

July 2015

## Property Taxes

John Daley and Brendan Coates



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This working paper was written by John Daley, CEO and Brendan Coates, Senior Associate, Grattan Institute. Danielle Wood, James Button, Hugh Parsonage, Priyanka Banerjee and Rebecca Joiner provided extensive research assistance and made substantial contributions to the report.

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The opinions in this working paper are those of the authors and do not necessarily represent the views of Grattan Institute's founding members, affiliates, individual board members, reference group members or reviewers. Any remaining errors or omissions are the responsibility of the authors.

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## Summary

Grattan Institute's working paper, *Fiscal Challenges for Australia*, published in July 2015, shows how Commonwealth and state government budgets are under pressure. The Commonwealth Government has run deficits for six years, largely because its spending on older households has increased rapidly.

State government spending on health and education and other vital areas is also growing faster than GDP. State revenues are threatened by the Commonwealth's decision in the 2014-15 Budget to ease some of its own budget pressures by substantially reducing promised funding to the states for hospitals and schools. Recent state government budgets provide no insight into how they will respond to the looming funding gap.

In a series of papers over the next two months, Grattan Institute will set out four priority reforms for repairing Commonwealth and state revenues. This paper shows how a broad-based property levy could help repair state government revenues without damaging the economy or the most vulnerable in our society.

Property taxes – which are levied on the value of property holdings – are the most efficient taxes available to the states. If they are designed well and applied broadly, property taxes do little to change incentives to work, save and invest. Unlike capital, property is immobile – it cannot shift offshore to avoid higher taxes. Concerns about the risks of multinational tax avoidance, the increasing mobility of capital around the world, and the increasing value of residential property relative to incomes, should make property taxes a priority in any tax reform.

The property tax base is large and growing fast. A low-rate, broad based property levy using the council rates base could raise about **\$7 billion a year** for state and territory governments through an annual levy of just \$2 for every \$1000 of unimproved land value, or \$1 for every \$1000 of capital improved property value.

The costs to property owners would be manageable. A homeowner would pay a levy of \$772 a year on the median-priced Sydney home, valued at \$772,000, or \$560 a year on the median-priced Melbourne home valued at \$560,000. People with low incomes and no wealth would pay nothing. Low-income retirees with high value houses could defer paying the levy until their house is sold.

Higher property taxes could also be used to fund the reduction and eventual abolition of state stamp duties on property. Stamp duties are among the most inefficient and inequitable taxes available to states, and their revenues are inherently volatile. Although abolishing stamp duties is not the focus of this report, shifting from stamp duty to a broad-based property tax would provide a more stable tax base for states, spread the tax burden more fairly, and add up to \$9 billion annually to GDP.

Calls to reform property taxes are not new. Property taxes are often unpopular precisely because they are highly visible and difficult to avoid. Yet they are also efficient and fair, and don't distort behaviour. Greater use of property taxes would be the best way for state governments to meet the growing pressures on their budgets.

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## 1 State government budgets face growing pressures

The Commonwealth is not the only government under significant budgetary pressure. Grattan Institute's *Fiscal Challenges for Australia* report, published in July 2015, shows that all state governments face growing budget pressures beyond the four-year forward estimates.

State government spending on health and education and other vital areas is growing faster than GDP. Most states significantly increased infrastructure spending over the last few years, and largely funded this through borrowing, so that future budgets must spend more to service the debt and depreciation.

Other pressures are threatening state revenues. Relatively constant revenues over the last decade may have masked increased vulnerabilities in individual revenue sources. In particular, untied revenues from the GST fell over the decade.<sup>1</sup> These falls were offset by rises in mining royalties and small increases in property and payroll taxes. Yet state royalties are now falling as commodity price falls outweigh volume increases.<sup>2</sup> As a result of GST distributions, all states effectively benefited from the rise in royalties, and all will suffer if they fall.

State revenues are also threatened because the Commonwealth has eased some of its own budget pressures by substantially reducing promised transfers to the states for hospitals and schools. The Commonwealth's decision to no longer contribute to growth in real spending per person in these areas beyond 2017-

18 presents the states with a potential \$16 billion revenue shortfall by 2024-25, and a big problem.<sup>3</sup> If spending per person continues to grow faster than inflation, then it is unlikely that other areas can be cut enough to make up the difference.

Recent budgets provide no insight into how state governments will respond to the looming funding gap. Most have shown a lack of enthusiasm for new revenue measures or substantive tax reforms.<sup>4</sup>

Hoping for the best is not a budget management strategy: it simply shifts the costs and risk of budget repair onto future generations. More active policy measures to achieve budget repair are required. While containing spending will be important, both the politics of budget repair and the sheer size of the budget gap mean that governments are unlikely to be able to restore budgets to balance without also boosting revenues.

Sustainable budgets depend on tough choices, not hope. To ensure that future generations do not have to foot the bill for today's inaction, these choices must be made.

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<sup>1</sup> Daley and Wood (2015), p.19

<sup>2</sup> State royalties are typically value-based; they are not simply charges based on volume.

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<sup>3</sup> Daley and Wood (2015), p.18

<sup>4</sup> While South Australia has announced the abolition of stamp duties on commercial property following the release of a comprehensive discussion paper on State Tax Reform (DTF SA (2015)), it hopes to fund this largely through an increased share of GST revenues (Government of South Australia (2015b)).

## 2 Property tax reform should be the states' priority

Greater use of property taxes is the best way for the states to meet their budget challenges. Property taxes – which are levied on the value of property holdings – are the most efficient taxes available to the states. If they are designed well and applied broadly, they do little to change incentives to work, save and invest.

The property tax base is large and growing fast. A low rate broad property levy using the council rates base could raise about **\$7 billion a year** for state and territory governments through an annual levy of just \$2 for every \$1000 in unimproved land value, or \$1 for every \$1000 in capital improved values. Although it would have marginally more impact on economic decisions, a levy on capital improved values would still have low economic costs, and may be simpler to implement since capital improved property values are easier to track.

A broad-based property levy might provide a path to longer-term reform of taxation on property, by funding the reduction and eventual abolition of state stamp duties for property. The Commonwealth Treasury nominates stamp duty as Australia's least efficient tax.<sup>5</sup> Stamp duties deter people from buying and selling property, and therefore can prevent them moving closer to jobs or upsizing and downsizing homes as their needs change. Stamp duties raised \$16 billion for the states in 2013-14.<sup>6</sup> Their costs to the economy and jobs are large.

The ACT is phasing out stamp duty over 20 years, and replacing the revenues with higher municipal rates.<sup>7</sup> South Australia plans to abolish stamp duties on commercial property, but has ruled out extending land taxes to owner-occupied housing. The government seems to be relying on higher GST revenues in order to abolish stamp duty, rather than relying more on efficient state taxes.<sup>8</sup>

Once a broad-based property levy becomes large enough, it might also be possible to phase out land taxes as currently designed. The states raised \$6.4 billion from land taxes in 2013-14, but carve outs from the land tax base (via exemptions for owner-occupied housing), thresholds, and progressive rates make them much less efficient taxes than they should be.

Property tax reform would also support reforms to the fiscal arrangements of the Australian federation. These reforms are under consideration through the Commonwealth's *White Paper on the Reform of the Federation* process. A broad-based property levy would boost states' revenues and give them greater control over their own destinies, with minimal drag on their economies. Other options to increase revenues include sharing in Commonwealth income tax receipts, or broadening or increasing the GST. Relative to these options, a broad-based property levy would do more to increase state government responsibility for funding their own spending.

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<sup>5</sup> Treasury (2015)

<sup>6</sup> ABS (2015b).

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<sup>7</sup> Treasury ACT (2012), p.21; Treasury ACT (2014), p.229.

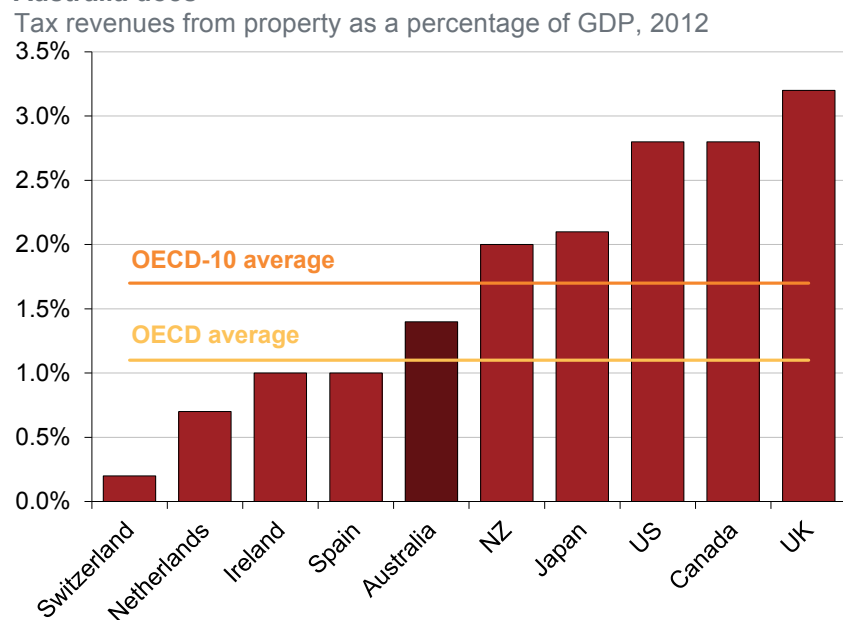
<sup>8</sup> Government of South Australia (2015a); DTF SA (2015).

### 3 Property taxes can generate substantial revenues

#### 3.1 Australian property taxes are relatively low

Australian governments derive far less revenue from property taxes as a share of GDP than they should. Australia’s property tax take is far below that of some comparable countries (Figure 1).

**Figure 1: Some countries raise more from property taxes than Australia does**

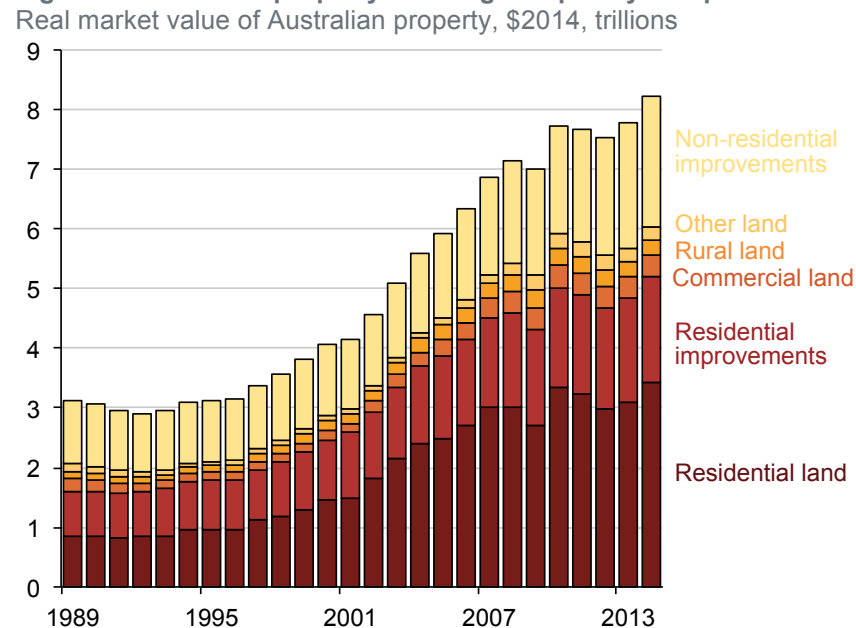


Note: Immobile property includes both land and buildings; recurrent taxes on immovable property includes taxes levied regularly in respect to use or ownership of immovable property, and excludes transaction taxes on property such as stamp duty.  
Source: OECD (2014); Grattan analysis.

#### 3.2 The property tax base is large and growing fast

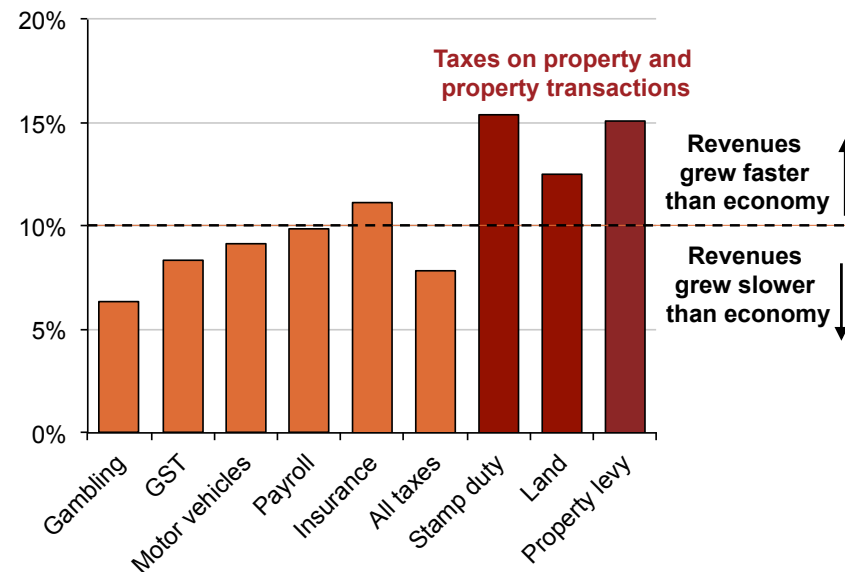
Property is potentially a very large tax base, worth \$8.3 trillion in June 2014. All Australian land was valued at \$4.3 trillion, and buildings and other improvements to land are worth \$4 trillion, with residential land and improvements worth about two-thirds of the total (Figure 2).

**Figure 2: Australian property values grew quickly this past decade**



Notes: 'Residential improvements' consists of the value of the stock of dwelling construction, 'Non-residential improvements' consists of non-dwelling construction; historical figures are inflated by the Consumer Price Index to \$2014.  
Source: ABS (2014b); ABS (2014d); Grattan analysis.

**Figure 3: Property taxes are one of the few ‘growth taxes’**  
 Percentage change in tax revenue for each 10 per cent increase in national GDP, 1990-91 to 2013-14, per cent



Note: ‘Property levy’ shows the revenues that would have been raised with a broad-based property levy of 0.2 per cent applied to unimproved land values had it been in place since 1990-91; GST is for the period since its introduction in 2000-01 to 2013-14.  
 Source: ABS (multiple years); Grattan analysis.

Land values tend to rise at least as fast as GDP. Over the past 25 years land values almost tripled, growing much faster than GDP (Figure 2).<sup>9</sup> Over the last 25 years, property taxes grew faster

than other state taxes, and faster than the GST since it was introduced in 2000 (Figure 3).<sup>10</sup>

Over the longer term, property values are likely to keep rising, even if the pace of growth is slower than over the past two decades. Some of the growth over the last two decades resulted from the long-term decline in interest rates. In future, property values, and therefore revenues from property taxes, may grow more slowly.<sup>11</sup> In the long run, property prices are likely to at least keep pace with incomes, and may well rise faster, depending on population growth, household size and whether supply of new properties keeps pace with the growth in demand.<sup>12</sup>

Revenues from property taxes tend to be less volatile than stamp duties on property sales (Figure 4). State Treasurers dislike volatility because it makes budgeting more complex. Volatility in property tax revenues can be reduced by levying taxes on the average of recent property valuations.<sup>13</sup>

<sup>9</sup> RBA (2014), p.6

<sup>10</sup> For more detailed analysis of historical trends in individual state tax revenue growth and revenue volatility, see Appendix A.

<sup>11</sup> RBA (2014), p.7

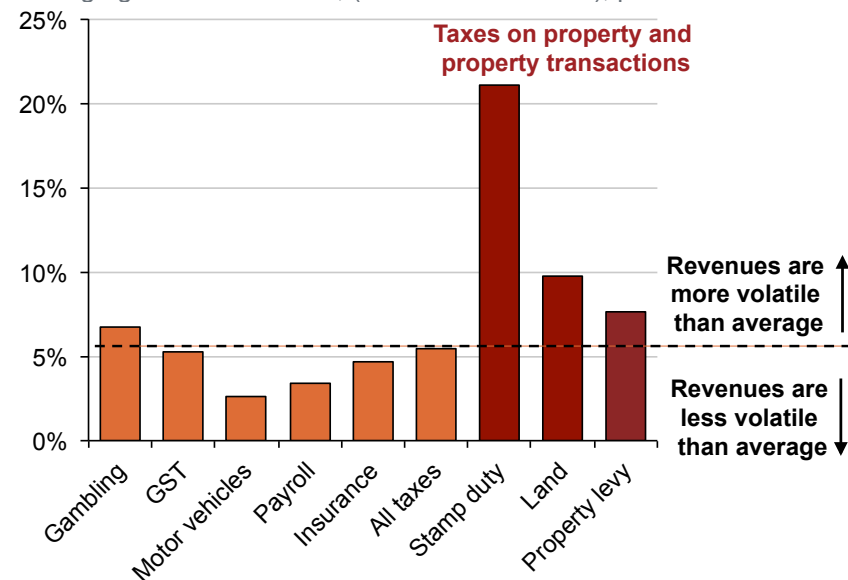
<sup>12</sup> Ibid. p.6

<sup>13</sup> Some states already use this approach to smooth land taxes and council rates.



**Figure 4: A broad based property tax would generate more stable revenues than other property taxes**

Standard deviation between annual revenue growth and long run average growth in Australia, (1990-91 to 2013-14), per cent



Note: 'Property levy' shows the revenues that would have been raised with a broad-based property levy of 0.2 per cent applied to unimproved land values had it been in place since 1990-91; GST is for the period 2000-01 to 2013-14 only, but displays similar volatility compared to state taxes assessed over this shorter period. Source: ABS (multiple years); Grattan analysis.

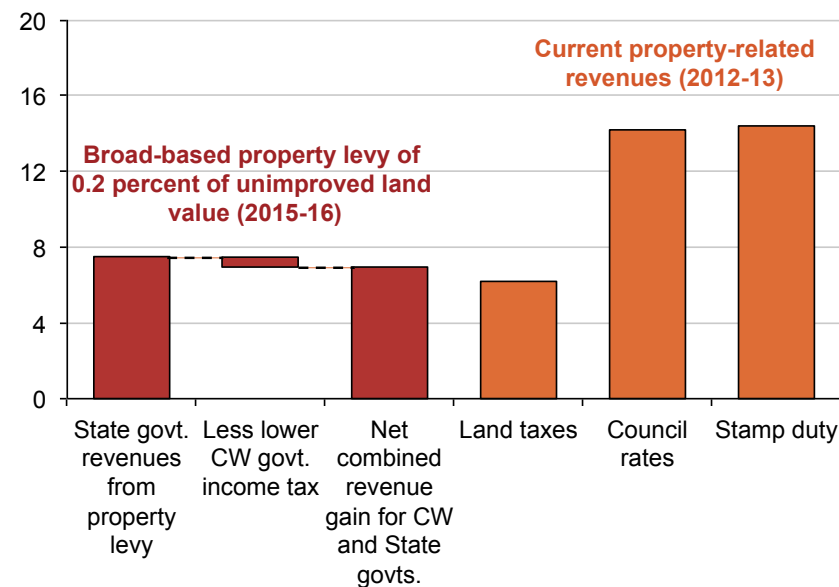
### 3.3 Potential revenue from a broad-based property levy

A levy applied to the existing council rates base would generate substantial extra revenues for states. A relatively modest property levy, charged at a rate of \$2 for every \$1000 of unimproved land value, could raise about \$7 billion a year from 2015-16 (Figure 5). A similar amount would be raised by a property levy charged at \$1

for every \$1000 of capital improved property value.<sup>14</sup> In comparison, state land taxes raised \$6.4 billion in 2013-14.<sup>15</sup>

**Figure 5: A property-based levy could generate significant revenues from a modest rate**

Forecast annual levy revenue and 2013-14 actual collections, \$ billions



Notes: Property levy revenue forecasts are for 2015-16, whereas land tax, council rates, and stamp duty revenues reflect 2013-14 collections. ABS land values for each state in the national accounts may differ, albeit not materially, from state Valuer-General figures due to different approaches, especially for residential land: see ABS (2014c), p. 419. Source: ABS (2014b); ABS (2014e); ATO (2014); Grattan analysis.

<sup>14</sup> Capital improvements on land are investments made which increase the value of the property, particularly buildings, as well as drainage and other works. In this report, the term 'improved value' is used to refer to any land value definition that includes the value of improvements when assessing the value of a property.

<sup>15</sup> ABS (2015b).

However, the property levy would reduce Commonwealth revenues by about \$0.5 billion, since property investors and firms would deduct the levy as an expense against their incomes.<sup>16</sup>

### **3.4 GST redistribution due to a property levy would not excessively reduce any state's revenue**

The Commonwealth Grants Commission (CGC) distributes GST revenues among the states to achieve what is known as horizontal fiscal equalisation. The goal is to enable each state to deliver the same level of government services and infrastructure to its residents as other states.<sup>17</sup> The CGC assesses the funds that each state would need to spend to provide the average level of services and the revenue each state would collect if it applied the average tax settings of all states. Each state then receives GST revenues to fill the gap, after accounting for other transfers it receives from the Commonwealth.

When state governments lift their spending, it usually alters the redistribution of GST revenues. Increases in state government spending, however funded, tend to shift GST revenues towards those states and territories, such as Queensland, SA, Tasmania and the NT, where it costs more to deliver services because populations are more remote or tend to use more public services.<sup>18</sup> As a result, when total spending increases across all states, net donors such as New South Wales and Victoria tend to receive a smaller share of GST revenues, while the share of the smaller states and territories grows. The precise GST impacts depend upon how states allocate their additional spending.

GST distributions would be altered if states raised revenues through a property levy. If all States implement a property levy, then NSW, Victoria, and WA would in effect give up some of their revenues through GST redistribution, while other states and territories would receive additional GST revenues. This redistribution reflects how property levies would raise more per person in NSW, Victoria and WA, as the value of property in these states is higher.

However, for a given scale of expenditure (and therefore revenue), a property levy would result in relatively less extreme GST redistribution than other state taxes, as Figure 6 shows. A property levy would distribute less GST money away from NSW than an increase in stamp duties would. Victoria would give up about the same percentage of new revenue, whether it raised the revenue through a property levy or through land taxes. Relative to increases in either land or payroll tax, a property levy would distribute much less GST money away from WA.

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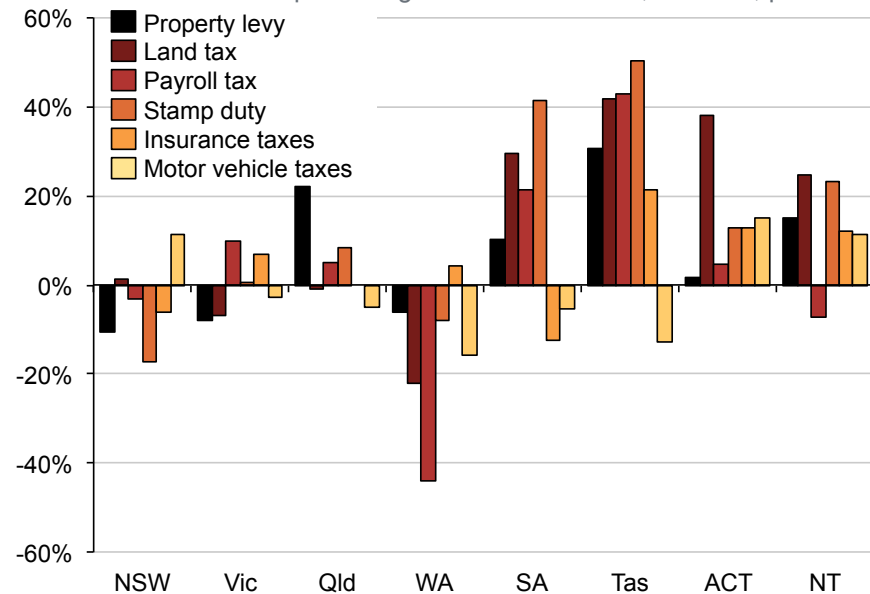
<sup>16</sup> Grattan analysis of ABS (2013); ATO (multiple years); ABS (2014e)

<sup>17</sup> Commonwealth Grants Commission (2015a), p.1

<sup>18</sup> For example, hospital services are used more intensively by some age groups and by indigenous people.

**Figure 6: A property levy generates less extreme GST redistribution than other major state taxes**

GST redistribution as a percentage of revenue raised, 2015-16, per cent

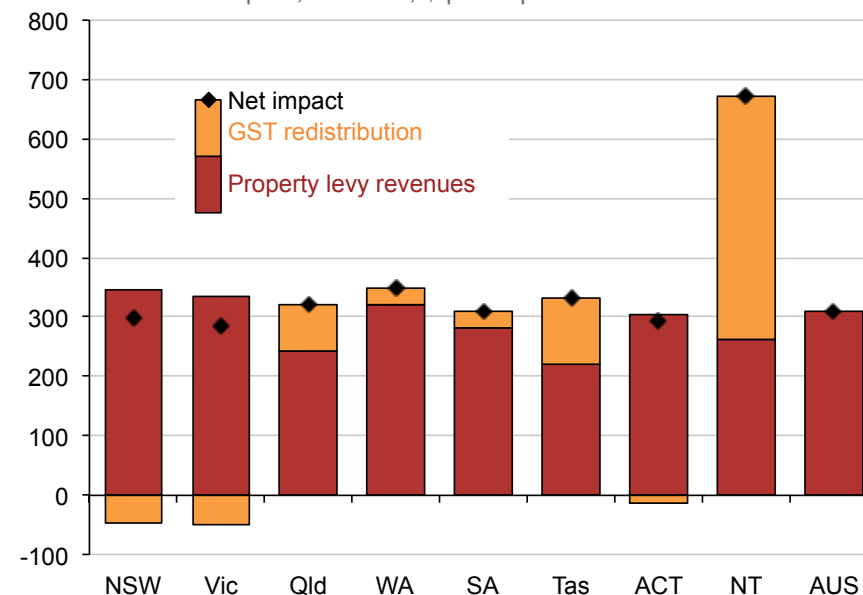


Note: Assumes all states introduce the property levy; excludes any expenditure side impacts on GST revenues from states spending any extra revenues raised  
 Source: Commonwealth Grants Commission (2015b); Grattan analysis.

For all states, the GST amounts redistributed would be small relative to the amount collected by a property levy. Figure 7 shows the combined effect on GST redistributions of increased spending (assuming current spending patterns), funded by a property levy imposed by all states. NSW and Victoria, with low service delivery costs and high property values, could lose at most 15 per cent of the revenues they raise via the levy to other states. These extra revenues would mostly flow to Queensland, Tasmania, and the NT.

**Figure 7: A property levy would raise slightly more per person in NSW and Victoria, but CGC redistribution would lead to similar outcomes in all States**

Simulated per capita annual property levy revenue, GST redistribution and net revenue impact, 2015-16, \$ per capita



Note: Assumes a levy of 0.2 per cent applied uniformly to unimproved land values in each state and territory; levy is fully captured by the CGC's methodology, and applied in 2015-16; states spend the revenues proportionate to their current expenditures; CGC assesses property levy revenues separately from state land taxes (if property levy revenues are incorporated into existing land tax assessment, this could have flow on impacts by altering the assessed land tax base). Source: ABS (2014a); ABS (2014b); Commonwealth Grants Commission (2015b); Grattan analysis.

Because of the CGC's methodology, GST impacts would be much smaller if only one state or a subset of states introduced the levy. For example, if NSW alone funded higher spending via the levy, it would forego about 5 per cent of the revenues it raised. If the

property levy revenues were used to fund the abolition of state stamp duties in a revenue neutral way, the GST impacts would be even smaller. NSW would replace one tax where it can raise more revenue per head (stamp duty) with another (property levy), while there would be no redistribution that reflected higher spending.

State tax policy changes normally have a delayed effect on GST distributions. The 2015-16 GST distributions, for example, are based on data from the 2011-12, 2012-13 and 2013-14 financial years. A state property levy introduced in 2015-16 would not begin to affect GST distributions until 2017-18, and the full impact would only be incorporated in 2019-2020.

However, if all states introduce the levy, the CGC may instead treat the new levy as if it had been in place for all of the three years of historical data used by the CGC. The CGC used this approach in 2006 when the states agreed to abolish certain state taxes.<sup>19</sup>

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<sup>19</sup> Commonwealth Grants Commission (2015b), p.23

## 4 Property taxes are relatively efficient

Property taxes – which are levied on the value of property holdings – are the most efficient taxes available to the states. Governments that want to increase the amount of revenue they raise will harm growth less with property taxes than with most other taxes. Unlike capital, property is immobile – it cannot shift offshore to avoid higher taxes. The risks of multinational tax avoidance, the increasing mobility of capital, and the increasing value of residential property relative to incomes, should make property taxes a priority in any tax reform.

### 4.1 Broad-based land taxes are the most efficient taxes

All taxes drag on economic growth. But some taxes do so less than others (Box 1). Broad land taxes are the most economically efficient taxes because they do not discourage working or investing. Unlike capital or labour, the supply of land is fixed. Someone must use the land: it cannot be moved away.

Land taxes do not distort decisions about land use, provided they apply in a way that the landowner can't avoid.<sup>20</sup> For example, a constant rate land tax applied to the unimproved value of all land prevents landowners from reducing their liability to such a tax by changing how they use their land. An empty block of land would pay the same tax even after it was developed.

Broad-based land taxes are much more efficient than stamp duties (Box 1). Given estimates of the inefficiency costs of stamp duties, abolishing stamp duties in all states and replacing them with a broad-based land tax could add \$9 billion a year to GDP.<sup>21</sup>

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<sup>20</sup> Treasury (2010), p.247

<sup>21</sup> Grattan analysis of KPMG Econotech (2011) and ABS (2015b).

Land is typically valued in its unimproved state.<sup>22</sup> The unimproved value of a parcel of land does not include the value of improvements, such as the construction of buildings on it. Instead, it depends on the most valuable use of the land that would generate the highest return – as residential housing, farmland, an office tower, an industrial site, and so on – subject to the land uses permitted under planning laws.<sup>23</sup>

Economic theory predicts that a tax on unimproved values – applied equally to all land – would result in land prices being lower than otherwise.<sup>24</sup> Yet rents should remain constant as the land tax doesn't affect how land is used (see Section 7.1).<sup>25</sup>

Land taxes can also capture some of the value created by public investment such as transport infrastructure. These gains are today taxed very lightly. Owner occupied housing is exempt from the two taxes that would capture some of the value of these gains: capital gains tax and land tax.

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<sup>22</sup> In this working paper, the term 'unimproved value' is used to capture a range of land value definitions, such as unimproved value, and site value, among others. Although there are differences in the definitions, they all capture the value of land separate from the value of major capital improvements, such as buildings. For example, see Hefferan and Boyd (2010), p.153

<sup>23</sup> Land use restrictions tend to reduce land values where they prevent land being used for its' first and best use. For example, Kulish, *et al.* (2011) find that residential building height restrictions result in lower land prices closer to the CBD where the height restriction is binding (p.11). However land use restrictions also tend to increase land values for land approved for certain uses by increasing the scarcity of that type of land. See Brueckner (2007) for a theoretical overview of the impact of land usage policies on land prices.

<sup>24</sup> Land taxes are capitalised into land values (Treasury (2010), p.247).

<sup>25</sup> *Ibid.*, p.248

**Box 1: Taxes and economic growth**

All taxes reduce growth because they distort decision making by households and firms.

Taxes influence household decisions about how much to save and spend, how many hours to work and what to invest in. Similarly, taxes affect the decisions of companies about how much and what to produce, how much labour and capital to employ and where to locate.

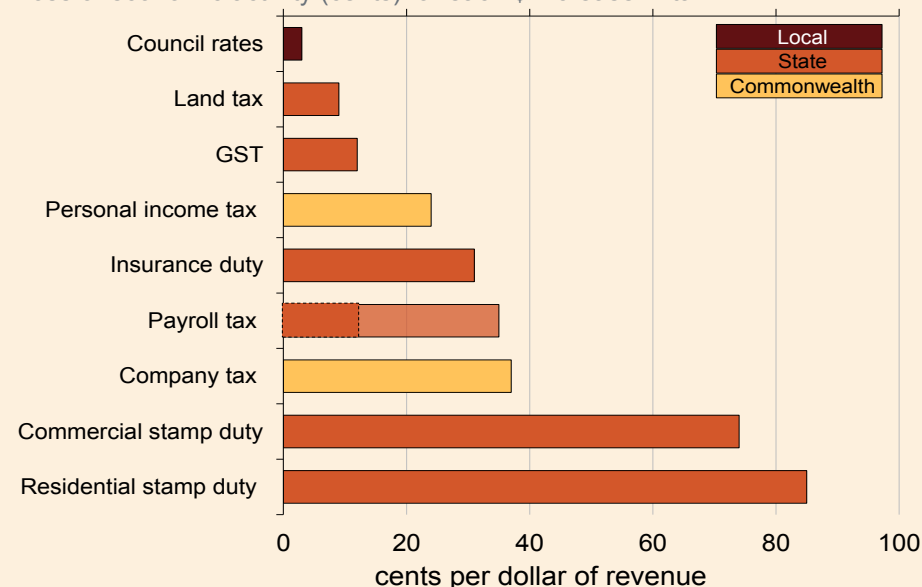
Welfare is reduced when people and firms make decisions different to the ones they would have made if taxes were not in place. This is measurable as a loss in economic output. Taxes also generate an administrative burden and encourage people to expend effort trying to avoid them. The diversion of resources to these unproductive activities reduces economic growth.

But some taxes drag on growth more than others. As a general rule, taxes on more mobile assets such as foreign financial capital are more likely to change behaviour and therefore harm growth compared to the taxation of less mobile assets such as land. Taxes on transactions, such as stamp duties, are particularly inefficient taxes. They distort the decision to buy and sell assets and so distort the optimal allocation of resources.

Economic models have been used to estimate the loss of efficiency from a range of taxes. Figure 8 shows the estimated loss of economic activity, or marginal excess burden, from each dollar increase in each tax.

There are potentially sizeable gains to productivity and economic growth if governments shift some of the tax burden towards more efficient taxes.

**Figure 8: Some taxes drag less on economic growth than others**  
Loss of economic activity (cents) for each \$ increase in tax



*Notes: All marginal excess burden estimates are from KPMG Econotech (2011) other than council rates that come from the KPMG modelling for Treasury (2010). These estimates are broadly consistent with Treasury estimates which evaluated a smaller range of taxes (Liangue Cao et al. (2015)). This more recent work suggests that the economic burden of broad based land taxes may be even lower, with a marginal excess burden of negative 10 cents, since the revenue from foreign owners of land would exceed the economic costs imposed on Australian residents*  
Source: Treasury (2010); KPMG Econotech (2011)

Property prices in major Australian cities have risen faster in suburbs closer to the CBD than in those located further out, which mainly reflects increases in the price of land, not what has been built on it.<sup>26</sup> Faster growth in land values in inner-city locations in Australian cities reflect, in part, the value of public transport, government-funded schools, parks and other public amenities, as well as proximity to employment opportunities.<sup>27</sup>

#### 4.2 Property taxes at low rates are a little less efficient than taxes on land, but are still attractive

Although they are less efficient than land taxes, property taxes - which include the value of capital improvements such as buildings - are still very efficient taxes. An OECD report found that reducing income taxes by 1 per cent of GDP, and increasing taxes on immobile property (both land and buildings) by the same rate would improve long run GDP per head by 2.5 percentage points.<sup>28</sup>

Property taxes are a little less efficient than land taxes because property taxes also tax the returns on capital invested to improve the property. This results in fewer improvements being made to land, such as fewer buildings, than would otherwise be the case. In the longer term, a portion of the property tax will be passed on to property users through higher rents for rental housing or for firms leasing premises, for example. The effect will flow on to other prices.

#### 4.3 Economic costs are particularly small with low tax rates

Under the low property tax rate we propose, any economic costs are likely to be very small. The economic costs of a tax tend to be

much lower for low tax rates.<sup>29</sup> On plausible assumptions, a property tax of 0.1 per cent of property value would tax the return on capital improvements at about 0.8 per cent.<sup>30</sup> To put this in context, a landlord doing capital improvements of \$100,000 would need to collect a mere \$8 extra a month in rent to recoup the costs of the tax.<sup>31</sup>

Unlike many other forms of capital investment, which can move to avoid higher taxes, most existing capital improvements to land, such as buildings, cannot be moved. Therefore taxing improvements on land would be unlikely to affect the *existing* stock of capital improvements. Along with the low tax rate we propose, this means that the effect of a property tax on new capital invested would be modest, as Box 2 illustrates.

While there are no estimates from Australia, several overseas studies have found that property taxes have relatively low economic costs. A survey of US property taxes found that every dollar collected reduced economic output by just six to 16 cents. On these estimates, property taxes are efficient relative to other state taxes such as payroll tax and stamp duty, as Figure 8 shows. Since taxes tend to be more efficient when levied at low rates, even these estimates overstate the economic costs of a proposed property tax of 0.1 per cent of property value – a tax rate 16 times smaller than those investigated in the US studies.<sup>32</sup>

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<sup>26</sup> Kulish, *et al.* (2011), p.22

<sup>27</sup> Kelly and Donegan (2015), p.87

<sup>28</sup> Johansson, *et al.* (2008), p.58

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<sup>29</sup> See KPMG Econtech (2010), p.18

<sup>30</sup> Assuming an average nominal pre-tax rate of return on capital of 12 per cent. The tax rate on capital improvements would rise to 1.4 per cent for an investment with a pre-tax rate of return on capital of only 7 per cent.

<sup>31</sup> This figure is independent of the rental return rate adopted.

<sup>32</sup> The weighted average of U.S. state property taxes in the year 2000 investigated by these studies is equivalent to an annual tax rate of 1.56 per cent of property values.

**Box 2: A modest property tax has a similar impact on property development returns as a land tax**

To understand how a property tax would affect returns on property development compared to a land tax, we consider a hypothetical investment.

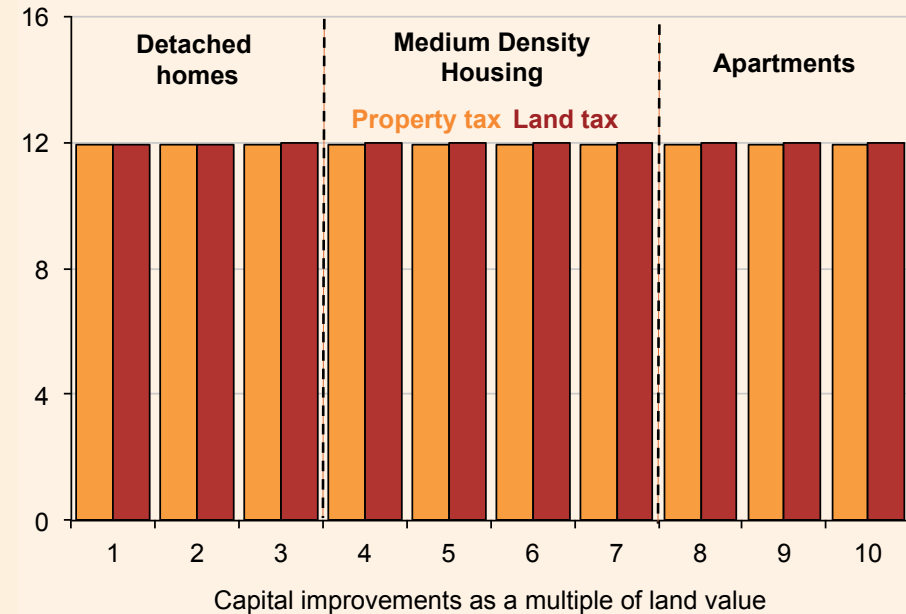
We compare a property tax of 0.1 per cent on improved value with a land tax of 0.2 per cent on unimproved value. These taxes would raise about the same revenue each year.

We consider an investor who buys land intending to develop it by investing in new capital improvements. We calculate the rate of return on the total investment given various levels of new capital improvement. Figure 9 shows that returns are very similar under the alternative regimes, even in cases where improvements account for most of the property value after redevelopment.

The differences only become material at much higher rates of tax. For example, comparing a property tax rate of 1 per cent to a land tax rate of 2 per cent (which would each raise about \$70 billion), the annual rate of return on new improvements worth twice the value of the land would be 0.3 percentage points lower. The difference in the rates of return would be greater – about 0.8 percentage points – for capital investment typical for apartments, where the building cost can be 10 times the land value.

**Figure 9: A low rate tax on improvements has little impact on returns on the total investment**

Annual rates of return after taxes on property for redeveloped property, per cent



Notes: Based on a property tax rate of 0.1 per cent, and a land tax rate of 0.2 per cent. Assumes a pre-tax rate of return on the total investment of 12 per cent. Source: Grattan analysis.



## 5 Legislative basis for property tax reform

Additional property taxes should build upon existing tax bases. State and local governments already levy two types of property taxes: land tax and council rates.

All states and territories except the Northern Territory levy land taxes. They base the taxes on the value of the land without capital improvements such as buildings. Land taxes exempt owner-occupied housing and most agricultural land – more than half of all land by value (Figure 2).

The other property tax base is the municipal rates levied by local councils, usually based on improved values. Because very few properties are exempt from this tax it is a much better base from which to charge a property levy.<sup>33</sup> Some States have already levied emergency services levies on this municipal rate base.

### 5.1 State land taxes are a compromised tax base

Existing state land taxes generate much less revenue than a broader-based land tax would. States raised \$6.4 billion from land taxes in 2013-14.<sup>34</sup> Exempting the family home from land tax excludes about 75 per cent of the value of residential land, and state government budgets forgo about \$5 billion in revenue.<sup>35</sup>

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<sup>33</sup> Land taxes also usually exempt much Commonwealth and State-owned land, and land used by public hospitals, libraries, cemeteries, charities, religious organisations, universities, schools and foreign embassies. See Productivity Commission (2008), p.105

<sup>34</sup> ABS (2015b).

<sup>35</sup> Treasury (2010), p. 261; Kelly, *et al.* (2013), p.24. Even though owner occupied housing accounts for 75 per cent of all residential land, imposing land tax on it would only raise \$5 billion as it would be taxed at comparatively low rates under the highly progressive rates of land tax currently in force.

Exemptions for agricultural land remove almost a further 10 per cent of land by value from the land tax base (Figure 2).<sup>36</sup>

States also apply substantial tax-free thresholds based on total landholdings before any tax is levied. These thresholds range from \$25,000 in Tasmania to \$600,000 in Queensland and further reduce state revenues from land taxes.<sup>37</sup>

Land taxes are also levied on a progressive scale so that people with larger land holdings pay a higher rate of land tax per dollar value of land owned. Progressive rates reduce the efficiency of the ideal land taxes that were discussed in Section 4. They discourage larger landholdings and partly explain why small investors dominate Australia's rental housing market, with relatively few landlords owning a large number of properties.<sup>38</sup>

For example, a small investor with a single investment property in Sydney built on land valued at \$750,000 pays land tax of \$5,508 in 2014. By comparison, a large investor owning ten such properties pays \$133,432 in land tax, or \$13,343 per property.<sup>39</sup>

Land tax exemptions also make the system more difficult to administer and for landowners to comply with.<sup>40</sup> Tax-free thresholds and progressive rate structures provide landowners with incentives to break up their land holdings and adopt complex ownership structures in order to reduce their land tax payments.

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<sup>36</sup> Treasury (2010), p.260

<sup>37</sup> Treasury NSW (2014), pp.31-33

<sup>38</sup> See Berry (2000); Wood, *et al.* (2010); Treasury (2010) p.261

<sup>39</sup> Treasury NSW (2014), pp.31-33

<sup>40</sup> Treasury (2010), p.261

Time and resources spent by firms to manage more complex structures are a burden on productivity.<sup>41</sup> Tax authorities use grouping provisions to overcome incentives to fragment land holdings, but impose additional costs in administering them.

Exempting owner-occupied housing is also very regressive. The exemption for the family home benefits households in the top income quintile by almost \$2000, but benefits households in the bottom income quintile by just \$400.<sup>42</sup>

State land taxes could be an efficient tax base provided that exemptions, thresholds and progressive tax rates were abolished. Yet extending the existing land tax base to cover owner occupied residential property and agricultural land would be politically difficult, and is likely to be portrayed as favouring businesses at the expense of consumers.

Similarly, removing tax free thresholds and shifting to a single flat land tax rate assessed at the property level would result in much lower tax liabilities for large landholders. Again, such a reform could well be portrayed as unfair: favouring a small number of wealthy landlords while increasing land tax liabilities for smaller landholders.

### 5.2 Council rates are a better taxation base than state land taxes.

Local councils levy rates on the value of unimproved land, and in some states, on capital improved values. Rates are applied to all properties within a council area with few exemptions. There are no exemptions for owner-occupied housing or agricultural land

and constant rates apply from the first dollar of property value with no minimum threshold. The largest exemption from council rates is for some non-profit, non-government organisations such as charities, schools and public hospitals.<sup>43</sup>

Council rates are levied at the same rate per dollar of land value of a property, regardless of the overall size of ratepayers' total property holdings, and so do not discriminate against large property investors.<sup>44</sup>

Municipal rates regimes vary across councils. Councils may levy a fixed charge, a variable rate based on property values, or a combination of the two. In some states, councils determine the tax base for rates by choosing between measures of unimproved or capital improved property values (Table 1).<sup>45</sup> Despite these differences, a state government levy added to council rates would be relatively simple to administer. In practice a government could set a state-wide rate, with the council rate as an additional charge that varies by council.

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<sup>41</sup> Gabbittas and Eldridge (1998), p.157

<sup>42</sup> Kelly, *et al.* (2013), p.27

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<sup>43</sup> For example, the City of Gosnells estimated the value of the rates revenue foregone by WA councils from exemptions to charities in WA at \$6.5 million, or 0.7 per cent of total state-wide council rates revenue for 2005-06. See Productivity Commission (2008), p.107

<sup>44</sup> In Victoria, for example, most councils determine rates on the basis of the assessed capital value of the property. See Hefferan and Boyd (2010), p.154

<sup>45</sup> Productivity Commission (2008), p.198

**Table 1: Approaches to valuing properties for council rates vary**  
Property value bases that can be used to set council rates in each state

| State | Basis for council rates               |
|-------|---------------------------------------|
| NSW   | Unimproved                            |
| QLD   | Unimproved                            |
| VIC   | Either unimproved or capital improved |
| WA    | Capital improved                      |
| SA    | Either unimproved or capital improved |
| TAS   | Either unimproved or capital improved |
| NT    | Unimproved                            |
| ACT   | Unimproved                            |

*Notes: 'Unimproved' refers to a set of land valuations that capture the value of the land only. 'Capital improved' refers to valuations that capture the value of the land and significant capital improvements made to that land, such as buildings.*

*Sources: Productivity Commission (2008); Mangioni and Warren (2014); Treasury NSW (2014).*

There are no constitutional barriers to states adopting the council rates base to raise revenues. Although councils set and often collect rates, they are ultimately levied under the authority of state government legislation.

**Table 2: Property-based emergency services levies are a template for property tax reform**

Structure of state property-based emergency services levies

| State    | Property value used |                    | Levy structure |               | Collection authority |
|----------|---------------------|--------------------|----------------|---------------|----------------------|
|          | Land only           | Land and buildings | Fixed charge   | Variable rate |                      |
| VIC      | x                   | ✓                  | ✓              | ✓             | Councils             |
| WA rural | ✓                   | x                  | ✓              | ✓             | Councils             |
| WA metro | x                   | ✓                  | ✓              | ✓             | Councils             |
| SA       | x                   | ✓                  | ✓              | ✓             | State govt.          |
| ACT      | ✓                   | x                  | x              | ✓             | State govt.          |

*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. Sources: Government of Victoria (2014); Revenue SA (2015); Rates Act (ACT) (2004); Government of Western Australia (2015).*

Governments in Victoria, South Australia, Western Australia and the ACT already use the council rates base for state-wide property-based levies to fund fire and emergency services. These levies provide a template for reform. They are charged as a share of land or property values. The levy rates are set at the state level. In Victoria and Western Australia (but not South Australia), notices of liability are issued as part of council rates notices, and levies are collected by councils and passed on to state governments (Table 2). Over time a large state property levy might lead to centralised collection of both property levy and council rates through state revenue offices.

## 6 Key design choices for a property levy

A modest levy on property values could generate significant revenues for states and territories, with less drag on economic activity than other available state taxes.

### 6.1 A flat rate levy on property values, with no fixed charge, is the simplest approach

The levy could be designed in a number of ways. A flat tax rate on property values would be the simplest. The levy would consist of a flat rate charged per dollar of property value, with no fixed charge per property. It would apply equally to all land, regardless of land use, and from the first dollar of property value with no minimum threshold. It would be assessed separately on each property owned, as currently occurs with council rates, using existing Valuer-General valuations.

A flat rate with no fixed charge would be more equitable than council rates and the existing state emergency services levies which both include a fixed or minimum charge. These reflect the fee-for-service implicit in charges for council services and emergency services. Yet these levies are inherently regressive as they fall more heavily on the less well off.<sup>46</sup> A state property levy aimed at raising general revenue should have no fixed charge.

Recent Commonwealth and state tax reviews have considered levying land tax with higher tax rates for land with a higher value

per square metre.<sup>47</sup> Yet the problems with progressive rates probably outweigh the benefits.

On the plus side, a progressive rate structure captures more of the spill-over benefits of public investments in infrastructure, such as transport infrastructure, parks, schools, and libraries that increase nearby property values. Higher taxes on vacant property in expensive inner-city locations might also speed development as higher property taxes increase holding costs.<sup>48</sup> A progressive tax rate would also be popular with politically powerful farming lobbies, since most farmland would be taxed at a low rate.

The progressive rate also reflects – albeit very approximately – the progressive nature of state stamp duties. If a property levy aims not only to raise additional revenue but to replace existing stamp duties, a progressive rate on the levy might provide less of a bonus to the owners of highly priced properties that currently incur high stamp duties when purchased.

However, a progressive rate property levy would still lead to different tax treatments for properties that at present incur the same stamp duty. For example, with tax calculated on the price of land per square metre, the owners of small inner city apartments would pay much more than they do under the replaced stamp duties. The owners of similarly priced outer suburban houses would pay much less.

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<sup>46</sup> Productivity Commission (2008) notes that ‘other things equal, imposing a minimum (or fixed) charge makes rates regressive (or less progressive) than otherwise’ (p.139).

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<sup>47</sup> Treasury (2010), p.265; Government of South Australia (2015c) p.41

<sup>48</sup> Wood, *et al.* (2012).

To the extent that a property levy is a tax on wealth, a levy charged at a progressive rate would treat people with similar wealth differently.

An increasing marginal tax rate based on the value of land per square metre would make a property levy more complex to administer. It would require more accurate and reliable land valuations since higher levy rates would compound any errors in the land valuation process.

A progressive tax rate should only be applied to unimproved land values, as otherwise it would significantly discourage investing in improvements. However, a progressive rate compounds the administrative complexities of taxing unimproved values: unimproved values are hardest to determine accurately where land values are highest, and hence the consequences of disputed valuations are worth more.

### **6.2 A levy rebate would reduce the burden on low wealth property holders, but would significantly reduce revenue**

Providing an exemption, or rebate, for the first portion of property tax liability would make the levy more progressive with respect to household wealth.<sup>49</sup> Households with lower wealth tend to own lower value homes, so the rebate would reduce the average property tax rate applied to low wealth property owners.

However, such a rebate could easily halve the revenue raised from the levy. A \$500 rebate on a property levy applied to unimproved land values would mean that no landowner would pay the property levy on landholdings worth less than \$250,000. Such

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<sup>49</sup> For example, see Slack and Bird (2014), p.8.

a rebate would exclude about half of all residential properties in NSW, even if property owners could only claim the rebate in respect of one property.<sup>50</sup>

A rebate would also provide incentives for landowners to fragment holdings across different legal entities in order to make use of multiple rebates, as currently occurs with state land taxes.

### **6.3 The levy should be applied to land values, but a levy on capital improved property values is a good alternative**

The property levy could be applied to only the unimproved value of land, or to the combined value of land and buildings. Although a tax on unimproved value is theoretically better, it increases implementation problems, and the practical impacts on investment of a levy on capital improved values would be small.

A levy on unimproved land values is preferable because it does not discourage investing in improvements. While many councils levy rates on capital improved values, state Valuer-Generals maintain comprehensive registers of unimproved land values to determine state land tax liabilities.<sup>51</sup> A levy on unimproved land values could be applied universally, with the levy listed as a separate item on ratepayers' council rates notices.

A levy on unimproved values would also make it easier to use increased levies to replace stamp duties over time. Replacing stamp duties would require higher rates of tax – potentially about 0.4 per cent of unimproved values.

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<sup>50</sup> Based on a property levy 0.2 per cent of unimproved land value, and median residential land values supplied by NSW Treasury.

<sup>51</sup> Councils in all states except WA currently have the option to levy rates based on land values (Table 1).

While it is less economically efficient, a levy based on property values is easier to administer and would be a good alternative. A tax on improved values would still be much more efficient than a stamp duty, and most other state taxes. Capital improved property values are easier to determine since market sales and rental data are more readily available. Effective property taxes require up-to-date, transparent and accurate property valuations. The recent shift towards capital improved values for council rates in some states reflects difficulties in determining the unimproved value of land, especially in dense urban areas where there are few, if any, market sales of unimproved land.<sup>52</sup>

### 6.4 An annual charge is simpler than a capitalised charge collected on sale

Some have suggested capitalising the property tax for all landowners, and collecting the capitalised charge (potentially including accrued interest) only when the property is sold.<sup>53</sup> This would mimic the political advantages of current stamp duties: they are paid less often, and only when the vendor is cashed up from a recent sale. Because the amount payable depends on how long the vendor has owned the property, a capitalised charge would reduce the problems of the current stamp duty regime, which discourages more frequent property turnover.

Yet this design has a number of problems. Above all, it would be complex to explain, and therefore unattractive to politicians.

A capitalised charge would also lead to significant increases in state gross debt as governments would collect promises of future payment rather than cash, unless interest was charged.

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<sup>52</sup> NSW Ombudsman (2005), p.24; Hefferan and Boyd (2010), p.153

<sup>53</sup> For example, see Slack and Bird (2014), p.8.

The approach also presents problems similar to those that arise with capital gains tax. Unless there is an interest charge on accrued tax then the property holder receives an interest free loan until the property is sold. The investor has large incentives not to sell, which locks people into holding properties – the precise problem that makes stamp duties so inefficient.

### 6.5 Levy deferral for pensioners: managing the impact for income-poor, asset-rich owner occupiers

However, capitalising the charge may be a good option to manage the impact on the relatively small number of income-poor, asset-rich owner-occupiers.

A property levy would pose difficulties for people who are asset-rich but income-poor, especially retirees who have limited incomes but own their own home. Retirees who want to stay in their homes should be able to do so. Many are emotionally attached to them. They provide continued access to social networks, and leaving them often carries large financial and emotional costs.

One option is to provide concessions to property owners with low incomes. State governments typically provide rebates on council rates to pensioners and other concession cardholders.<sup>54</sup> Similar concessions also apply in those states that charge property-based fire services levies.

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<sup>54</sup> In most cases, states provide a fixed rebate on council rates, and reimburse councils for the foregone rates revenues. Many councils also offer an additional fixed rebate on municipal rates for pensioners and concession card holders. In most cases, property-owning pensioners still have some residual rates liability after these concessions are applied.

Yet exempting or providing concessions to asset-rich, cash-poor landowners would be unfair to younger taxpayers. It also ignores the substantial resources of some retirees. Concessions based on pension eligibility are already poorly targeted: many wealthier Australians receive the Age Pension. Of mature age households with a million dollars of net assets, about 80 per cent receive welfare benefits.<sup>55</sup>

A fairer approach would be for state governments to allow asset-rich, income-poor households to defer paying the levy until they sell their property. Deferral arrangements are already available for seniors paying council rates in South Australia, Western Australia and the ACT (Box 3).<sup>56</sup>

The amount could accrue as a debt against the property, with an appropriate caveat registered at the Land Title Office. Interest should be charged on the balance to reflect the cost of deferral. A safety net might be provided by a stipulation that the debt cannot account for more than 20 per cent of the value of the property, and would be non-recourse.<sup>57</sup> This would protect ratepayers from longevity risks – where individuals live longer than expected and the debt comes to exceed the value of the property as interest charges continue to compound over time.

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<sup>55</sup> Daley, *et al.* (2013b), p.37

<sup>56</sup> Brownfield (2014), p.10

<sup>57</sup> Under a non-recourse loan, the creditor cannot claim any other assets of the borrower if the borrower defaults and the collateral is insufficient to repay the debt.

### **Box 3: The South Australian Postponement of Rates Scheme**

The Postponement of Rates Scheme, operated by South Australian councils, allows retirees to postpone payment of council rates. Similar schemes operate in Western Australia and the ACT. The scheme is designed to help elderly ratepayers to finance their rates payments by unlocking the value of home equity. Such households may own their own homes and are therefore asset-rich, but on low incomes.

Eligible ratepayers can postpone a portion of the rates applied to their principal place of residence. Any rates after the first \$500 each year can be postponed. The scheme is only available to ratepayers that own their property alone, or with their spouse.

Ratepayers incur interest on the outstanding debt, which compounds monthly. The interest rate is set at the average borrowing costs for councils in that year, which was 6 per cent in 2013-14. Ratepayers receive an update on their postponed rates debt, and any accrued interest, as part of their rates notices each year. The accrued debt is payable when the property is sold or transferred to someone else and no surviving spouse remains living in the house.

To be eligible, a ratepayer must be over 60 years of age and work less than 20 hours a week in paid employment. Ratepayers must also have at least 50 per cent equity in their property after accounting for any outstanding mortgage debt if the mortgage was registered before 25 January 2007.

In reality, very few retirees would use this safety net. At the tax rates proposed, 30 years of deferred levy and the accumulated interest would still only be 5 per cent of the property value.<sup>58</sup>

Yet the safety net could become more important if the levy rate were raised in future - to fund the abolition of stamp duty, for example.

Levy deferral schemes should be statewide since state governments would ultimately receive the revenues. A statewide scheme could also incorporate existing council rate deferral schemes and be extended to state-based emergency services levies.<sup>59</sup>

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<sup>58</sup> A 0.1 per cent levy on property value, with payment deferred for 30 years would result in a deferred charge equivalent to 4 per cent of the property value, including deferred interest. This assumes a 7 per cent nominal interest rate and 3 per cent annual growth in nominal house prices. With a 10 per cent nominal interest rate, the deferred charge would be equivalent to 7 per cent of the property value.

<sup>59</sup> State governments typically reimburse councils for the rate revenue foregone under council rate deferral programs.



## 7 The levy would not impose unreasonable burdens

### 7.1 The levy would reduce property values, but would have little impact on rents

An increase in property taxes usually reduces property values, all else being equal, with little impact on rents. Potential buyers of property will reduce how much they are willing to pay by the future cost of property tax payments.<sup>60</sup> Therefore the tax liability is capitalised into the property value. For example, a 0.2 per cent levy on unimproved land values would be expected to reduce land values by between 3 and 6 per cent.<sup>61</sup>

A levy on unimproved land values would have no impact on rents. If a landowner tried to pass on the tax by charging higher rents, some people would decide not to rent, thereby lowering rental demand and causing rents to fall back again.

A levy on capital improved property values might lead to small rent rises, since it would discourage some investment in new improvements and therefore affect the supply of housing. Over time, landlords are likely to pass on to renters some of the additional costs that the levy imposes on improvements. Yet as Figure 9 shows, the impact on rents is likely to be small as the levy would have only a very small impact on the returns that accrue from investing in new improvements. For example, if a

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<sup>60</sup> There is considerable literature documenting the capitalisation of property taxes into land values. For example see Wallace E. Oates and Schwab (2009). Wood, *et al.* (2012) adopt a similar approach to estimate the impact of the Henry Review recommendations on land values in Victoria (p.22).

<sup>61</sup> The impact of the tax on land values depends upon the discount rate adopted. For example, a property levy would lower land values by 6 per cent with a discount rate of 2 per cent, but by only 3 per cent if a 6 per cent discount rate is adopted. This analysis assumes a levy of 0.2 per cent on land values only.

landlord sought to pass through the full cost of the levy after investing \$500,000 in developing improved land priced at \$500,000, it would increase the annual rent by 1 per cent, or \$10 a week.<sup>62</sup> In reality the impact would be smaller as only a small share of the levy would be passed through because new improvements are a small share of the total housing stock.

### 7.2 Costs for property owners would be manageable

A homeowner would pay a levy of \$772 a year on the median Sydney house valued at \$772,000, or \$560 a year on the median Melbourne home valued at \$560,000. The average levy burdens on households in other major Australian cities would be lower (since property prices are lower), and lower still in regional areas (Table 3).

The average burden of the levy on each property owner would be smaller than existing council rates for most owners (Figure 10).<sup>63</sup> Property holders with higher incomes would pay more in absolute terms than those with lower incomes. Those with higher incomes tend to own more valuable homes, and are more likely to own an investment property.<sup>64</sup>

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<sup>62</sup> Rents would rise by 1.3 per cent for a real rental yield (excluding any capital gains) of 4 per cent. For a rental yield of 7 per cent, the percentage increase in rents drops to 0.7 per cent. Both examples reflect a property levy of 0.1 per cent of capital improved property values.

<sup>63</sup> This analysis assumes a levy of 0.2 per cent on land values only. The results would be broadly similar for a levy on capital improved property values of around 0.1 per cent.

<sup>64</sup> Grattan analysis of ABS (2013)

## Property taxes

**Table 3: Costs for property owners would be manageable**  
Property levy payable on the average home by capital city, \$2015-16

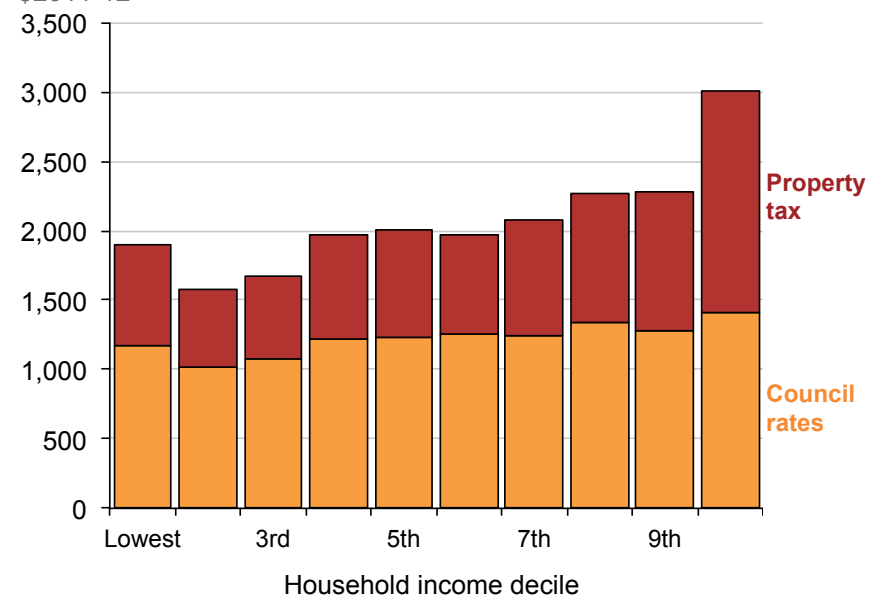
| City             | Median dwelling price | Property levy per year |
|------------------|-----------------------|------------------------|
| <b>Sydney</b>    | \$772,200             | \$772                  |
| <b>Melbourne</b> | \$560,000             | \$560                  |
| <b>Brisbane</b>  | \$455,000             | \$455                  |
| <b>Perth</b>     | \$510,000             | \$510                  |
| <b>Adelaide</b>  | \$405,000             | \$405                  |
| <b>Hobart</b>    | \$315,500             | \$316                  |
| <b>Darwin</b>    | \$515,000             | \$515                  |
| <b>Canberra</b>  | \$535,000             | \$535                  |

*Notes: Based on a 0.1 per cent levy on capital improved property values, applied to the median prices of homes in major Australian cities, as at June 30, 2015.*

*Sources: RP Data Core Logic (2015); Grattan analysis.*

**Figure 10: The property levy would be less than council rates for most property owners**

Property taxes payable by property owners in each income decile, \$2011-12



*Note: Simulated impact of applying a 0.2 per cent levy to unimproved land values; average rates and levy 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 (2013); Grattan analysis.*

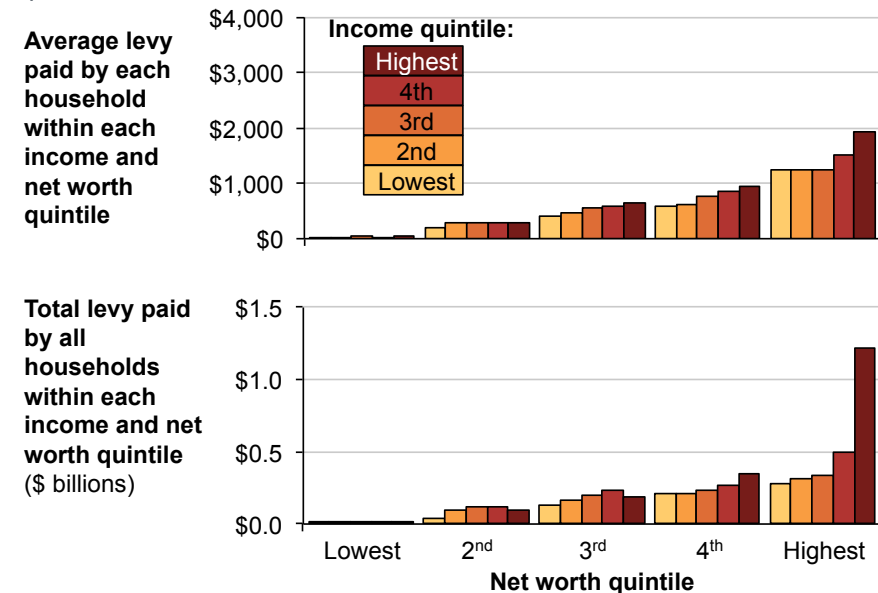
### 7.2.1 Impact on those worst off

The impact of revenue measures on the poorest households is a particular concern.<sup>65</sup> While measures of inequality traditionally focus on income, material wellbeing depends upon both income and accumulated wealth. Assessing taxpayers' capacity to pay should consider the ability of households to draw on their net wealth, or generate income from their assets.<sup>66</sup> This approach is especially important when considering wealth taxes such as a property levy. Consequently the distribution of both wealth and income are relevant in assessing the impact of a property levy. A particular concern is households that are in the bottom 20 per cent of the income distribution *and* have low net worth.<sup>67</sup>

A property-based levy would fall largely on households with higher net worth, reflecting their greater property holdings (Figure 11). Households that are both income and asset poor would, on average, pay almost no levy. By contrast, households ranked among the top 20 per cent by net worth – of at least \$640,000 – would pay an average of \$1933 annually.<sup>68</sup> About a quarter of all revenues raised by the levy would come from the 7.5 per cent of households that are in *both* the top disposable income quintile and top net worth quintile.

**Figure 11: A property-based levy would be targeted towards those with greater means to pay**

Average levy and total levy paid within each income and net worth quintile, \$2011-12



*Note: 2011-12 dollars; Simulated impact of applying a 0.2 per cent levy to land values only; Households that have reported negative household disposable income and negative net wealth have been excluded from the analysis; quintiles are grouped by equalised disposable (i.e. post tax) income and net worth of each household. Source: ABS (2013); Grattan analysis.*

Within each wealth quintile, households with higher disposable incomes would pay a higher property levy. Yet given the nature of a property levy, liability depends more on wealth than income. Some households in the bottom 20 per cent of the income distribution but with significant net assets would pay a significant levy. For example, low-income households in the top 20 per cent

<sup>65</sup> Daley, *et al.* (2013a), p.21

<sup>66</sup> OECD (2013), p.180

<sup>67</sup> The ABS adopts the concept of household net worth, rather than household wealth, in the Survey of Income and Housing. See ABS (2014f), p.19 for a detailed discussion on this issue.

<sup>68</sup> The equivalent net worth figure for a two adult household in the top income net worth quintile would be \$960,000. For a two adult family with two children aged under 15, this rises to \$1.34 million. Grattan analysis of ABS (2013); ABS (2014b)

of households by wealth would pay about \$1250 a year.<sup>69</sup> This category includes a significant number of retirees.<sup>70</sup> The proposed levy deferral schemes would support such asset-rich, income-poor households by allowing them to use their property assets to finance the levy.

The impact of the levy on households with low net worth would be minimal (Figure 12). For households in the lowest net worth decile, the average levy is equivalent to 0.03 per cent of their net worth, or just 30 cents for every \$1000 of net worth.<sup>71</sup>

Households in the fourth and fifth net worth deciles would pay the highest percentage share of their household net worth through the levy. There are two reasons why.

First, many of these middle-wealth households may be young homeowners who have recently purchased residential property. They are likely to have relatively high levels of *gross* property assets, on which the levy is calculated. Since these assets are financed largely by debt, these households would have comparatively low *net* worth, but large levy liabilities.

Second, while property holdings increase with household net worth, property tends to account for a lower share of net worth among the wealthy. Instead wealthier households tend to hold a greater share of their net worth in financial assets, such as equities, bonds and superannuation funds. Since the levy does not apply to these assets, these wealthy households on average would incur lower levy charges as a share of their net worth.

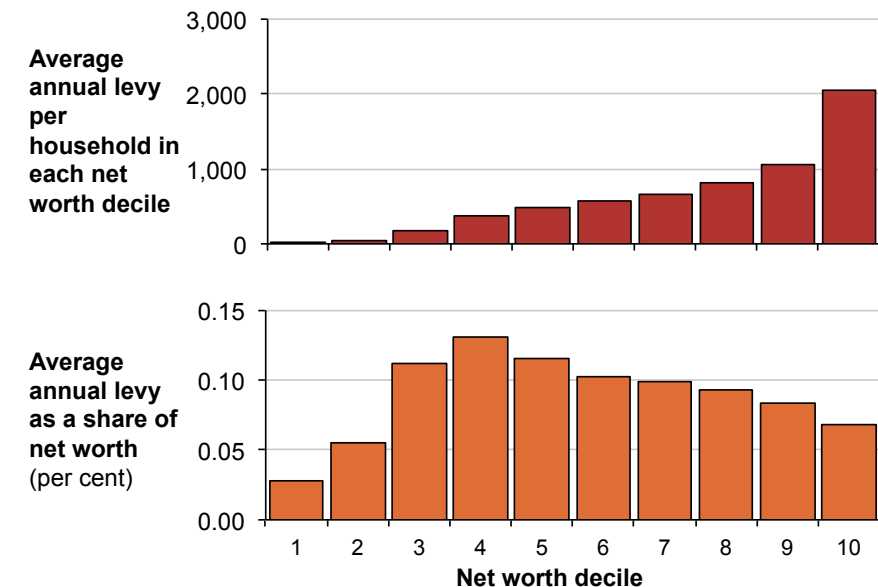
<sup>69</sup> Grattan analysis of ABS (2013); ABS (2014b)

<sup>70</sup> For earlier commentary on this issue see Harding and Warren (1999), p.11; Productivity Commission (2008), pp.156-158

<sup>71</sup> Grattan analysis of ABS (2013); ABS (2014b)

Nevertheless, high net worth households may pay more than our analysis indicates. Well-off households are more likely to hold their residential property assets in trusts, or other legal entities. These would pay the levy, but cannot be captured by statistical analysis at the household level.

**Figure 12: The burden would be lowest for low wealth households**  
Average levy and levy paid as a share of net worth within each net worth decile, \$2011-12



*Note: Simulated impact of applying a 0.2 per cent levy to land values only; excludes households that report negative household disposable income or negative net worth; deciles grouped by equalised net worth of each household.*  
*Source: ABS (2013); Grattan analysis.*

## Appendix: State tax revenue growth and revenue volatility

Section 3.2 analyses trends in growth in revenues from major state taxes, and the volatility of those revenues for the period 1990-91 to 2013-14, for all states combined. The aggregate trends over 25 years were:

- State property taxes such as land tax and stamp duty grew faster than other state taxes;
- State property taxes revenues were more volatile than other state taxes;
- Our proposed broad-based property levy would have been less volatile than other property taxes, especially stamp duty.

However, trends in state tax revenues varied across states, and across different time periods. State-specific economic developments affected the growth in state tax bases, and the volatility of state tax revenue streams. Meanwhile explicit tax policy changes by state governments also affected revenues.

This appendix breaks down in more detail the trends in revenue growth and revenue volatility among major state taxes for the five largest states: New South Wales, Victoria, Queensland, Western Australia and South Australia. Trends in revenue growth and revenue volatility for each of these states are presented over three time periods: 1990-91 to 2013-14, 1990-91 to 1999-2000, and 2000-01 to 2013-14. Trends in revenue growth and volatility for all states combined are also presented for two sub-periods: 1990-91 to 1999-2000; and 2000-2001 to 2013-14.

The trends in revenue growth and revenue volatility in individual States are generally consistent with the national averages. Compared to other property taxes, a broad based property levy would have produced faster growing, more stable revenues for most states, across most time periods.

However, there are some exceptions.

Over the period 2000-01 to 2013-14, stamp duty revenues grew slower than Gross State Product (GSP) in New South Wales, Queensland and Western Australia (Figure 17). Weaker than average property markets in this period caused a significant fall in stamp duty revenue for these states over these periods, particularly during the Global Financial Crisis.

In New South Wales, the property market was particularly weak between 2002-03 and 2008-09, with a fall in the number of property transfers leading to lower revenues from stamp duties on conveyances.<sup>72</sup> The median price of houses transacted in Sydney grew by only 21.4 per cent over this period, while the total number of property transfers fell by more than 30 per cent.<sup>73</sup>

In Queensland, the state government lifted the exemption threshold on stamp duty for first-home buyers from \$320,000 to \$500,000 in 2008-09, eroding the tax base.<sup>74</sup> The Queensland property market also declined after the Global Financial Crisis. The median price of houses transacted in Brisbane fell by an

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<sup>72</sup> Commonwealth Grants Commission (2009), p.18.

<sup>73</sup> Grattan analysis of ABS (2015a)

<sup>74</sup> Treasury and Trade Qld (2014)

average of 5 per cent between 2008 and 2012, whereas GSP increased by 23 per cent over the same period.

Queensland revenues from a broad-based property levy would have grown slower than GSP over the period 1990 to 1999. In this period, total land value increased by only 60 per cent, compared to the approximately 300 per cent increase in total land value over the period 2000 to 2013.<sup>75</sup>

In Western Australia, stamp duties fell from 15.4 per cent of state revenues in 2005-06 to 10.6 per cent in 2008-09, due to a similar decline in the property market.<sup>76</sup> The median price of houses transacted in Perth fell by 10 per cent between 2008 and 2012, whereas GSP rose by 56 per cent over the same period. Moreover, the Western Australian State Government doubled the exemption threshold on stamp duties for first-home buyers in 2007-08, lifting the threshold for residential properties to \$500,000.<sup>77</sup> In 2008-09, stamp duties for residential properties were also lowered, with a 15 per cent cut to stamp duty on a median price house.<sup>78</sup> This further eroded the tax base, where residential land value accounted for over 75 per cent of total land value in Western Australia.

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<sup>75</sup> Grattan analysis of ABS (2014b)

<sup>76</sup> Commonwealth Grants Commission (2010), p.13.

<sup>77</sup> Treasury WA (2007)

<sup>78</sup> Treasury WA (2008)

**Figure 13: Revenues from property taxes grew faster than the economy in all states except WA**

Percentage change in tax revenue for a 10 per cent increase in Gross State Product, 1990-91 to 2013-14



Note: 'Property levy' shows the revenues that would have been raised with a broad-based property levy of 0.2 per cent applied to unimproved land values had it been in place over the period.

Source: ABS (multiple years); ABS (2014b); Grattan analysis.

**Figure 14: A broad based property levy would generate more stable revenues than other property taxes in all states except WA**

Standard deviation between annual revenue growth and long run average growth, 1990-91 to 2013-14



Note: 'Property levy' shows the revenues that would have been raised with a broad-based property levy of 0.2 per cent applied to unimproved land values had it been in place over the period.

Source: ABS (multiple years); ABS (2014b); Grattan analysis.

## Property taxes

**Figure 15: Revenue from property taxes grew slower than many other taxes between 1990 and 2000**

Percentage change in tax revenue for a 10 per cent increase in Gross State Product, 1990-91 to 1999-2000

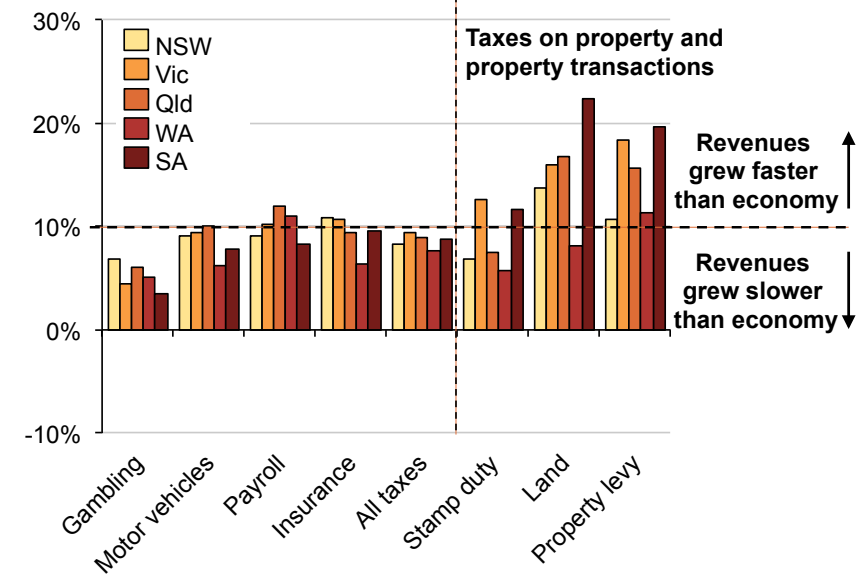


Note: 'Property levy' shows the revenues that would have been raised with a broad-based property levy of 0.2 per cent applied to unimproved land values had it been in place over the period.

Source: ABS (multiple years); ABS (2014b); Grattan analysis.

**Figure 16: Revenue from property taxes grew faster than many other taxes since 2000**

Percentage change in tax revenue for a 10 per cent increase in Gross State Product, 2000-01 to 2013-14



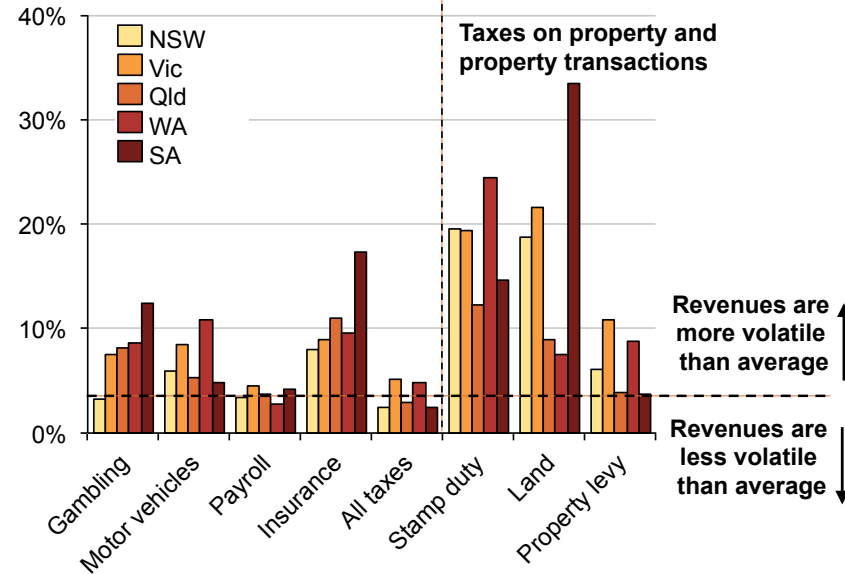
Note: 'Property levy' shows the revenues that would have been raised with a broad-based property levy of 0.2 per cent applied to unimproved land values had it been in place over the period.

Source: ABS (multiple years); ABS (2014b); Grattan analysis.



**Figure 17: A broad-based property levy would have been less volatile than other property taxes, and many other taxes between 1990 and 2000**

Standard deviation between annual revenue growth and long run average growth, 1990-91 to 1999-2000

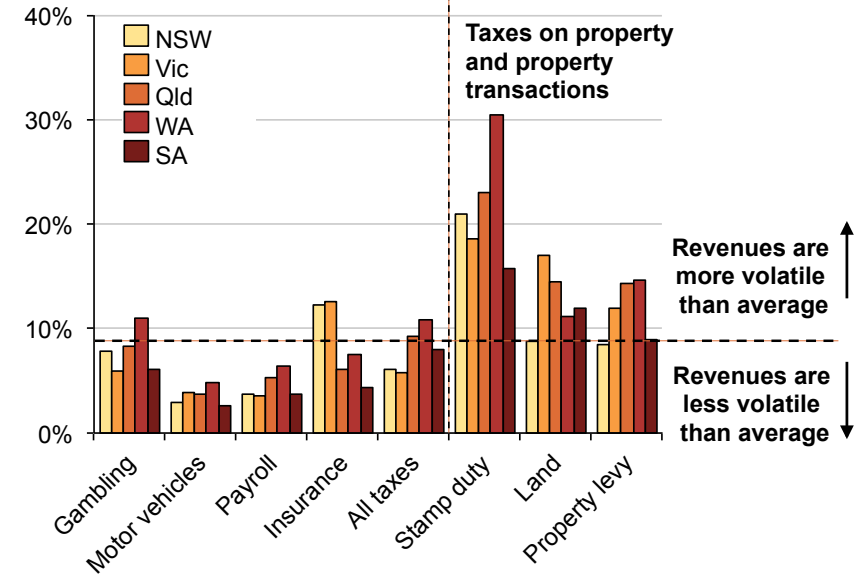


Note: 'Property levy' shows the revenues that would have been raised with a broad-based property levy of 0.2 per cent applied to unimproved land values had it been in place over the period.

Source: ABS (multiple years); ABS (2014b);Grattan analysis.

**Figure 18: A broad-based property levy would have been less volatile than other property taxes except in WA since 2000**

Standard deviation between annual revenue growth and long run average growth, 2000-01 to 2013-14

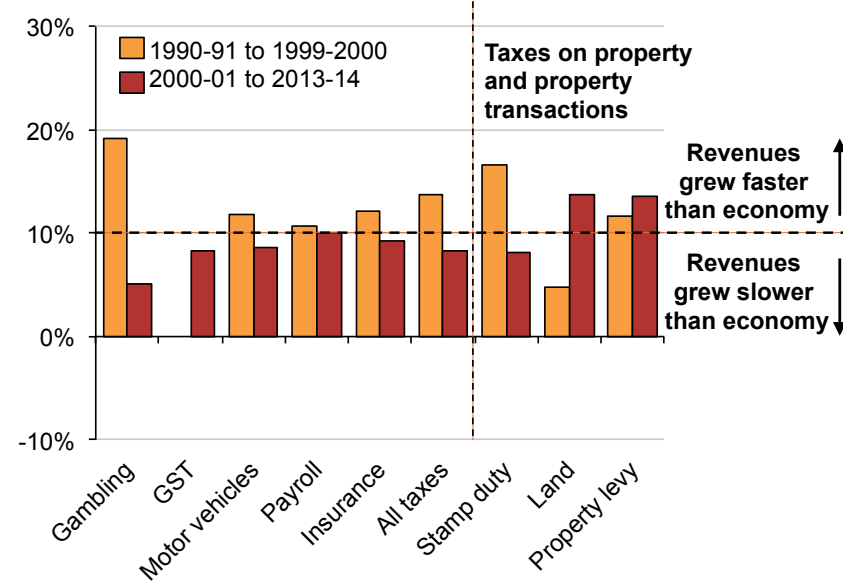


Note: 'Property levy' shows the revenues that would have been raised with a broad-based property levy of 0.2 per cent applied to unimproved land values had it been in place over the period.

Source: ABS (multiple years); ABS (2014b);Grattan analysis.

**Figure 19: Unlike most other taxes, a broad-based property levy would have grown faster than GDP between 1990 and 2000, and between 2000 and 2014**

Percentage change in tax revenue for a 10 per cent increase in national GDP, all states

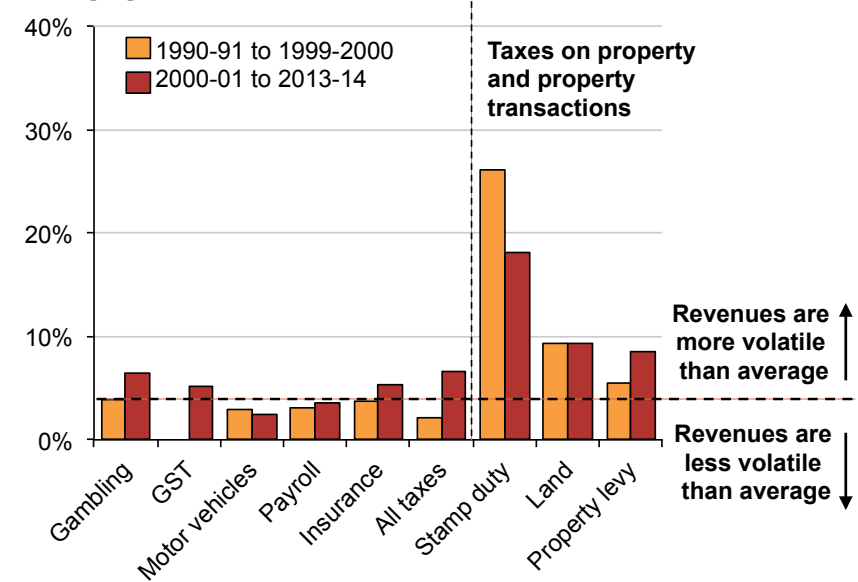


Note: 'Property levy' shows the revenues that would have been raised with a broad-based property levy of 0.2 per cent applied to unimproved land values had it been in place over the period.

Source: ABS (multiple years); ABS (2014b); Grattan analysis.

**Figure 20: A broad-based property levy would have been less volatile than other property taxes between 1990 and 2000, and between 2000 and 2014**

Standard deviation between annual revenue growth and long run average growth, all states



Note: 'Property levy' shows the revenues that would have been raised with a broad-based property levy of 0.2 per cent applied to unimproved land values had it been in place over the period.

Source: ABS (multiple years); ABS (2014b); Grattan analysis.

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