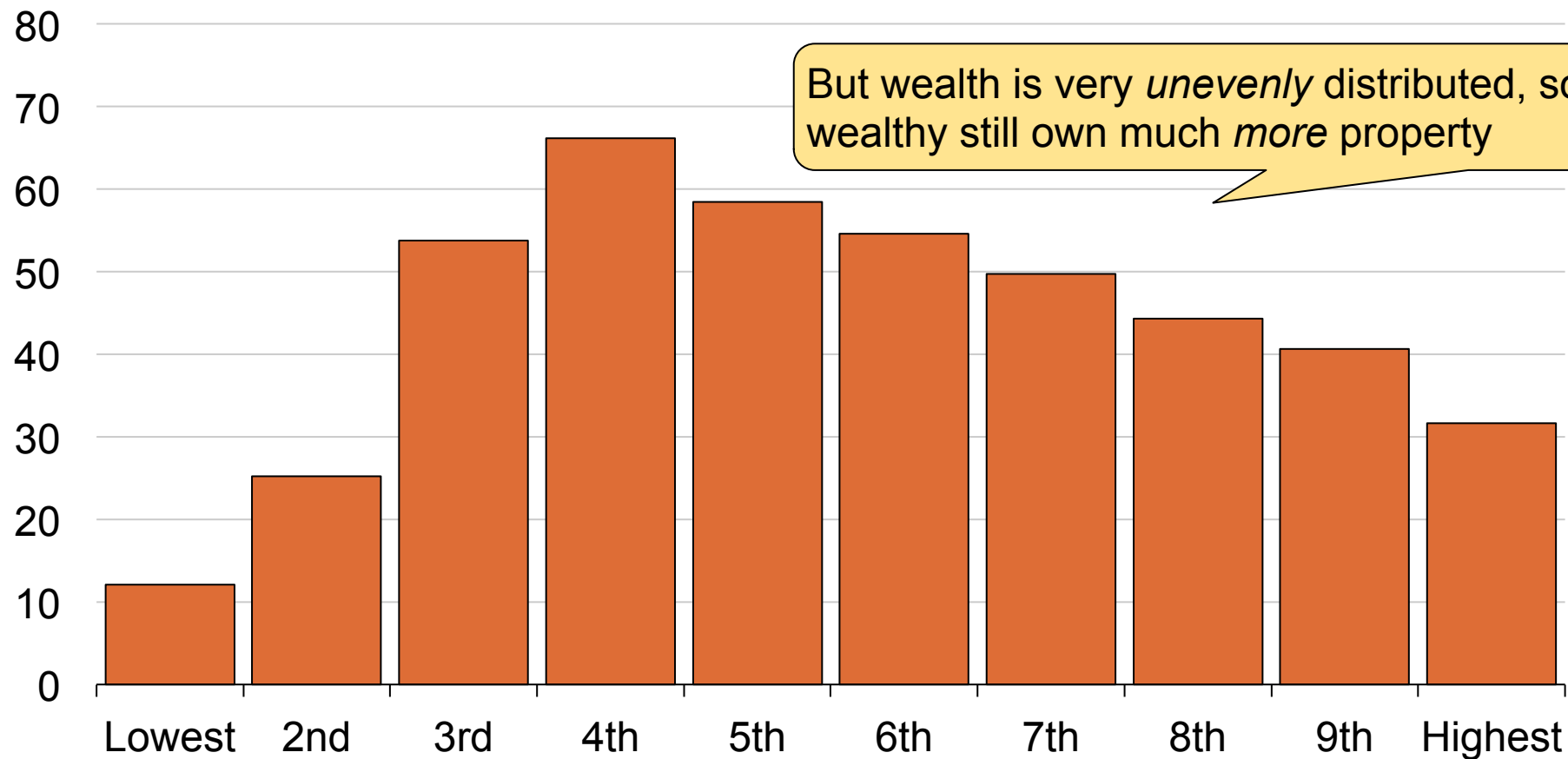
What do we care about when designing taxes?

<p>Efficiency</p>	<p>(Almost) all taxes affect economic choices of individuals and businesses, producing welfare losses:</p> <ul style="list-style-type: none"> • The more mobile the tax base, the higher the economic costs • The narrower the tax base, the higher the economic costs as individuals and firms change their behaviour to avoid the tax
<p>Equity</p>	<p>Horizontal equity: those in the same economic position (income, wealth or family type) should pay the same amount of tax</p> <p>Vertical equity: those with greater ability to pay (income or wealth) should pay proportionately more</p> <p>Intergenerational equity: the wellbeing of future generations should be at least no lower than the current generation</p>
<p>Simplicity</p>	<p>The tax system should be easy for individuals to comply with and for government to administer</p>

Equity: wealthier h'holds hold a smaller share of total wealth directly in property than the middle

Gross land holdings as a share of households' net worth

Per cent



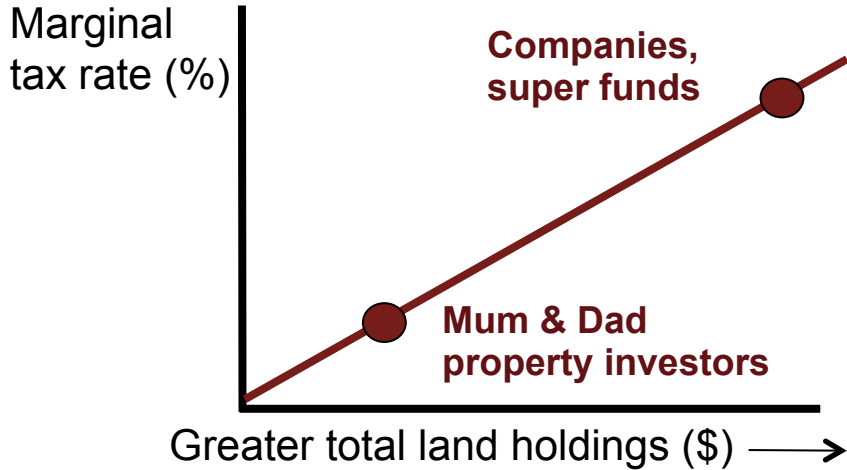
Equivalised household net worth by decile

Note: Assumes land accounts for 66 per cent of capital improved property value in metro areas and 54 per cent in regional and rural areas.

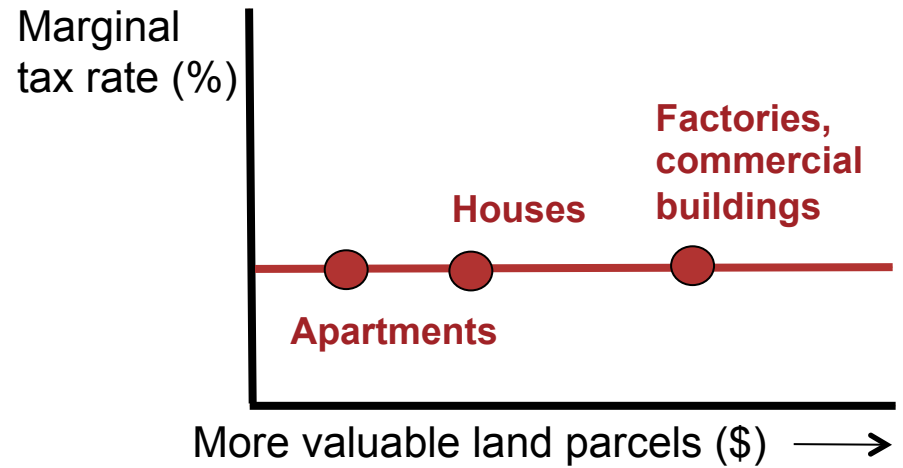
Source: ABS Survey of Income and Housing 2013-14; Grattan analysis.

What form of property tax should replace stamp duty?

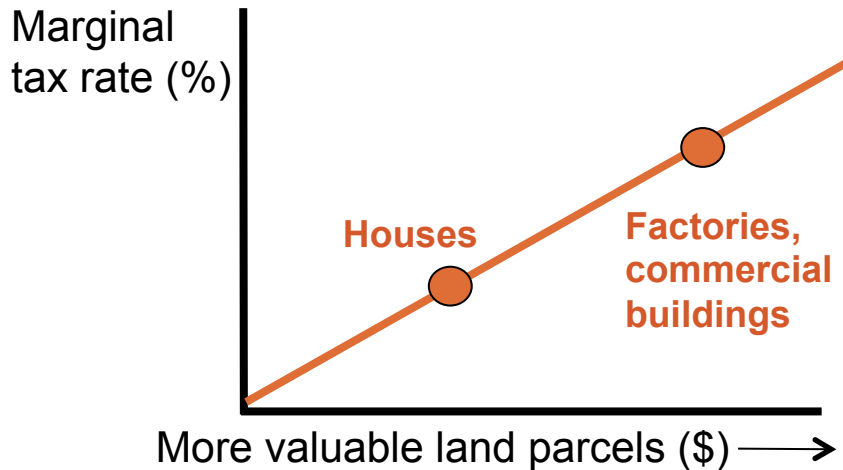
State land taxes: progressive tax on total land holdings



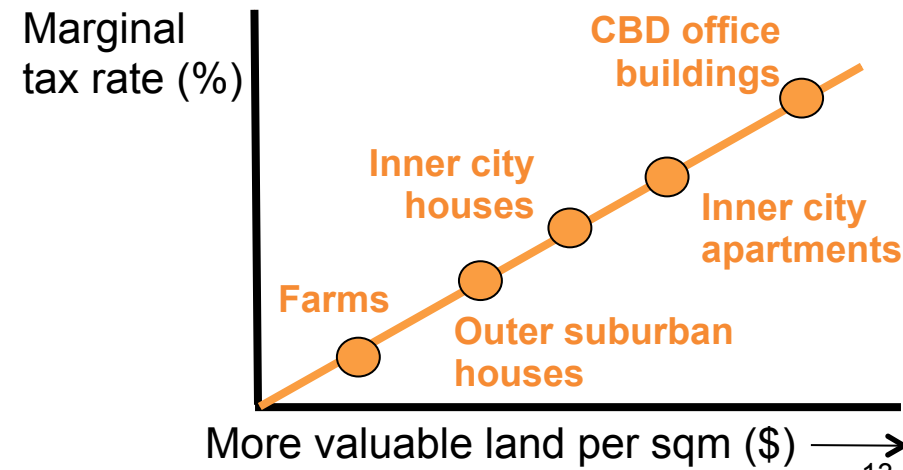
Uniform flat land tax on property value



Progressive tax on property value



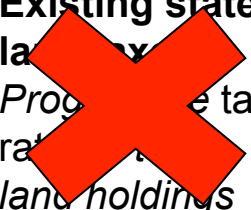
Henry: progressive tax on land value per sqm



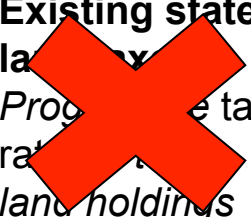

What form of property tax should replace stamp duty?

Tax rate	Efficiency	Equity	Simplicity
Existing state land taxes: <i>Progressive tax rate on total land holdings</i>	Strongly discourages large land holdings: institutional inv'ment in housing, factories	Progressive as wealthier h'holds own more land Some costs borne by renters via higher rents	Strongly encourages fragmented land holdings Encourages complex ownership structures
Grattan model: <i>A uniform flat rate per dollar of property value</i>	No effect on land use choices if applied to land Flat rate limits costs if on improvements	Regressive to income: older h'holds own more land Hits middle wealth most since v wealthy hold less land Fairer when over lifecycle	Simple to understand and administer
ACT model: <i>Progressive rate on each property value</i>	<i>Somewhat</i> discourages large land holdings Costly on improvements	Modestly progressive: wealthier h'holds own more valuable land	Simple to understand and administer
Henry model: <i>Progressive rate on land value per sqm</i>	No effect on land use choices if applied to land Costly on improvements Encourages density	Modestly progressive: inner city landowners likely to be wealthier Treats those with similar income / wealth differently	Compounds challenges in valuing inner-city land Hard for taxpayers (& wonks) to understand

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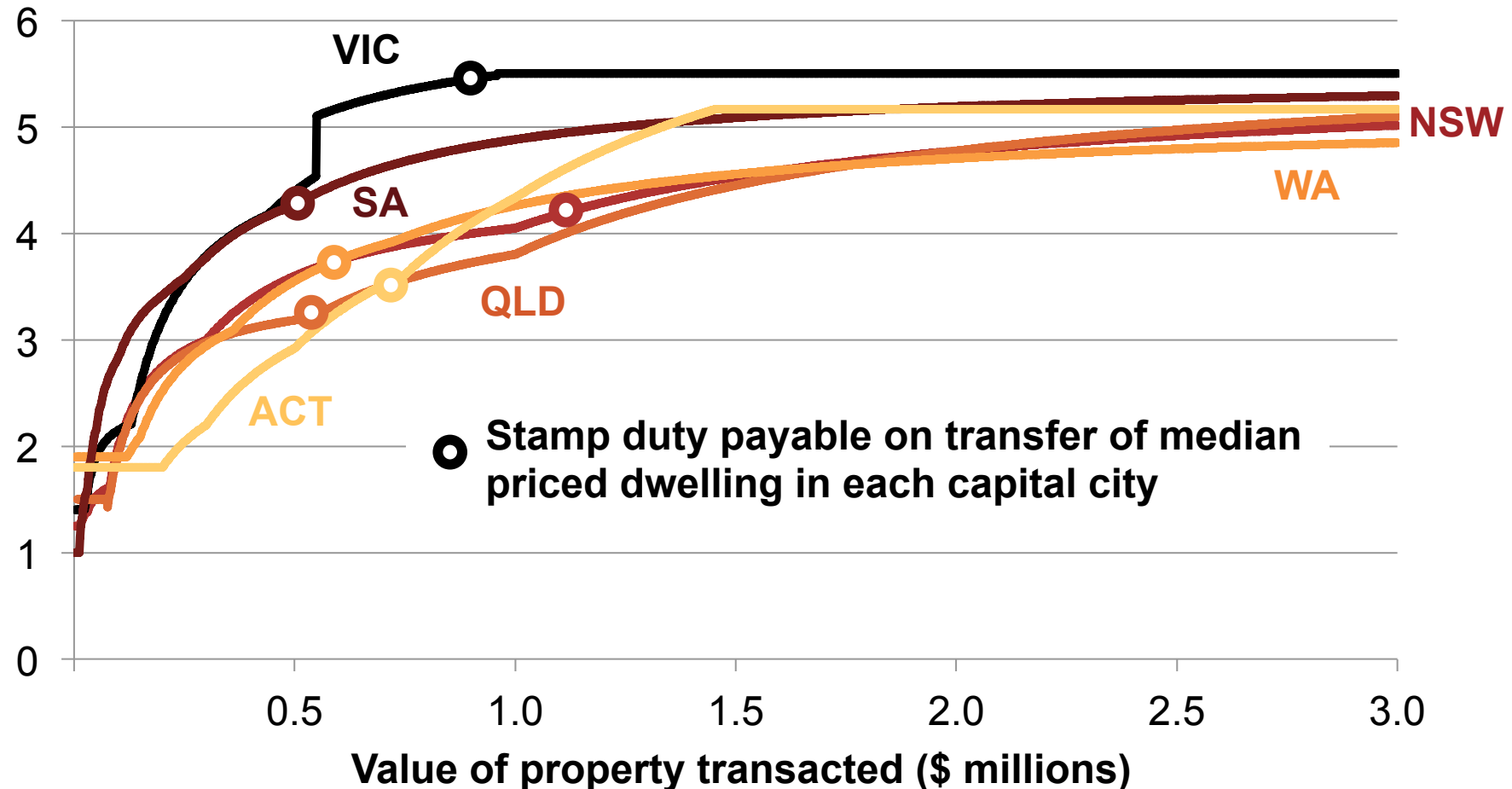
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State stamp duties are “progressive”: purchasers of more valuable properties pay a higher tax rate

Average stamp duty rates, 2017

Per cent

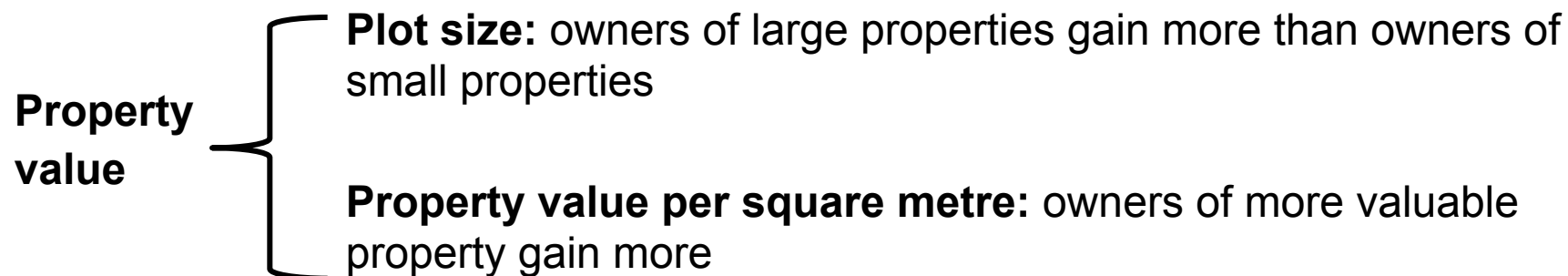


Source: ACT Revenue Office (2017); NSW Government Office of State Revenue (2017); Queensland Government (2017); Revenue SA (2017); Tasmanian Government (2017); State Revenue Office Victoria (2017); Government of Western Australia Department of Finance (2017).

Property tax reform should not impact *overall* property prices, but generates windfall gains and losses

Replacing one property tax for another raising the same revenue should have little impact on *overall* house prices

But there will be windfall gains and losses among existing property owners from the abolition of stamp duties:

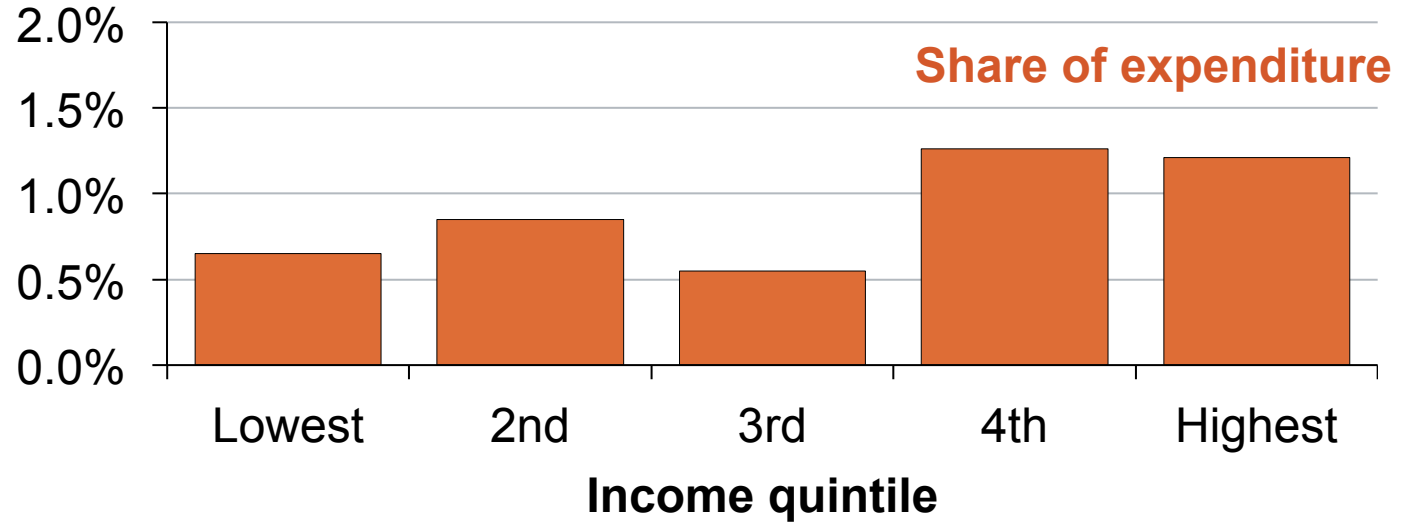


Turnover: owners of properties that are frequently transacted (i.e. small homes, apartments or investment properties) gain more

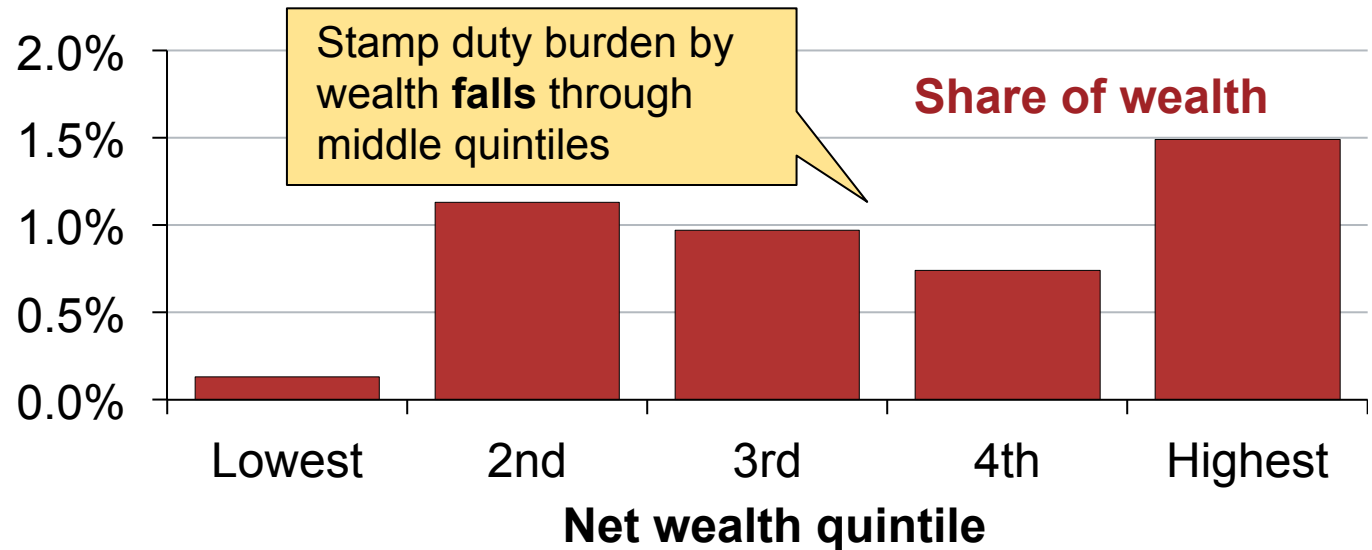
The big empirical question is how these dimensions link to income and wealth

Wealthier households pay more stamp duty per \$ of income *on average* than poorer households in SA

Average stamp duty as share of household expenditure, South Australia



Average stamp duty as share of household wealth, South Australia

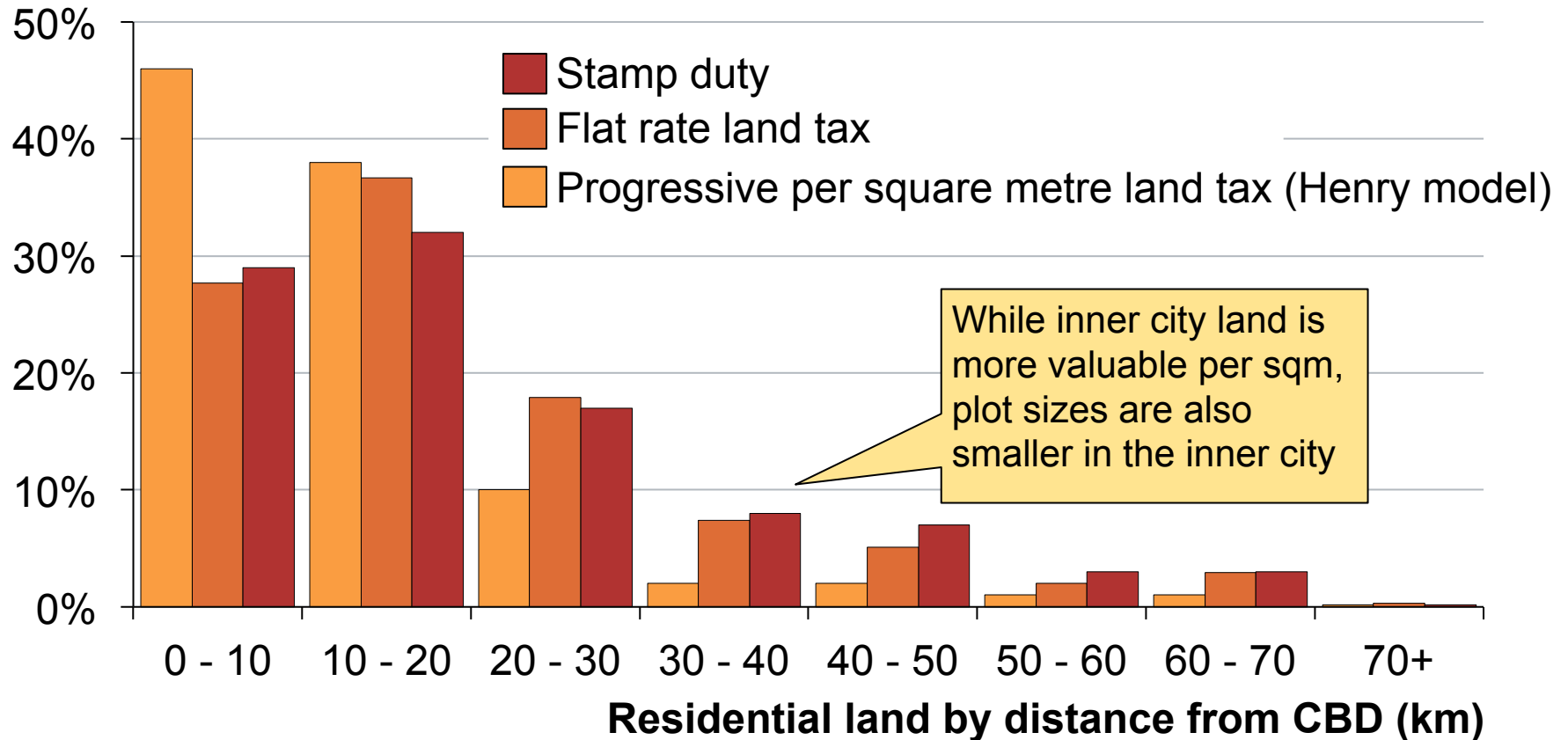


Note: Stamp duty incidence is based on the value of property purchased in the three most recent years. Includes owner occupied and investment property.
Source: Phillips (2015), *The Distributional Impact of State Taxes for South Australian Households*, NATSEM.

A flat rate land tax could *broadly* match the spatial distribution of residential stamp duty burdens

Share of revenue raised on residential land by distance from CBD, Melbourne

Per cent



While inner city land is more valuable per sqm, plot sizes are also smaller in the inner city

Note: Wood et al (2012) specify a progressive land tax schedule with a tax-free threshold for land valued at less than \$287 per square metre, with marginal tax rates rising in linear fashion from 0.9 per cent to 1.4 per cent in 0.1 per cent increments. The aggregate amount of revenue generated by stamp duty is less than the proposed land tax schedule because approximately 25 per cent of stamp duty transactions in the VG data could not be matched to their property characteristics in the valuation data. Excludes apartments as data on dwelling size was not available for strata title dwellings. Source: Wood et al (2012); Grattan analysis.

Mapping the windfall gains and losses from property tax reform is particularly complex

If stamp duty is replaced by...

Tax structure	Winners	Losers
Grattan model: <i>A uniform flat rate per dollar of property value</i>	Owners of large or high value homes Homes that are frequently transacted	Owners of low value homes Homes that are infrequently transacted
ACT model: <i>Progressive tax rate based on individual property value</i>	<i>Depends on the progressive land tax rate structure adopted</i> Homes that are frequently transacted	<i>Depends on the progressive land tax rate structure</i> Homes that are infrequently transacted
Henry model: <i>Progressive tax rate based on land value per square metre</i>	Owners of large outer suburban homes Farmers	Owners of valuable inner city land (i.e. inner city apartments, CBD office space) Owners of land zoned for scarce uses (i.e. shopping centres)

A **progressive** tax on the **individual property values** would most closely **match progressive stamp duties** which are also assessed on **individual property values**

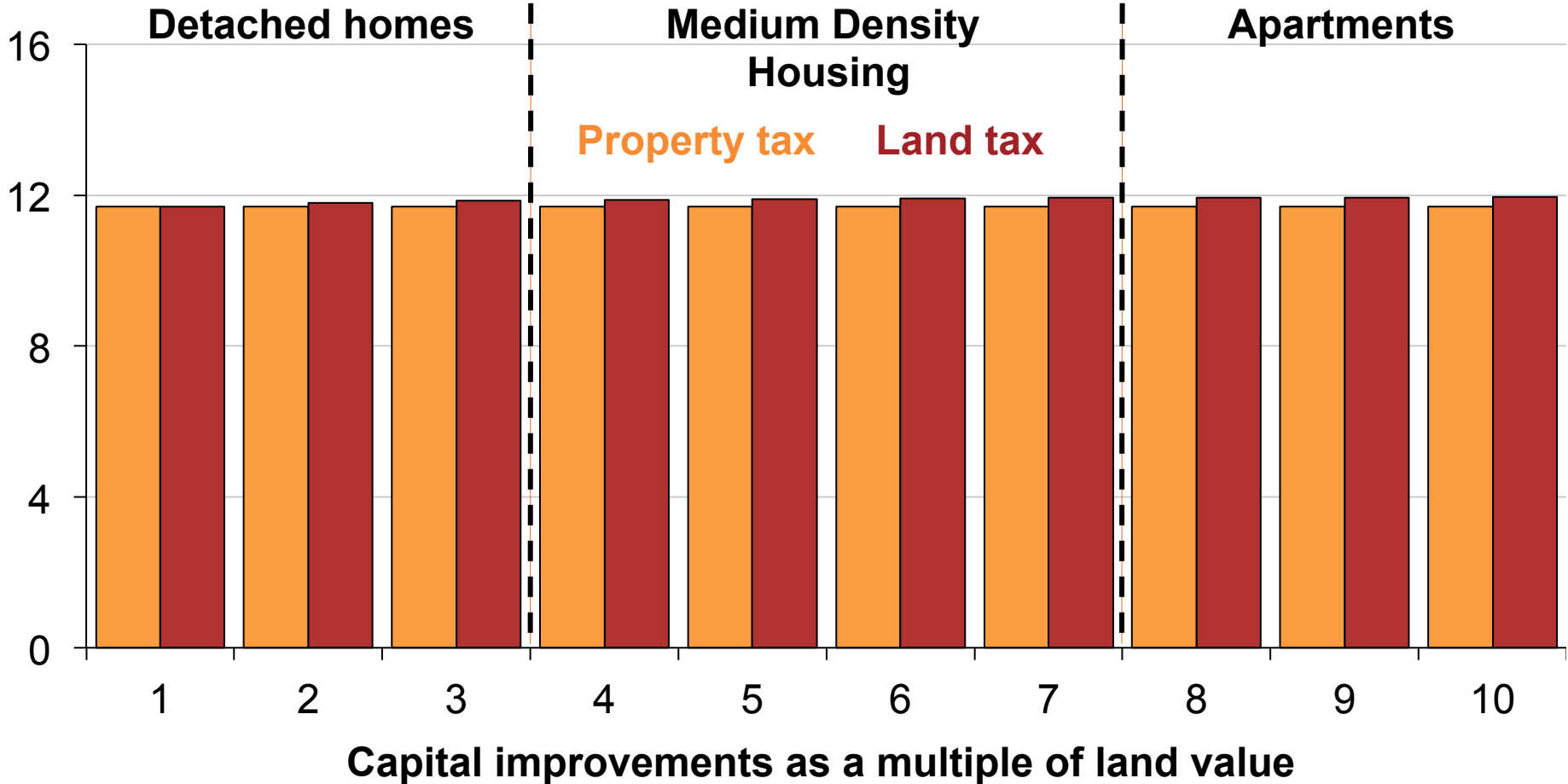
Council rates is the best property tax base to fund the abolition of stamp duties

Land uses included in various property tax bases

Land use	Stamp duty	State land tax	Council rates
Residential investment property	✓	✓	✓
Commercial property	✓	✓	✓
Owner occupied housing	✓	✗	✓
Primary production	✓	✗	✓
Not-for-profits, public hospitals	✗	✗	✗
C'wealth, state and local govt. owned land	✗	✗	✗

Although a tax on unimproved values is theoretically preferable, it doesn't affect incentives *that* much

Return on capital employed
Percent



Notes: Based on a property tax rate of 0.3 per cent, and a land tax rate of 0.6 per cent. Assumes a pre-tax rate of return on the total investment of 12 per cent.

Source: Grattan analysis.

Taxing capital improved property values may also be administratively simpler in some states

Property value bases that can be used to set council rates in each state

State	Basis for council rates
New South Wales	Unimproved
Queensland	Unimproved
Victoria	Either unimproved or capital improved
Western Australia	Capital improved
South Australia	Either unimproved or capital improved
Tasmania	Either unimproved or capital improved
Northern Territory	Unimproved
Australian Capital Territory	Unimproved

Notes: The ACT funds fire services via a levy based on unimproved property values for commercial property only, with a fixed charge for residential and rural land. The ACT also uses the average of unimproved land values over the past 3 years; WA sets minimum charges for the total levy collected on each property, which act as a de facto fixed charge for some ratepayers.

Source: Daley and Coates (2015), *Property Taxes*, Table 1.

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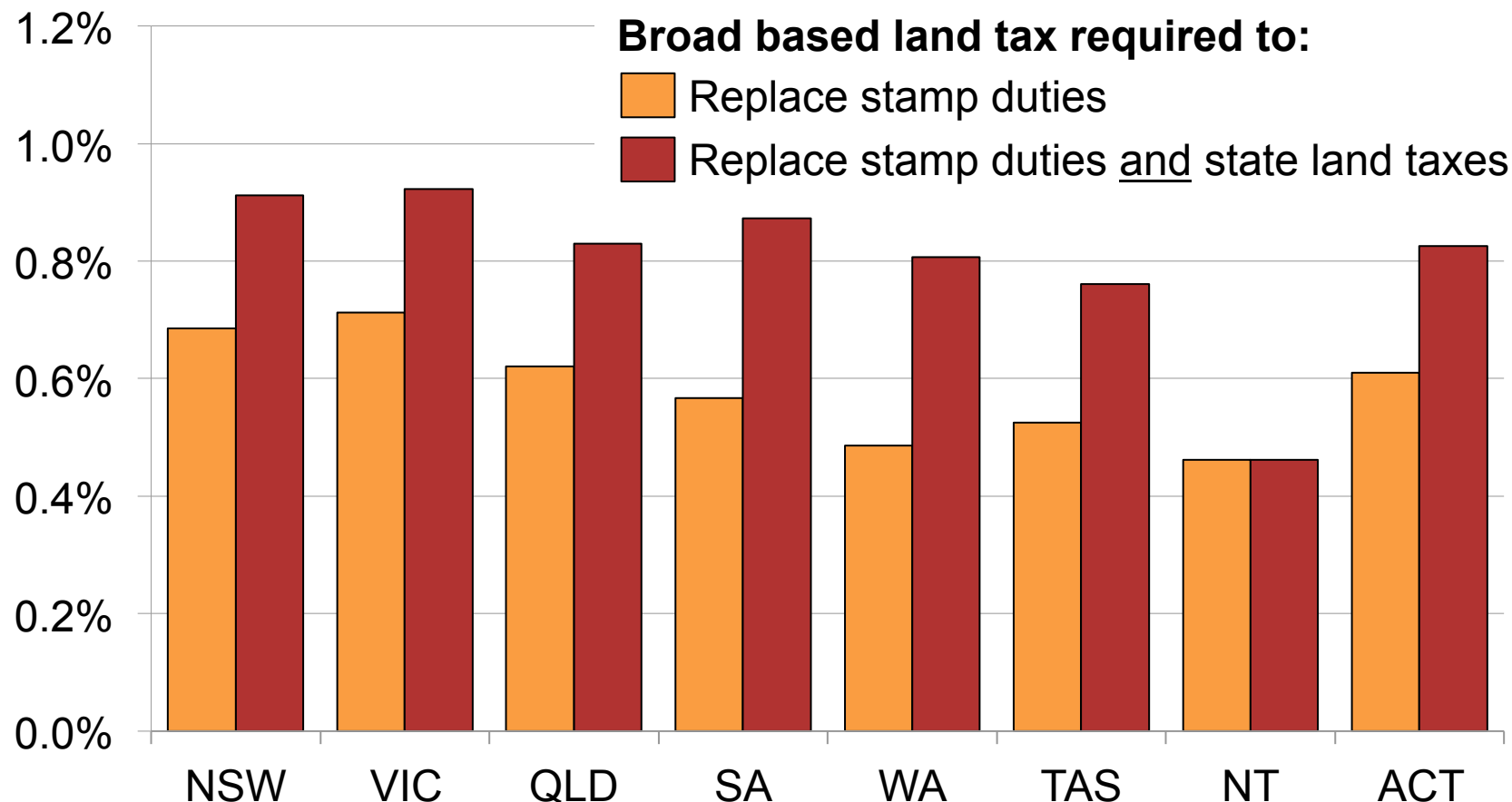
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Annual flat land taxes of between 0.5% and 0.7% could replace stamp duties in all states

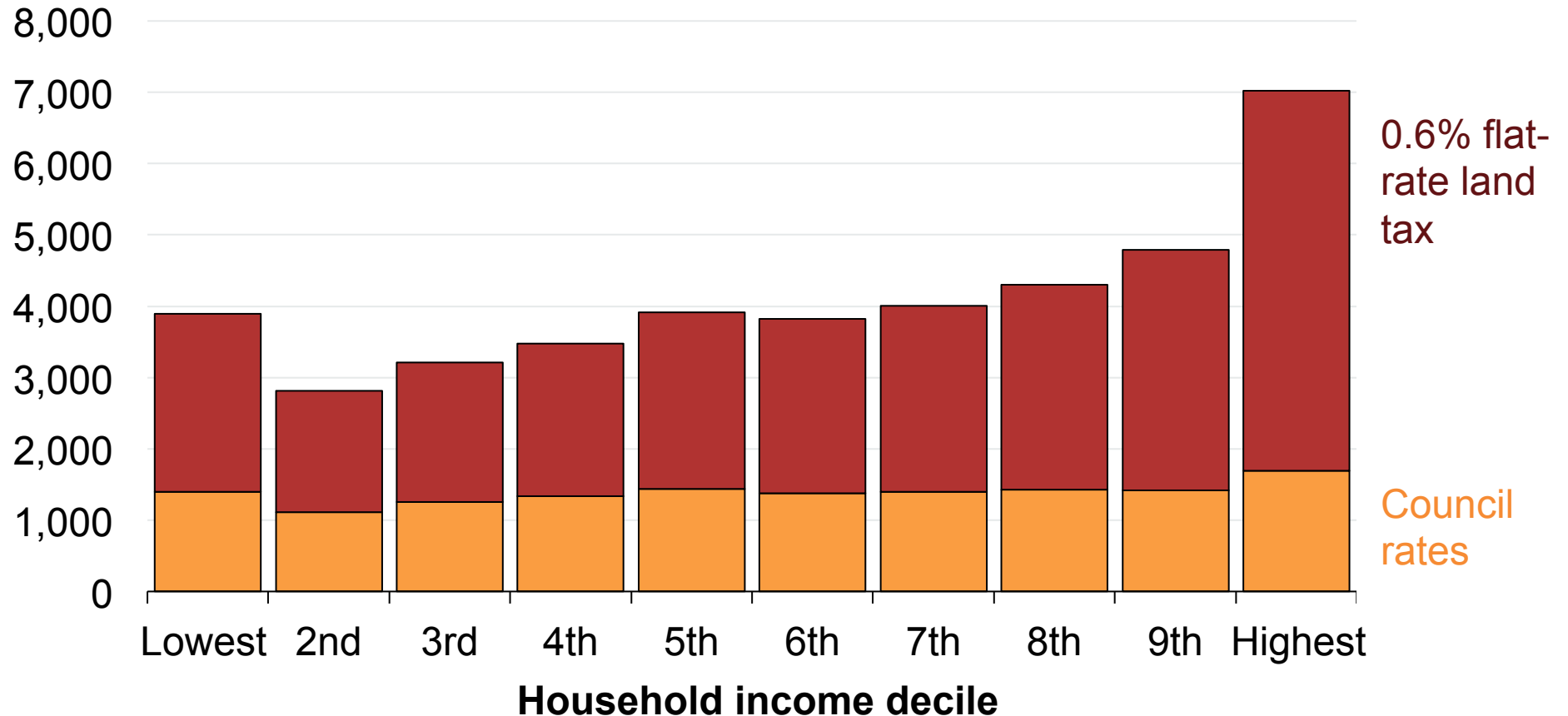
Land tax rate required in fund abolition of stamp duty on property and state land taxes in 2015-16, per cent



Notes: Flat rate land tax applied to the unimproved land equivalent of the council rates property base (i.e. including owner occupied housing and agricultural land) in each state. There is no land tax in the Northern Territory. Excludes any revenue boost from 2nd round economic impacts of the tax. Source: ABS (multiple years); NSW Valuer General (2017); Grattan analysis.

A uniform 0.6% land tax on all residential land would be double the size of council rates paid by homeowners

Property taxes payable by property owners in each income decile \$2014 per household

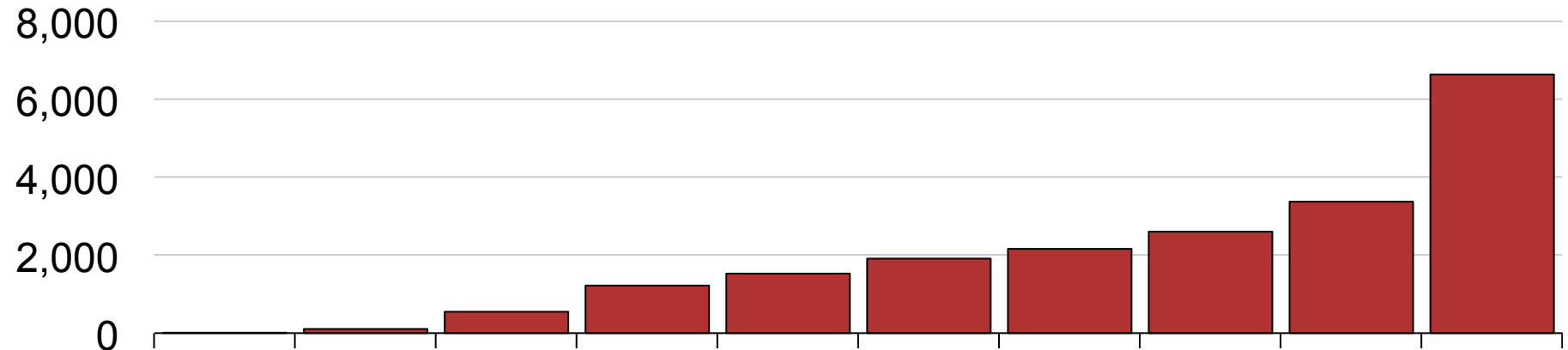


Notes: Average rates and land tax costs are calculated based only on those households within the disposable income decile that would pay the levy; households reporting negative household disposable income and negative net wealth are excluded from the analysis; council rates include all charges, net of rebates, but exclude water charges; deciles are grouped by equivalised disposable (i.e. post tax) income of each household.

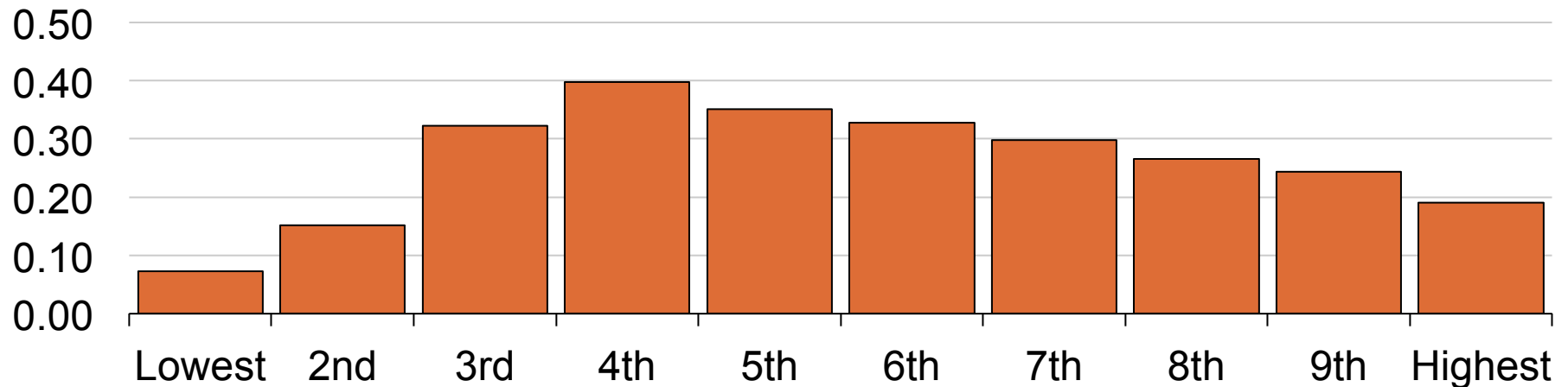
Source: ABS Survey of Income and Housing 2013-14; Grattan analysis.

A uniform 0.6% land tax imposes the highest dollar cost on the wealthy, but the middle feels more pain

Average annual land tax per household, \$ 2013-14



Average annual land tax as a share of net worth, percent

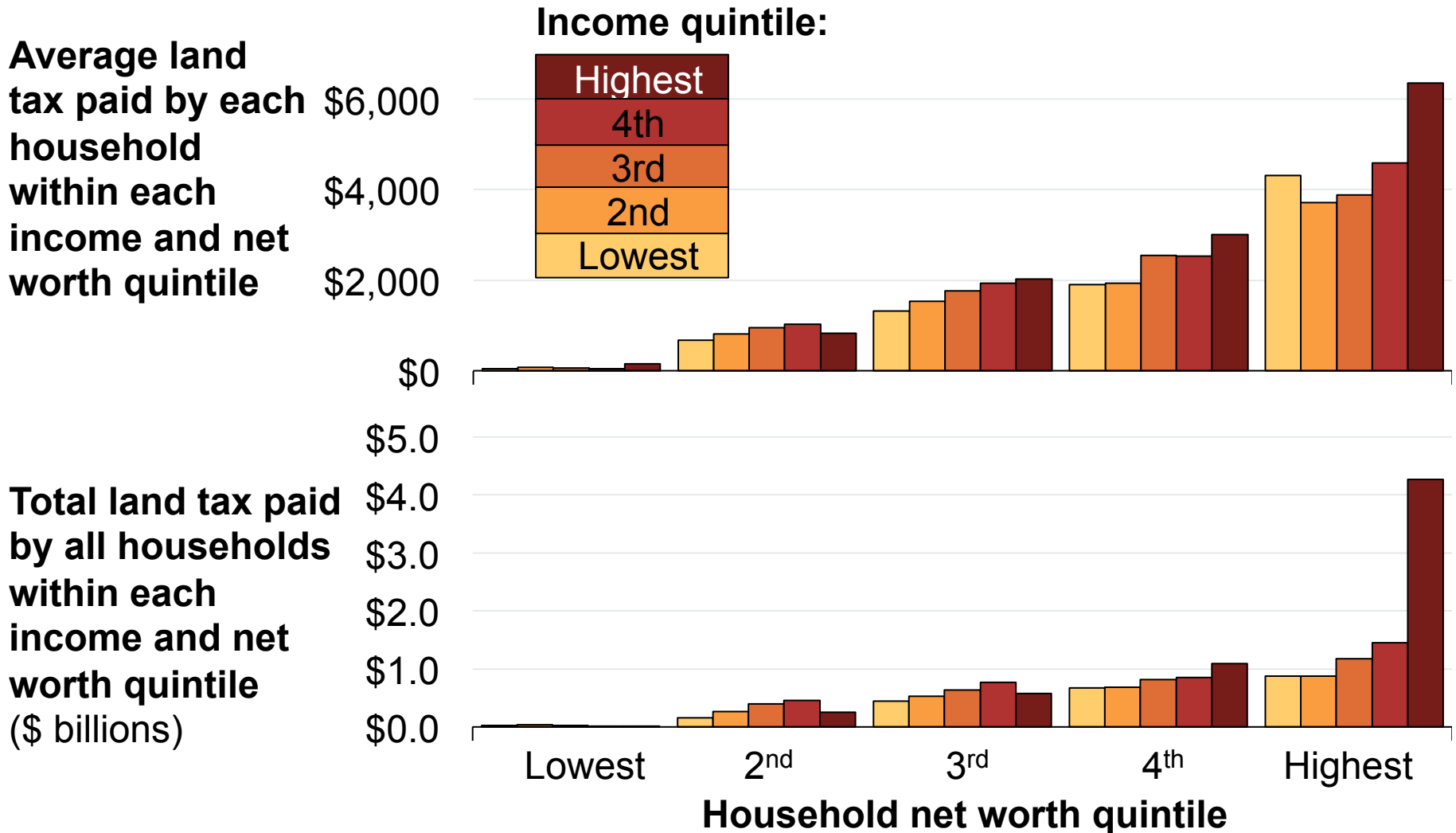


Equivalised household net worth by decile

Notes: Excludes households that report negative household disposable income or negative net worth; deciles grouped by equivalised net worth of each household.

Source: ABS Survey of Income and Housing 2013-14; Grattan analysis.

Distributional impacts of a 0.6% uniform land tax are fairer if both income and wealth are considered



Notes: Households that have reported negative household disposable income and negative net wealth have been excluded from the analysis; quintiles are grouped by equivalised disposable (i.e. post tax) income and net worth of each household. Estimates tax collections reflect only the direct costs paid by households, and ignores land tax paid by firms and other landholding entities.

Source: ABS Survey of Income and Housing 2013-14; Grattan analysis.

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Proposals to swap stamp duty for a broad based property tax have always fallen down in the transition

Any transition from stamp duties to property taxes must overcome three key hurdles:

Revenue stability	<ul style="list-style-type: none">• Stamp duties account for ~27% of states' own source tax revenues• Any temporary decline in state tax revenues will hurt states' headline budget balances even when finance covers the the revenue shortfall
Asset-rich, income-poor households	<ul style="list-style-type: none">• A relatively small number of older asset-rich, income poor households own a lot of property, but lack the income to pay the recurrent property tax each year
Recent property purchasers	<ul style="list-style-type: none">• Risk of "double taxation" for those that recently paid stamp duty on a new home

There are three approaches to switching from stamp duty to a broad based property tax

***Gradual* shift from stamp duty to land tax (ACT approach)**

- Gradually phase down stamp duties, funded by a gradually increasing, revenue-neutral, broad based property tax
- ACT transition is over 20 years (10 years would be better)

***Compulsory* switch to land tax at next sale**

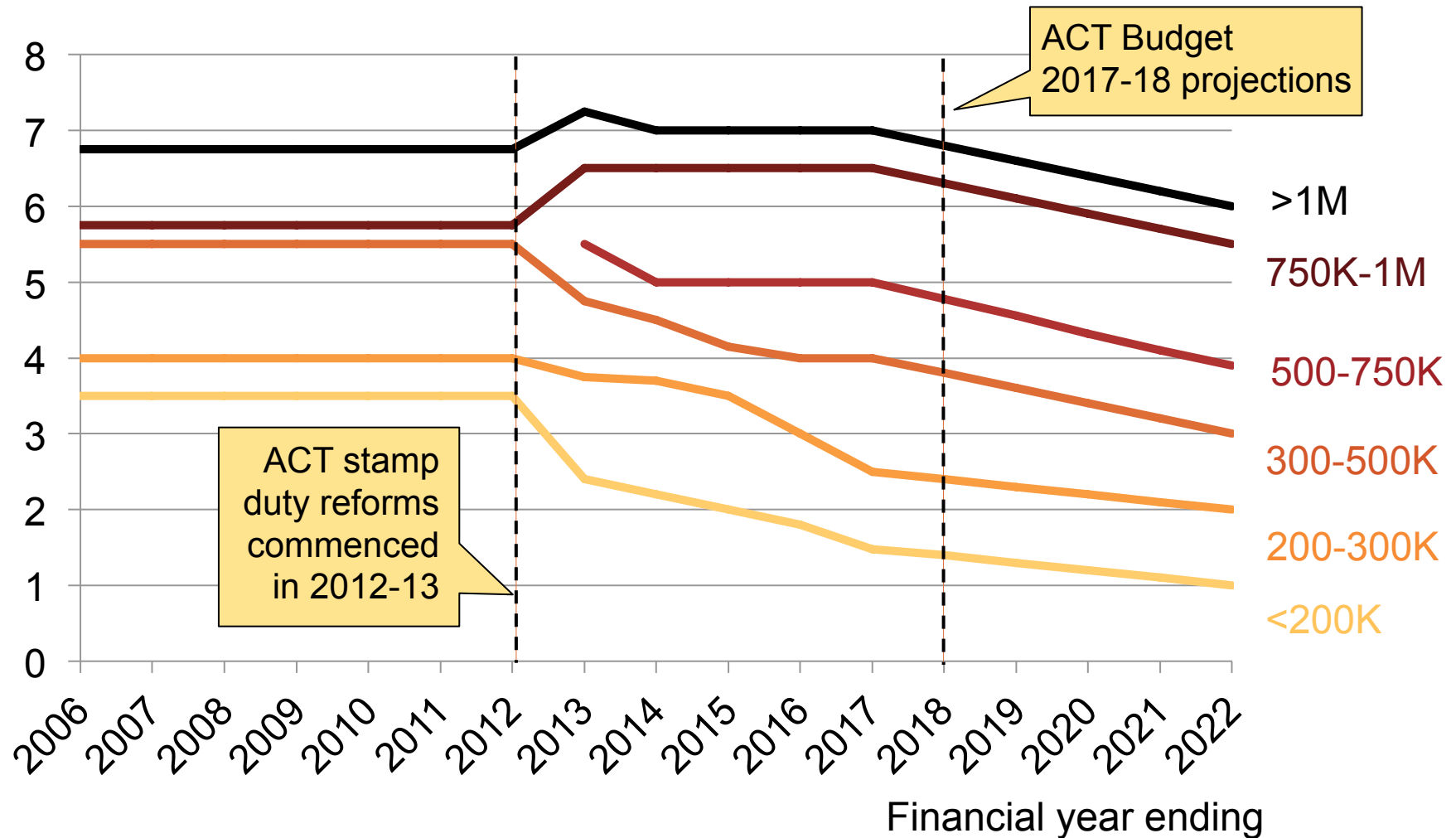
- Stamp duty is abolished entirely on all properties
- Properties become liable for recurrent property tax when next transacted

***Voluntary opt-in* to land tax at next sale**

- New purchasers choose whether they pay upfront stamp duty, or recurrent property tax each year
- Future purchasers of “property tax” properties can’t revert back to paying stamp duty

ACT approach: gradually abolish stamp duties, while making stamp duties and municipal rates more progressive

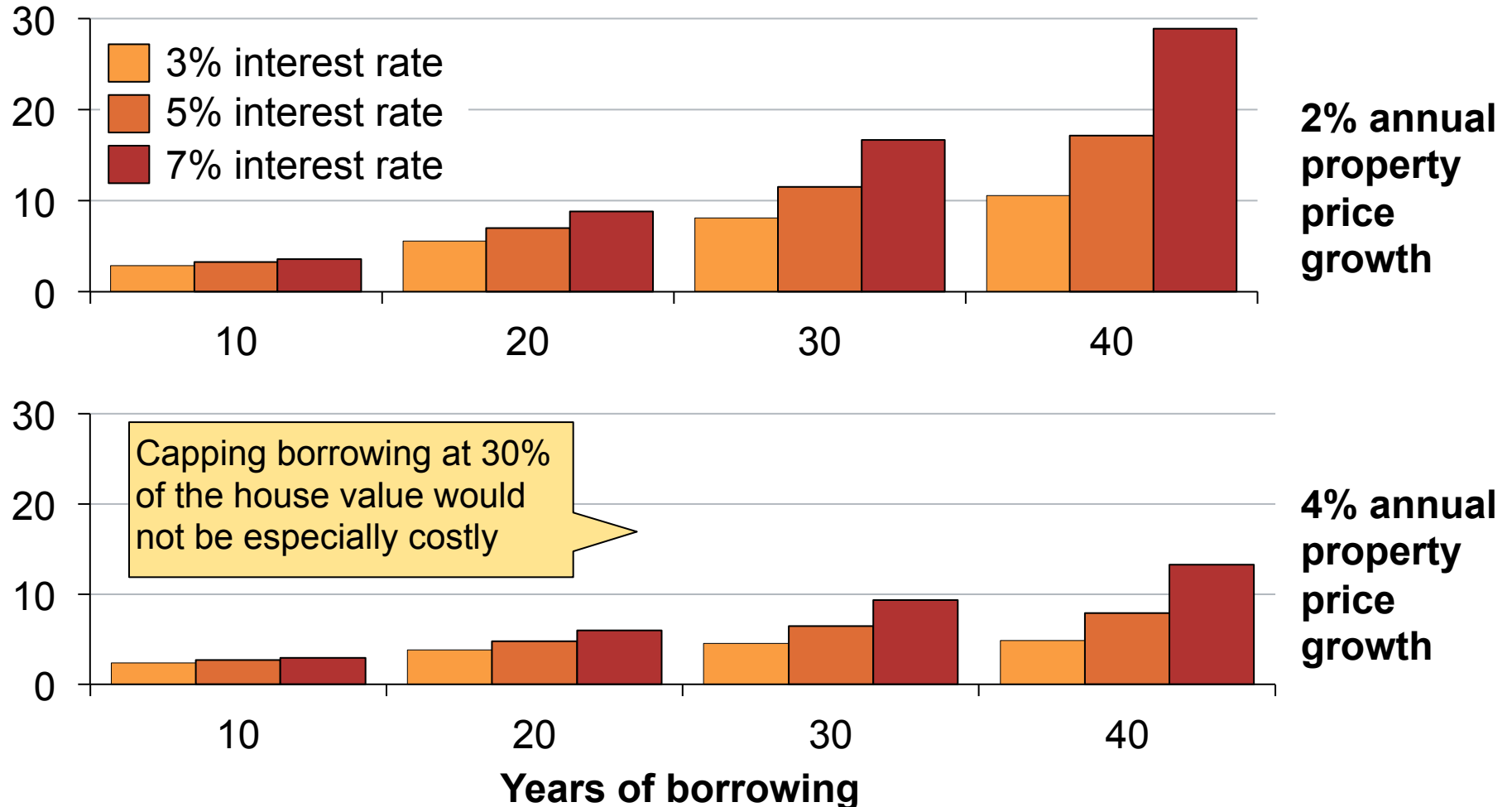
Marginal stamp duty rates on residential property, per cent



Source: Prosper (2016); ACT Revenue Office (2017); ACT Budget Papers 2017-18

Deferring the property tax would be manageable for most retirees

Property tax debt as a share of property value, per cent



Notes: The model assumes a land value to property value ratio of 1:2. The model further assumes a broad based land tax rate of 0.6% of unimproved land values.

Source: Grattan analysis.

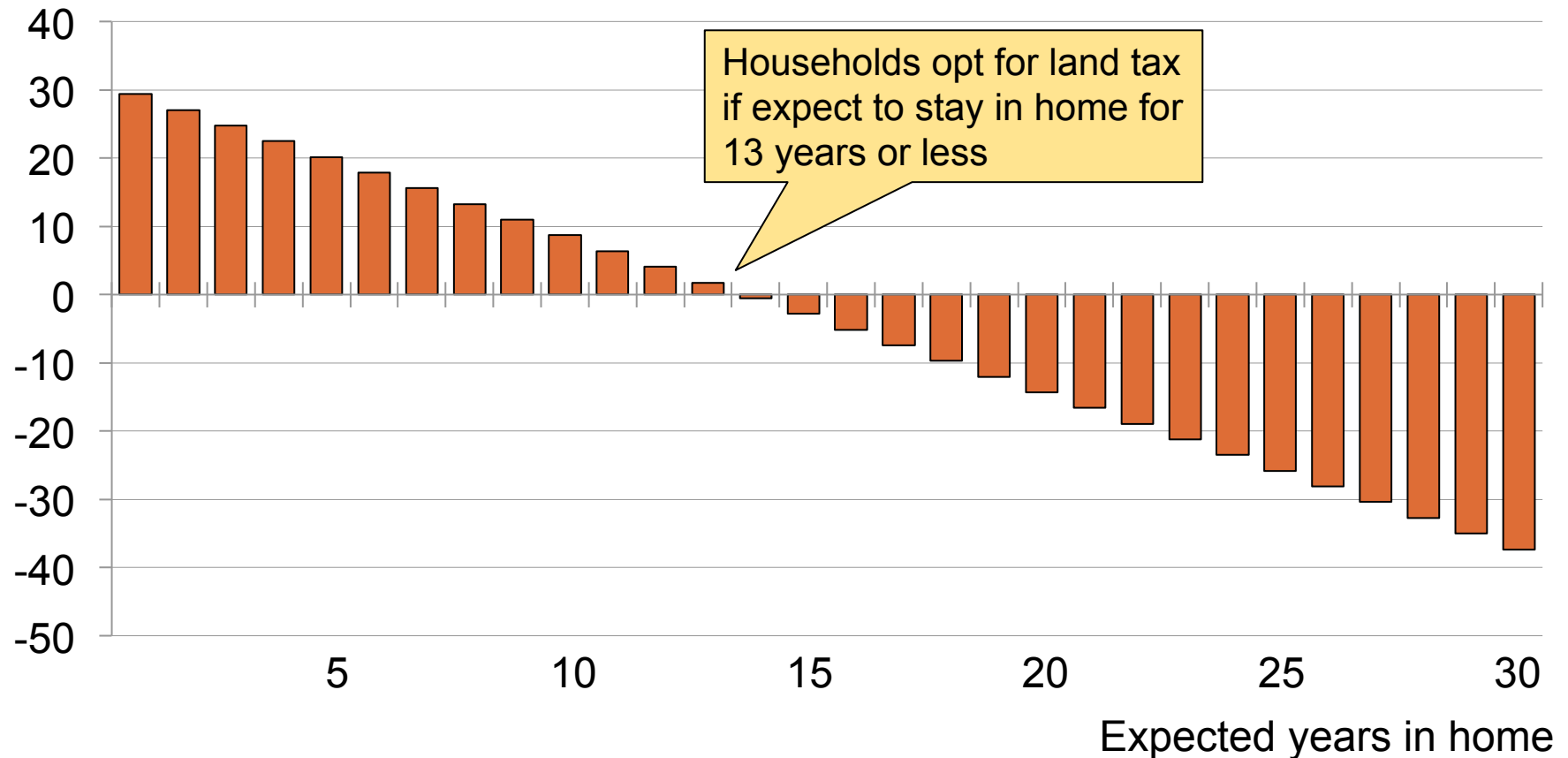
A gradual transition (ACT approach) best balances the competing objectives

Transition model	Pace of switch to land tax	Revenue stability	Asset rich – income poor households	Political difficulty
Gradual shift from stamp duty to land tax (ACT approach)	Full switch within 10-20 years (policy lever)	Maintains tax revenues during transition (but lose flexibility)	All seniors pay <i>some</i> land tax from beginning of transition	Asset-rich, income-poor h'holds can't avoid paying (but can secure as debt against home)
Compulsory switch to land tax at next sale	~70% switch after 20 years* ~90% switched after 40 years* “Lock-in” effects	Cash flow shortfall in transition can be financed, but still hits budget bottom line & must be repaid	A few seniors pay land tax if they downsize, but most don't And big inter-gen transfers	H'holds forced to pay land tax when purchase a home Recent purchasers unaffected
Voluntary opt-in to land tax at next sale	Bulk of properties switch to land tax within 50 years But large number of long-held family homes never switch	Cash flow shortfall hits budget bottom line in short term & must be repaid <i>Permanant funding gap</i> as infrequent sellers always opt for stamp duty (adverse selection)	No senior pays land tax unless they choose to And very big inter-gen transfers	No one forced to pay land tax Can be sold as a “housing affordability” measure as helps some first homebuyers overcome deposit hurdle

Notes: * Likely overestimates pace of switch under compulsory option since assumes all properties are turned over at the average rate.

The opt-in model: purchasers choose whether to pay stamp duty or recurrent property tax

Net present value of financial gains from choosing land tax over stamp duty on median-priced NSW home, \$ thousands

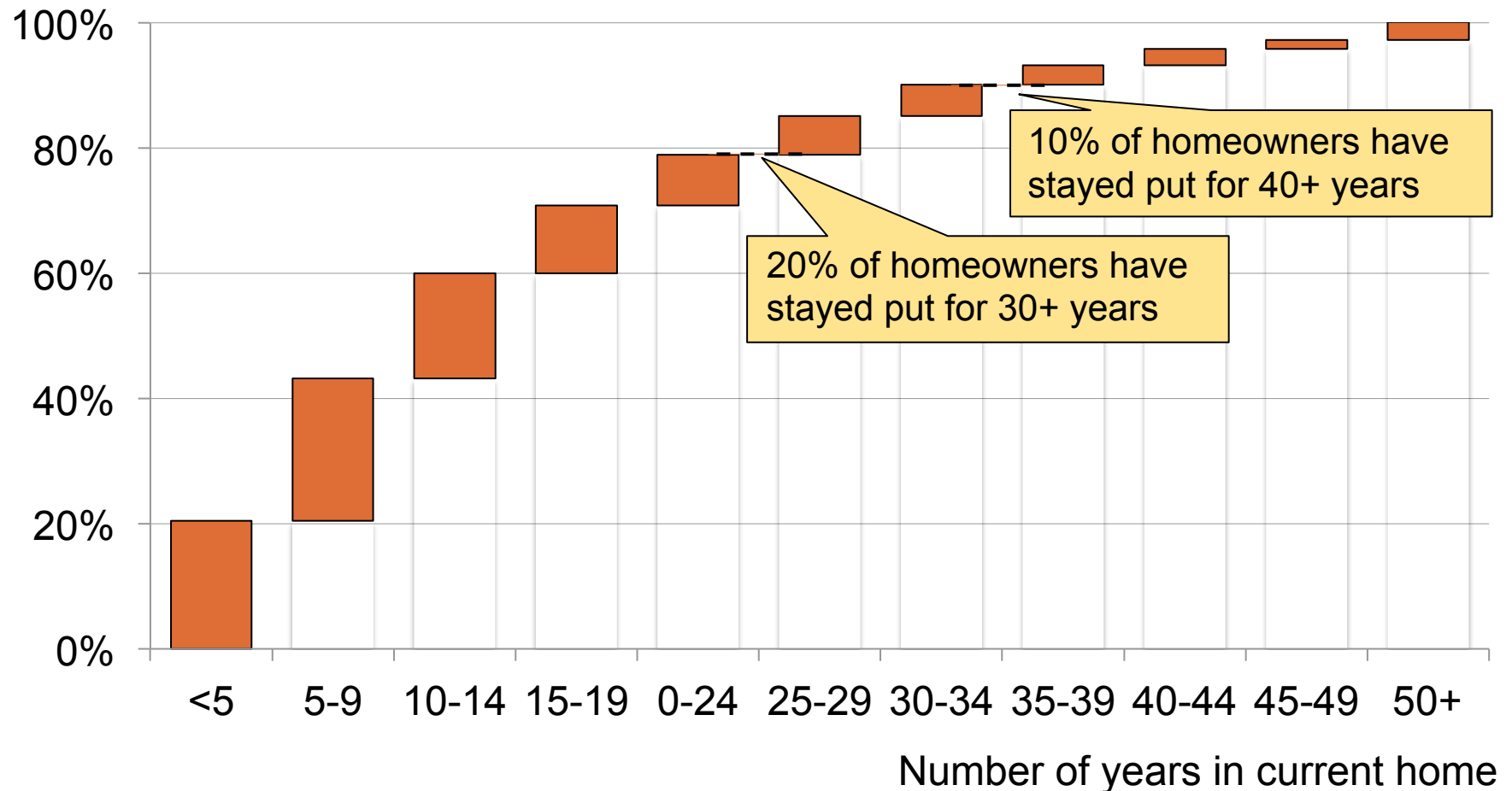


Notes: Based on median-priced Sydney home valued at \$805,000, current NSW stamp duty rate schedule, a 0.6% land tax and assuming that land is 50% of total property value; discount rate and growth in land values of 5%.

Source: Grattan analysis.

Some long-term homeowners will take a long time to transition, will always choose stamp duty

Share of all owner occupied homes by length of tenure, 2013-14



Notes: Number of years in current home is at time of survey, not when sold. Therefore understates average tenure, and distribution of tenures among owner occupiers.

Source: ABS Survey of Income and Housing 2013-14, Grattan analysis.