



EXECUTIVE SUMMARY

Pathways to state property tax reform

Inquiry into pathways to housing tax reform

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Peter Davidson	Australian Council of Social Services
Karen Doran	ACT Treasury
Saul Eslake	University of Tasmania
Glen Hepburn	Department of Treasury and Finance, Victorian Government
Brian Howe AO	University of Melbourne
Caryn Kakas	Department of Family and Community Services, NSW Government
Paul McBride	Department of Social Services, Australian Government
Greg Smith	University of Melbourne Law School
Peter White	Department of Health and Human Services, Tasmanian Government

Executive summary

Reforming state and local government taxes that apply to property can contribute to creating a fairer and more sustainable housing system as well as delivering additional economic and social dividends.

The politics of subnational property tax reform is challenging and requires support and commitment from all levels of government if it is to be realised. Reflecting on these challenges this report proposes a nationally coordinated incremental strategy with clearly defined short, medium and long-term objectives.

- Short-term **administrative reforms**. These include the further integration of state and local property tax collection, enhanced data sharing between state and national revenue authorities and, over time, the establishment of a nationally consistent valuation regime and property register
- The creation, short to medium-term, of a **simpler and fairer revenue neutral transfer duty** regime as a foundation for more substantive reforms. New modelling reveals that a flat 6 per cent transfer duty rate with a carefully designed threshold would result in over 60 per cent of property buyers at the bottom of the price distribution paying less transfer duty.
- A medium to long-term strategy (10–20 years) to **replace transfer duties with a broad-based recurrent property tax**. This report models a range of scenarios using 2015–16 Corelogic data of all residential property in Australia. This analysis reveals that a modest annual property tax of between \$47 and \$130 per annum on median value properties could fund a 10 per cent reduction in transfer duties. This annual property tax could gradually be increased over a period of 10 to 20 years to offset the revenue currently sourced from existing transfer duties on residential property.

The incremental yet nationally coordinated reform strategy with clear long-term objectives outlined in this report provides a practical pathway to reform Australia's subnational property tax regime which will create a more efficient and equitable housing outcome.

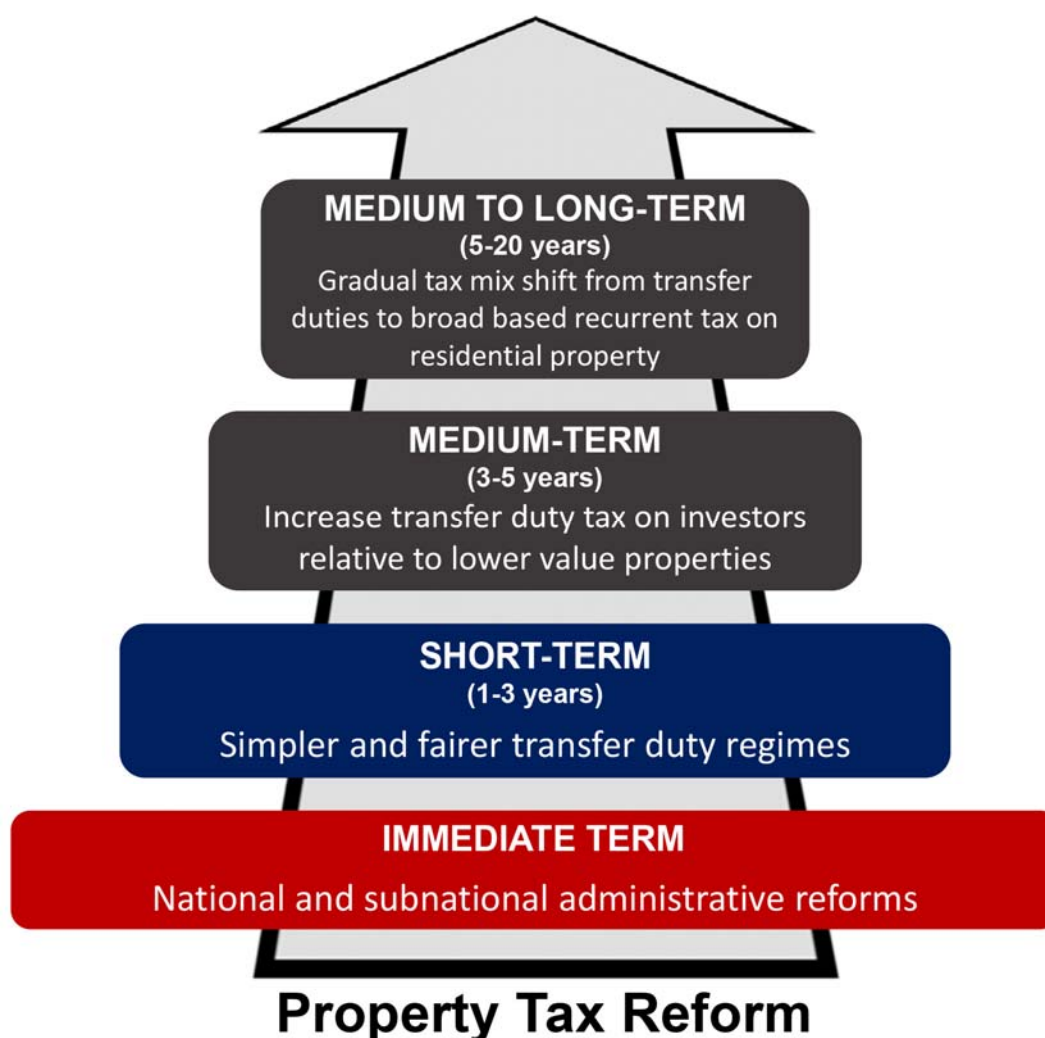
Key findings

This report has been designed to develop a pragmatic pathway to subnational housing tax reform. In addition to the specific policy proposals, the report provides a commentary on the political and administrative challenges that can undermine any reform initiative. These challenges are especially important in the case of subnational property tax reform where a lack of intergovernmental coordination has been identified as a major barrier to policy change.

The report highlights the need to set national reform priorities and to develop a coordinated approach to property tax reform while still granting state and local governments the right to determine policy settings and the trajectory of reform.

Having established the need to set long-term goals for reform, the report identifies four stages of a subnational property tax reform agenda to achieve these goals (see Figure 1 below).

Figure 1: A pathway to subnational property tax reform



Source: Authors.

- 1** The immediate focus is on implementing administrative reforms designed to provide a foundation on which future property tax reforms can be built:
 - developing nationally consistent valuation methods for residential property
 - establishing a national register of property valuations and ownership
 - further integration of state and local tax collection and enhanced data sharing between all levels of government.
- 2** In the short term, the focus should be on creating a simpler and fairer transfer duties regime as a foundation for more substantive reform. The benefits of establishing a simplified transfer duty regime identified in the report include:
 - that a simplified transfer duty regime provides a foundation for more substantive reforms designed to address housing policy objectives

- that a single rate transfer duty with a carefully designed duty-free threshold applied to all residential property transactions would cut transfer duty for a majority of home buyers with the greatest benefits accruing to buyers of low value properties (see Table 1 below).
- modelling of the distributional implications by property value for each state demonstrates how a simplified transfer duty regime can be applied across diverse property markets
- building on this simplified framework by presenting modelling across a range of options shows that the transfer duty rate and threshold can be adjusted to determine the incidence of the transfer duty burden.

Table 1: Tax-free thresholds and break-even points for a flat transfer duty rate of 6 per cent

State	Median property price (\$)	Threshold		Break-even points	
		Value (\$)	Proportion of median (%)	Value (\$)	Purchasers (%)
NSW	653,697	245,529	37.6	682,500	62.3
VIC ¹	635,872	110,905	21.1	303,000	17.6
QLD	424,966	220,983	52.0	468,000	58.6
WA	481,605	213,351	44.3	546,000	63.3
SA	381,059	127,274	33.4	397,500	61.8
TAS	283,886	143,078	50.4	327,000	60.6

Source: Authors' own calculations based on CoreLogic data.

¹Note: All properties below the break-even point in a given state would pay less transfer duty relative to the current regime. As explained in greater detail in Chapter 6, the Victorian case is complex due to the interaction of PPR concessions.

The following two subsequent goals for subnational property tax reform will also contribute to creating a fairer and more sustainable housing system.

3 A medium-term shift in the mix of transfer duties:

- This element of the overall reform strategy focuses on shifting the tax incidence of transfer duties on residential property from owner-occupiers purchasing lower value properties toward investors and those purchasing high-value properties.
- Shifting the costs incurred by transfer duties from owner-occupiers to investors will help meet housing policy goals by dampening demand for investment properties and increasing home ownership rates. Because the quantum of transfer duties raised is unchanged under this scenario, the reforms are not dependent on the states introducing a new broad-based property tax.

4 A long-term pathway to a broad-based recurrent property tax:

- The report concurs with the significant body of research which finds that replacing property-related transfer duties with a broad-based recurrent property tax would contribute to housing policy goals and deliver a range of economic and social dividends.
- The report highlights the political barriers to a transfer duty to property tax transition and recommends a nationally coordinated incremental approach in which broad-based state-level residential property tax is gradually increased to fund the abolition of transfer duties over a 10 to 20 year period. This 'phase out, phase up' model is similar to the approach that has already been adopted in the ACT.

- The recurrent residential property tax should be levied on the same base as local government rates using a capital improved value, highest and best use (CIV + HBU) method. The administrative reforms outlined above will enable the effective implementation of this new residential property tax. Existing state land taxes, as they are applied to residential investment properties, should be integrated into the broad-based property tax.
- Detailed modelling presented in this report (see summary in Table 2 below) suggests that an annual property tax of between \$47 and \$130 per annum for a median value dwelling would be required to reduce a reformed transfer duty by 10 per cent (e.g. from 6.0% to 5.4%).
- With appropriate deferral provisions, this tax could gradually be increased to fund further reductions in transfer duties.
- Despite the benefits of reform, the report acknowledges that the implementation of a new, broad-based tax on households will be challenging and will only be achievable if the wider benefits for housing affordability, intergenerational equity and economic efficiency are widely promoted.
- The Commonwealth Government therefore has a key role to play in coordinating and supporting subnational housing tax reform. In addition to providing national leadership the Commonwealth can provide administrative support, incentive payments and eliminate any disincentives associated with introducing a state-level broad-based property tax.

Table 2: Recurrent property tax rate required to fund 0.6 per cent reduction in transfer duty rates and annual property tax paid on median value properties, all states

State	Threshold (baseline ¹ reform, 6 per cent rate)	Required rate of recurrent property tax to reduce transfer duty rate by 0.6 percentage points.	Median (\$)	Annual recurrent property tax paid on median-priced property (\$)
NSW	245,529	0.0317	653,697	129.24
VIC	110,905	0.0306	524,872	126.64
QLD	220,983	0.0383	424,966	78.12
WA	213,351	0.0248	481,605	66.61
SA	127,274	0.0342	381,059	86.88
TAS	143,078	0.0335	283,886	47.28

Source: Authors' own calculations based on CoreLogic data.

¹Note: The 'baseline' reform scenario is described more fully in Chapter 4. It involves applying a 6 per cent transfer duty on residential property above a specific duty-free threshold (see above). The threshold has been calculated for each state to ensure quantum of revenue raised equals that raised by the 2015–16 schedule in a particular state.

Policy reform process

The potential benefits of subnational property tax reform, both in terms of improving housing outcomes and its capacity to deliver more general economic and social dividends, are well understood. This report documents and analyses key political barriers to reform before presenting a reform agenda that balances short-term political imperatives with longer term policy goals.

Fiscal and market objectives

A major political barrier to tax reform for governments is the fiscal impacts of revenue changes and distributional consequences for households which have the potential to create political difficulties or mobilise taxpayer and stakeholder resistance to government policy. The reforms presented in this report give close consideration to these issues, and are designed to minimise the risk of significant budget or market disruption. Objectives include:

- a revenue neutral reform pathway for each of the states
- a layered reform framework with inbuilt flexibility designed to reflect and respond to current government policy environments, and minimise political disruption or adverse market consequences—for example, the incremental reform strategy advocated in this report will enable governments to avoid making sudden policy changes during periods of high market volatility
- enhancing the fairness of the property tax system over the medium to long-term by reducing the relative transfer duty paid by purchasers of low value properties
- minimising the impact of tax redistribution by ensuring that under almost any scenario most property owners (and would-be owners) would be better off relative to the status quo; while reflecting the broader goals of property tax reform and ensuring that the majority of tax increases falls on the owners of higher value and/or investment properties
- contributing to housing affordability, residential mobility and the efficiency of the national tax system by replacing transfer duties on residential properties with a broad-based recurrent property tax.

A national strategy to address housing affordability

The taxation of housing and housing-related income is only one factor contributing to poor housing outcomes for a growing number of Australians. Given the complexities of housing markets, a national approach that includes all levels of government and key stakeholders will be required if reform is to be achieved. The challenges to achieving the political cooperation and coordination required may be formidable, but there are historic precedents, such as the introduction of the National Competition Policy in the 1990s.

The steps required to reform the subnational property tax arrangements include:

- adopting common valuation methods, joint administration and data sharing
- securing a commitment from the Commonwealth Government to facilitate reform and redistribute some of its economic dividends
- establishing a credible intergovernmental forum to facilitate deliberation and joint decision-making.

Establishing a commitment to high-level objectives including administrative reforms

The prospects of reform will also be enhanced if state and national leaders commit to achieving high level goals as a national priority. These goals will be challenging, but evidence gathered for this report suggested that community concerns about housing access and affordability are growing. The broad direction of housing policy can no longer be shaped by narrow concerns about the distributional equity of tax policy changes or their likely impact on property values. High-level objectives include:

- promoting the wider community benefits of more accessible and sustainable housing for all Australians in national political discourse

- focusing on actions for which there is multi-party support—this report demonstrates that some structural and administrative reform is possible without significant redistribution between households
- adopting a staged and gradual approach to those reforms that have distributional consequences and only once the broad principles of reform are accepted.

Institutionalising a pathway to reform

Whether there is a nationally coordinated approach to reform or states are incentivised to act unilaterally, any long-term reform agenda must be institutionalised. Governments have to set and report against regular targets and develop a clear framework for reviewing progress and adapting to changing circumstances. This has been the approach adopted in the ACT. Reform pathways include:

- beyond establishing an intergovernmental forum to promote reform, individual governments need to make clear commitments to reform including short, medium and longer-term targets
- reform progress should be evaluated regularly and a clear framework for reviewing reform strategy must be established—specifically, governments must commit to clear timeframes for implementing administrative reforms, simplifying transfer duty bases and starting the transfer duty to land tax transition
- ideally this monitoring embraces a nationally coordinated effort.

The incremental and staged strategy proposed in this report represents the most pragmatic pathway to subnational tax reform. The risk is that governments' priorities will change and they won't achieve prior commitments. Institutionalising reform by implementing the processes and procedures described above offers a feasible political strategy to ensure that long-term policy objectives are achieved.

The study

This study is part of a wider AHURI Inquiry into pathways to housing tax reform. The study has two elements—a review and empirical analysis, each with distinctive methods. The report begins with an overview of the study in Chapter 1 which sets out the reasons for the study in the context of the broader Inquiry and outlines the methodology used to conduct the review and on which the modelling of the reform proposals is based. The first element of the study, the review, follows in Chapter 2 and 3. Chapter 2 sets out in detail the existing subnational residential property tax regime in Australia and in particular investigates these in reference to historical and current policy directions, including current reform proposals. Chapter 3 builds on this detail and establishes its relevance to the study from a political economy perspective. In this context, the chapter sets out the rationale for the short, medium and long-term reform strategies presented.

Chapters 4 to 6 provide in-depth descriptions of the empirical analyses and their findings, with the chapters structured to reflect the layered and incremental approach to reforms. Chapter 4 starts with the foundations of reform found in addressing administrative inefficiencies in state and local land taxes. Chapter 5 builds on these reforms and develops revenue neutral strategies for a simpler and fairer transfer duty regime for residential property. Together these provide a strong foundation for comprehensive reform, outlined in Chapter 6 through a series of pragmatic long-term strategies for progressive transfer duty reforms as well as the mix between transfer duties and recurrent property tax. Chapter 7 concludes by setting out the tax design advantages and contributions of the proposed reform in current policy context.

The reform proposals presented in the report are based on an extensive review of the relevant technical and policy literature as well as coverage of associated political debates. Reform

proposals have been discussed with a range of stakeholders over the period of the study. In all cases proposals seek to balance political and policy considerations with a view to developing a politically viable pathway to reform.

The empirical analysis of the distributional and revenue implications of the reform proposal is informed by new modelling using Corelogic's database of all residential dwellings in Australia. This is arguably the most comprehensive and contemporary dataset on residential property in Australia and this study has used data from 2015–16 on residential dwelling sales as well as data on the value of all residential dwellings using their most sophisticated automated valuations. For the purposes of modelling the 9.6 million dwellings in the Corelogic dataset, dwellings have been grouped by property value sets while differentiating between houses and units.

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