PROPERTY COUNCIL of Australia

Property Council of Australia
ABN 13 00847 4422

Level 1, 11 Barrack Street
Sydney NSW 2000

T. +61 2 9033 1900
E. nsw@propertycouncil.com.au

propertycouncil.com.au
@propertycouncil

Australia's property industry
Creating for Generations

19 March 2021

Hon Dominic Perrottet
Treasurer
52 Martin Place
SYDNEY NSW 2000

By email: TaxReformTaskforce@treasury.nsw.gov.au

Dear Treasurer

The Property Council welcomes the opportunity to provide comments on the NSW property tax consultation paper (the Consultation Paper).

As Australia's peak representative of the property and construction industry, the Property Council's members include investors, owners, managers, developers of property across all asset classes.

Stamp duty is an incredibly harmful tax and the Property Council strongly supports the NSW Government's intention to phase this out for the good of the wider economy.

However, the challenge is to design a replacement tax that is not itself distorting or economically harmful. The experience in the ACT highlights the critical risks that need to be addressed to ensure we are not simply moving from one bad tax regime into a new tax regime where the annual tax impost is so high as to impose significant burdens on household budgets and act as a handbrake on business and investment. Almost half way through the reform plan, higher valued commercial properties in the ACT remain subject to a 5% stamp duty and an annual property tax rate of about 5.5%. We are mindful of and grateful for the NSW Government's commitments not to replicate the ACT experience.

In drawing on these experiences, the NSW property tax reform model should reflect the following principles:

1. **Genuine opt-in choice** – this is crucial to ensuring there is no 'double tax' where a taxpayer is subject to both stamp duty and property tax (as is the case in the ACT currently) and allows taxpayers to determine which regime best suits their circumstances. It is not always the case that an annual property tax will be the better outcome.
2. **Reform does not result in higher taxes for commercial property sector** – the experience in the ACT has unfortunately resulted in a disproportionate share of the tax reform burden resting with commercial property owners, which is bearing a stamp-duty like rate of property tax payable every year. Capital is highly mobile and can be invested in other jurisdictions which would have detrimental impacts for NSW businesses and investment.

3. **Recoverability of property tax for commercial property owners** – there should not be any restrictions or prohibitions introduced for commercial property owners that would limit recoverability of property taxes where they do opt-in to the regime.
4. **No increase in cost of housing development** – the setting of the property tax rate that applies for residential developers should not increase the cost of housing development or reduce housing diversity and choice – this would be counter to the objective of improving housing affordability and mobility.
5. **An 'open to all' reform model – no transition thresholds** – an 'open to all' reform model would ensure all purchasers have a real choice, market distortions are minimised and the transition occurs in a reasonable time frame. If price thresholds are included in the final model to alleviate the short-term budget impacts of the reforms, then the following additional principles should be considered:
   - There should be no thresholds for newly constructed residential dwellings – this is critical to boosting velocity of transactions, facilitating new housing supply and driving economic activity and jobs.
   - The threshold for existing residential dwellings should be set as high as possible to capture the bulk of the market (including Sydney metro) to maximise the mobility and economic efficiency impacts of the reform.
   - There should be no threshold for commercial property to best allow the market to respond to economic settings and ensure there are not distortive impacts on price, values and investment.
   - There should be a clearly legislated timetable setting out when the thresholds will be increased to cover all properties – this ensures we are not sitting here 10, 20 or 30 years down the track with no clarity on when certain properties will be able to opt-in to the regime.
6. **Tailored approach for property types that do not fit clearly within the residential or commercial categories**– assets that are currently exempt from land tax such as retirement villages, emerging asset classes such as purpose-built Build-to-Rent housing, and charitable institutions currently exempt from stamp duty and land tax should maintain their current concessional treatments. These property types should not be worse off under the property tax option which would mean additional tax rates would be required in the reform model.
7. **Underpinned by a robust valuation framework based on unimproved land value** – we support basing the property tax on unimproved value of an individual property as this ensures the property tax is not a tax on capital and removes the current distortions that arise due to the aggregation rules. It will also be critical to develop a principles-based valuation framework to underpin the annual valuation process that provides certainty to taxpayers and integrity to the system.

Now is also the time to remove the counter-productive foreign tax surcharges on residential property. The economic and housing landscape has changed markedly since the measures were introduced, and the surcharges simply add costs to new housing and jeopardise viability of new projects. Removing the foreign investor surcharges would send the right signal to global capital and investors that NSW is open for business and will kickstart our COVID recovery.

Our attached submission provides responses to the specific policy design questions posed in the Consultation Paper and expands upon these principles.

We appreciate the engagement we have had to date with Treasury and welcome any opportunity to discuss these issues further.

Yours sincerely

Jane Fitzgerald
NSW Executive Director

Belinda Ngo
Executive Director – Capital Markets

Submission to NSW Treasury

Property Tax Consultation Paper

19 March 2021

EXECUTIVE SUMMARY

Stamp duty is an incredibly harmful tax and the Property Council strongly supports the NSW Government's intention to phase this out for the good of the wider economy.

However, the challenge is to design a replacement tax that is not itself distorting or economically harmful. The experience in the ACT highlights the critical risks that need to be addressed to ensure we are not simply moving from one bad tax regime into a new tax regime where the annual tax impost is so high as to impose significant burdens on household budgets and act as a handbrake on business and investment. Almost half way through the reform plan, higher valued commercial properties in the ACT remain subject to a 5% stamp duty and an annual property tax rate of about 5.5%.

Neither a politically unpalatable new annual property tax on the family home nor a disproportionate burden being borne by commercial property owners benefits the people of NSW and we are mindful of and grateful for the NSW Government's commitments not to replicate the ACT experience.

Our submission draws on these experiences to provide a set of principles that should underpin the property tax reform approach, and responses to the specific policy design questions posed in the Consultation Paper.

Now is also the time to remove the counter-productive foreign tax surcharges on residential property. The economic and housing landscape has changed markedly since the measures were introduced, and the surcharges simply add costs to new housing and jeopardise viability of new projects. Removing the foreign investor surcharges would send the right signal to global capital and investors that NSW is open for business and will kickstart our COVID recovery.

PROPERTY TAX REFORM PRINCIPLES

The NSW property tax reform model should reflect the following principles:

1. **Genuine opt-in choice** – this is crucial to ensuring there is no 'double tax' where a taxpayer is subject to both stamp duty and property tax (as is the case in the ACT currently) and allows taxpayers to determine which regime best suits their circumstances. It is not always the case that an annual property tax will be the better outcome.
2. **Reform does not result in higher taxes for commercial property sector** – the experience in the ACT has unfortunately resulted in a disproportionate share of the tax reform burden resting with commercial property owners, which is bearing a stamp-duty like rate of property tax payable every year. Capital is highly mobile and can be invested in other jurisdictions which would have detrimental impacts for NSW businesses and investment.
3. **Recoverability of property tax for commercial property owners** – there should not be any restrictions or prohibitions introduced for commercial property owners that would limit recoverability of property taxes where they do opt-in to the regime.
4. **No increase in cost of housing development** – the setting of the property tax rate that applies for residential developers should not increase the cost of housing development or reduce housing diversity and choice – this would be counter to the objective of improving housing affordability and mobility.
5. **An 'open to all' reform model – no transition thresholds** – an 'open to all' reform model would ensure all purchasers have a real choice, market distortions are minimised and the transition occurs in a reasonable time frame. If price thresholds are included in the final model to alleviate the short-term budget impacts of the reforms, then the following additional principles should be considered:
   - There should be no thresholds for newly constructed residential dwellings – this is critical to boosting velocity of transactions, facilitating new housing supply and driving economic activity and jobs.
   - The threshold for existing residential dwellings should be set as high as possible to capture the bulk of the market (including Sydney metro) to maximise the mobility and economic efficiency impacts of the reform.
   - There should be no threshold for commercial property to best allow the market to respond to economic settings and ensure there are not distortive impacts on price, values and investment.
   - There should be a clearly legislated timetable setting out when the thresholds will be increased to cover all properties – this ensures we are not sitting here 10, 20 or 30 years down the track with no clarity on when certain properties will be able to opt-in to the regime.
6. **Tailored approach for property types that do not fit clearly within the residential or commercial categories–** assets that are currently exempt from land tax such as retirement villages, emerging asset classes such as purpose-built Build-to-Rent housing, and charitable institutions currently exempt from stamp duty and land tax should maintain their current concessional treatments. These property types should not be worse off under the property tax option which would mean additional tax rates would be required in the reform model.
7. **Underpinned by a robust valuation framework based on unimproved land value** – we support basing the property tax on unimproved value of an individual property as this ensures the property tax is not a tax on capital and removes the current distortions that arise due to the aggregation rules. It will also be critical to develop a principles-based valuation framework to underpin the annual valuation process that provides certainty to taxpayers and integrity to the system.

RESPONSE TO CONSULTATION QUESTIONS

Question 1: Do you agree that stamp duty is out of date and is a handbrake on the economy? Is there merit in replacing it with a broad-based annual property tax?

Property is currently a highly taxed asset class – with taxes imposed across all three levels of government and throughout the property asset life cycle. The property industry is the State's largest collective taxpayer, contributing around $22.3 billion, equating to 52.1% of total State taxes and local government rates, fees and charges revenues in 2018-19.

The Property Council has been advocating for the abolition of stamp duty for decades.

As the Consultation Paper notes, every credible economist in the country acknowledges that stamp duty is a highly inefficient tax that does significant economic damage. It is 50 per cent worse for the economy than company tax (measured in terms of marginal excess burden), gives families less choice by locking them into inappropriate housing, reduces transaction volumes, lowers labour mobility, restricts housing supply and is a highly volatile revenue source for state and territory governments.

However, the major obstacle to abolishing stamp duty is determining the most appropriate replacement revenue. This challenge has been exacerbated in recent years due to the significant role stamp duty has played in state budgets.

For example, in 2019-20, the NSW Government collected almost $7 billion in stamp duty revenues, representing about 23 per cent of total tax revenues for the year. Since 2019, NSW stamp duty brackets have been indexed to CPI, however, this followed many decades of bracket creep where higher house prices swept more and more properties into higher stamp duty brackets, and the State became increasingly reliant on stamp duty revenues.

About $4.5 billion of land tax is also collected, and as noted in the Consultation Paper, this is primarily borne by about 8.5 per cent of residential properties and 25 per cent of commercial properties.

The Henry Tax Review recommended that stamp duty should be replaced with more efficient taxes, such as those levied on broad consumption or land bases (recommendation 51).

The possibility of replacing stamp duty with a broad consumption tax was originally canvassed in the agreement between the Commonwealth and State and Territory leaders in 1999 to introduce the GST as a way of providing a stable and growing source of revenue and abolish inefficient taxes. Under that agreement, all states agreed to use the additional GST revenue to fund the abolition of commercial stamp duty 'at a time to be determined'. However, only South Australia has done so to date (see Box 1 below).

The NSW proposal focuses on replacing stamp duty with an annual property tax and makes a strong case for how this would boost home ownership and household mobility.

As the ACT experience shows (see box 2 below), the sustainability of replacing a quarter of the state's tax budget with an annual property tax will be limited by how much revenue could be collected without creating an unbearable recurring impost on taxpayers.

Recommendation 1: Government to work with industry to learn from the ACT experience and ensure we are not simply moving from one bad tax regime to a new tax regime which imposes significant burdens on household budgets and act as a handbrake on business and investment.

Box 1: Abolishing commercial stamp duty in South Australia

Following a comprehensive tax review process, the SA Government announced in 2015 that it would embark on a three-year plan to abolish stamp duty on commercial property transactions. This was estimated to cost the state $389 million over three years.

Stamp duty was reduced by one-third each year for three years, with the tax fully removed from 1 July 2018. The purpose of the reform was to drive economic activity and growth and reflected that the states had received GST revenues under the 1999 intergovernmental agreement.

Box 2: Learnings from the ACT 'tax reform' process

In 2012 the ACT began a 20-year 'tax reform' process to abolish stamp duty and replace this with a single land tax style property tax (combining their previous commercial property land tax regime with general rates). Eight years on, key facts are now clear:

- **Stamp duty isn't being abolished**

  Total stamp duty revenue has only fallen by 1 per cent in nominal terms from $268m in 2011/12 to a budgeted $265m in 2019/20. While stamp duty revenues are budgeted to fall to $217m in 2020/21, much of this can be attributed to lower numbers of real estate transactions during the COVID-19 pandemic. In fact, the ACT Government expects commercial stamp duty revenues to rise by 20 per cent in 2021/22.

  While some stamp rates have been lowered, others haven't. Indeed, the top stamp duty rate was actually increased from 6.75 per cent to 7.25 per cent for properties over $1m as the first act in this reform process in 2011.

  In 2018 the ACT introduced separate stamp duty rates for commercial and residential properties. Commercial properties valued above $1.5m are now subject to a flat 5 per cent stamp duty rate, while lower valued commercial properties are not subject to stamp duty. During Stage 3 of tax reform, the commercial stamp duty tax-free threshold will increase, to reach $2 million in 2025-26.

  For residential properties, stamp duty payable in the ACT isn't radically different from that which is payable in neighbouring states. For example, a $650,000 residential property purchase would attract stamp duty of $17,880 in the ACT, compared to $15,100 in Queensland or $24,682 in NSW.

- **The changes haven't been revenue neutral**

  Total property tax revenues (stamp duty, land tax and general rates) have increased by 77 per cent over this time, with the ACT Government now receiving $461m more in property taxes than it did in 2011/12. While stamp duty revenues have been largely unchanged, the ACT's 'broad based land tax' revenues have more than doubled, increasing from $324m to $762m.

- **Businesses are being double taxed**

  The burden of the ACT's tax changes has been particularly large on businesses.

  Business properties with land values above $600,000 are subject to general rates of up to 5.54 per cent. This is effectively a stamp duty sized tax that is payable *every* year.

  The top tax rate in the ACT's commercial property general rates scale is now nine times higher than for residential land owners.

- **Household budgets are struggling to keep up with rate rises**

  While owner occupiers are subject to lower property rates than commercial property owners, they have also faced significant year on year increases, with residential rates forecast to raise almost $400m in government revenue in 2020/21.

- **No one knows how high these taxes will go**

  The ACT Government has not published any forward pathway to eventual stamp duty abolition and what this might mean for the levels of general rates. The ACT Government has indicated, in the latest budget papers, that from 1 July 2021, commercial general rates will increase on average by 3.75% per annum, with no corresponding timelines for reducing stamp duty.

Question 2: The annual property tax would be based on unimproved land value, much like the way council rates are currently calculated – what do you think of this approach?

The Property Council supports the proposal to apply the property tax based on unimproved land value of an individual property. This ensures the proposed property tax is not a tax on capital which is consistent with the principles set out in the Henry Tax Review, as well as the NSW Government's decision to not implement Capital Improved Value as the basis for setting rates in its response to the IPART council rating review.

The alternative, that is, taxing the improved value of the land, would tax the labour and capital used to drive productivity, rather than the government's "economic rent" from the land itself. From a practical point of view, this would discourage investment, distort the efficient use of land, and adversely impact the overall productivity of the economy. This effectively discourages any business activity that has intensive land use or involves significant factors of production, such as manufacturing.

The proposal also removes the distortionary impacts of aggregating holdings, where the same property can be taxed at different rates.

If this proposal is to proceed, we recommend a stream of work to develop a principles-based framework that would underpin the annual valuation process and provide certainty to taxpayers and integrity to the system. This would seek to address the existing complexities with land valuations that can often end up in costly and lengthy disputes and legal challenges (see examples of common issues in Box 3 below), which are likely to be exacerbated as more and more parcels of land are subject to the annual property tax.

Recommendation 2: Property tax regime is underpinned by a robust valuation framework based on unimproved land value.

Box 3: Current complexities with land valuations

Rezoning example

ABC Property Group has a 99-year Crown lease over a parcel of land and has built a 10-story office building. The lease does not allow ABC Property Group to use the land for residential purposes.

The area surrounding the office building is increasingly used for residential purposes, and the land leased by ABC Property Group is then revalued to reflect the 'highest and best use' of the site as residential despite the limitations under the terms of the Crown lease.

Under the proposed tax regime, this impact will be exacerbated if the land continues to be valued as residential (even where there are legal restrictions in place prohibiting this use), while bearing the higher commercial property tax rate.

Question 3: Do you agree that it would be attractive to be able to choose an annual property tax rather than paying a large lump-sum stamp duty on a purchase and, for investors, the current annual land tax?

As the Consultation Paper notes, every taxpayer's circumstance is different – an individual looking to purchase their 'forever home' may find that paying the stamp duty is a better option, while an individual planning to move home frequently, or closer to the beginning of their home owner journey, may prefer the property tax option.

We strongly support the 'choice' principle as it will allow taxpayers to assess which approach may be preferable for their circumstances. In fact, without having choice as a fundamental underpinning of the plan, our support would be more difficult to give. It is not always the case that an annual property tax will be the better outcome.

How taxpayers assess the choice between stamp duty (and land tax) or property tax will differ significantly depending on a raft of factors, including:

- The nature of the taxpayer – which influences the expected hold period of the property and the tax rate that they are subject to (if an investor). For those seeking a mortgage, an annual property tax could also impact their maximum borrowing capacity.
- The nature of the asset – which will determine the potential property tax rate applicable.
- The nature (value) of the land (on which the property tax is to be calculated) compared to the property value (on which stamp duty is typically calculated).
- The expected hold period – as a longer hold period may mean paying stamp duty upfront could give a better financial outcome or provide more certainty.
- The expected increase in the rate of annual property tax payable over time or land valuations and 'trust' in government to not increase this exponentially.
- The taxpayer's appetite to be an 'early adopter' of the choice and what assurances or support may be provided by the government in this regard to facilitate broader transition to the tax in the longer term.
- The expected impact making the choice will have on the property's future re-sale value given all future buyers will be subject to the property tax once the choice is made.
- The impact of the tax on market pricing and vendor expectations as the system matures. To the extent the tax creates an escalation in market pricing this may negate the benefit of the upfront stamp duty saving.
- The complexity associated with transacting within a dual tax system and how this impacts the taxpayer's readiness to transact, particularly in a competitive bid context.

- The recoverability of the property tax from tenants, especially for commercial properties where land tax can be fully passed on to tenants.
- The deductibility of the property tax against income tax payable (if an investor).

We have included a few illustrative examples of these factors at Box 4 below.

Most discussion of this proposal to date has focussed on the impact for households and residential owners which is not surprising given the fundamental shift that is proposed.

However, owners, investors, developers and business properties in NSW already pay very high land tax rates. It is critical in settling on a final model, the different market structures and dynamics for residential and commercial property are taken into consideration in assessing the risks, drivers and efficiencies relating to a stamp duty land tax switch.

Considerations for long-term commercial property owners

Land taxes have the effect of reducing net income from a commercial property asset, which is the primary investment metric for such assets which are typically acquired with a long-term investment horizon.

Any increase in annual property tax costs would add to the holding costs of the asset and therefore further reduce net income. Aside from having a negative impact on values and investments into the NSW commercial property market, the commercial impact of a higher property tax would be borne by either the business tenants of the building or owners of commercial properties, including the 16 million Australians invested in commercial property via their superannuation funds.

While land may not be able to be moved, capital is highly mobile and can be invested in other jurisdictions or other asset classes, for example, equities or bonds which do not attract either land tax or stamp duty. Both domestic and foreign capital is sensitive to increases in statutory and other fixed operational costs for commercial property, and institutional investors will naturally look to other more attractive markets and asset classes where the risk/return profile is more appealing.

Therefore, ensuring there is a genuine choice available for commercial property owners will be essential.

Considerations for residential developers

The Consultation Paper does not clearly set out how the proposed property tax regime could apply for residential developers. For example, will residential developers be subject to the owner-occupied residential property rate of 0.3%, the investment residential property rate of 1% or the commercial property tax rate of 2.6%? Can residential developers make the choice on acquiring a parcel of land for development, or is the choice made by the ultimate purchaser of the house or apartment?

These unanswered questions, along with the differing hold periods that can occur for developers (for example, for a greenfield site vs infill development), will all influence whether a stamp duty or property tax would be the preferable option.

Developers will seek to provide the most optimal outcomes for their end customers, and the proposed tax regime should not increase the cost of housing development or reduce housing diversity and choice.

Box 4: Illustrative examples of factors that may influence choice

Hold period – owner occupier purchasing new home

Jordan and Linh are looking to purchase a new home for their growing family. They have found a new four-bedroom home and land package in Sydney. They intend to live in the home indefinitely.

Assume the property value is $1,100,000 and the unimproved land value is $450,000.

Jordan and Linh will have the choice of:

- Paying stamp duty upfront of $45,505, or
- Paying an annual property tax of $1,850 per annum – over 25 years, this would equal $46,250 in nominal terms, and could be higher as land values rise or the rates increase over time.

Nature of taxpayer and asset – investor purchasing an apartment for rental

Fatima is looking to purchase a one-bedroom apartment as an investment.

Assume the property value is $650,000 and the strata unit land value is $120,000.

Fatima will have the choice of:

- Paying stamp duty upfront of $24,585 and no land tax (as the property is under the tax-free threshold), or
- Paying an annual property tax of $2,700.

The annual property tax payable by Fatima would exceed the benefit of not paying stamp duty if she intends to hold the property for more than 9 years. However, Fatima may also consider the income tax implications of stamp duty vs property tax, noting that stamp duty would be a capital cost and reduce her capital gains tax liability when she sells the property, while annual property tax would be an expense that can be offset against any rental income in calculating her personal income tax liability.

Value of land as proportion of property value – business purchases industrial site

Pottery Pty Ltd is looking to purchase an industrial shed for their new business. Their building requirements are minimal but require a large parcel of land for their activities.

Assume the property value is $15,000,000 and the unimproved land value is $12,000,000.

Pottery Pty Ltd will have the choice of:

- Paying stamp duty upfront of $810,000 and an annual land tax of $209,556, or
- Paying an annual property tax of $312,000.

The additional $102,444 of annual property tax payable by Pottery Pty Ltd would exceed the benefit of not paying stamp duty if the company intends to hold the property for more than 8 years.

Triggering a choice

It is not clear from the Consultation Paper what types of transactions would trigger a choice, and what would be excluded.

For example, for residential developers, do they make the choice on acquiring a parcel of land for development, or is the choice made by the ultimate purchaser of the house or apartment? Would entering into a 99-year lease trigger a choice? What happens for sub-divisions, partitions or amalgamations of land?

Clarity is also required on the implications for partial acquisitions, and circumstances where there has been a change in trustee or custodian with no change of beneficial owner.

Recommendation 3: Given the varying impacts across different property sectors, it is critical that property owners are given a genuine choice on whether to opt-in to the regime.

Recommendation 4: Government to work with industry to identify what types of transactions will trigger a choice and what would be excluded.

Question 4: Is an opt-in and gradual approach the best way of ensuring a fair transition to the property tax?

As noted above, transitioning away from a tax base that currently represents one quarter of the state's budget is extremely challenging.

Our learnings from the ACT show that a gradual phase in of property tax and phase out of stamp duty has not given rise to a fair transition, with many taxpayers subject to both stamp duty and annual property tax. We applaud the NSW Government for not going down a similar path as an opt-in approach will mean taxpayers are only subject to stamp duty (and land tax) or property tax, not both.

However, there remain significant unknowns with the transition approach put forward, including:

- How long is 'gradual'? The Consultation Paper notes that even after 20 years, more than half of all properties would not have elected into the property tax regime.
- What are the implications for the existing stamp duty and land tax regimes over time? Will they be ratcheted up to force taxpayers to opt-in to the property tax regime?
- Even with the initial proposed thresholds (see further comments below at question 8), the Consultation Paper estimates the transition will give rise to a $2bn annual loss. Given the ACT experience, there is significant concern that this funding gap (and the pressure it places on the State's budget and credit rating) could lead to higher business taxes to make up the shortfall.
- What are the implications of setting opt-in thresholds were only some properties are able to opt-in from day one? Could this give rise to pricing impacts and inefficiencies?
- What are the implications of having a bifurcated market where some properties remain eligible for buyers' to make the choice, and some properties have been irrevocably opted-in to the property tax regime? Could this give rise to pricing impacts and inefficiencies? There are also complexities on how this may impact land valuations and determinations of market rent when some properties are in the regime, and some properties remain in the existing regime.
- As noted in our response above, there are likely to be many scenarios where a particular asset type or owner will never logically opt-in to the property tax regime. What does this mean for the long-term success of the reform plan, which is presumably built on the assumption that all properties will eventually opt-in to the property tax regime? Industry is concerned this could lead to policy or technical changes that compel taxpayers into the regime.

Recommendation 5: The final reform plan should include a detailed explanation of the transition plan which includes implications for revenue, pricing and market efficiencies over the short, medium and long term, and the structural implications if there are properties that remain outside the property tax regime into perpetuity.

Question 5: Would you delay a home purchase if it meant you could opt-in to the property tax? Should there be a limited window for retrospective opt-in to the property tax, after it commences?

The Government has rightly acknowledged in the Consultation Paper that the canvassing of tax reform options does have real-time impacts on prospective buyers in the market.

We would support measures that would allow taxpayers the ability to opt-in retrospectively from the day of the announcement to when the legislation commences.

Recommendation 6: The final reform plan should include a retrospective opt-in timeframe to minimise disruptions to the market following the announcement.

Question 6: Should there be different property tax rates for residential owner-occupied properties, residential investment properties, farmland and commercial properties?

We acknowledge the proposal put forward in the Consultation Paper that these reforms will be revenue neutral across groups of property owners. We note that the ACT reforms were also intended to be revenue neutral, and which has unfortunately resulted in a disproportionate share of the reform burden resting with commercial property owners, who are paying a stamp duty-like tax every year. It is critical to the success of the plan that this commitment be durable to provide confidence and certainty for long term and non-residential property investors and owners.

We would request that Government disclose the total stamp duty and land tax revenues currently collected across the four proposed categories to ensure greater transparency and accountability of the 'revenue neutral' approach of the reforms and to enable future tracking against Treasury estimates in this regard. This would also clarify whether the different tax rates proposed are reasonable.

As we noted above, the property tax rate set for each of the categories will play a significant role in assessing whether to opt-in to the regime.

The implications for houses and apartments will also differ – while both may be subject to the same residential owner occupier rate, the land value for a house is likely to be higher than the land value attributed to an apartment giving rise to different tax outcomes. This would accord with the economic theory behind a property tax regime which is to maximise the efficiency of land use, however, it could result in changing demand for different types of housing.

It is also possible that the property tax could result in a bias towards low value land properties which are typically less well serviced from an infrastructure perspective and more distant from large population basis. These broader zoning, planning and environmental implications of the reforms should be fully ventilated and assessed as part of the cost/benefits of the reform plan.

In addition, the Consultation Paper does not set out details on the implications for a range of property types that do not fit clearly within the four categories, including:

- Unimproved land acquired for the purposes of residential development.
- Assets currently exempt from land tax such as retirement villages and childcare.
- Emerging assets such as purpose-built Build-to-Rent housing which is eligible for newly legislated land tax treatment if certain planning and tax conditions are satisfied.
- Mixed use precincts or other assets which have a combination of commercial and residential features.

Given the 'revenue neutral' objective of these reforms, the starting point when considering these additional property categories should be to ensure any existing policies and tax treatments are carried over into the new regime (see Box 5 below for further discussion on retirement villages and Build-to-Rent housing). We would also see merit in having an additional property tax category with a 0% tax rating to address properties that are currently not subject to land tax.

The paper also does not discuss taxpayers currently exempt from both stamp duty and land tax such as charities and eligible not-for-profit operators, and it would be our expectation that these reforms do not cause adverse implications for these groups.

Recommendation 7: Government should disclose the total stamp duty and land tax revenues currently collected across the four proposed categories to ensure greater transparency and accountability of the 'revenue neutral' approach of the reforms and to enable future tracking against Treasury estimates in this regard.

Recommendation 8: The broader zoning, planning and environmental implications of the reforms should be fully ventilated and assessed as part of the cost/benefits of the reform plan.

Recommendation 9: Government to work with industry to assess how the property tax regime would apply to property types that do not fit clearly within the four categories, which could include developing a 0% property tax category to deal with assets that are currently exempt from land tax.

Recommendation 10: Government to confirm taxpayers currently exempt from both stamp duty and land tax such as charities and eligible not-for-profit operators would not be worse-off under these reforms.

Box 5: Property types currently subject to distinct policy choices

Retirement villages

Retirement villages are subject to extensive state-based legislation and are broadly defined as any residential complex predominately occupied by retired persons who are aged over 55 years. Land lease communities are also a small but growing part of the seniors housing sector.

Treasury projects a doubling of the seniors' population by 2050. An increased investment in the seniors housing sector needs to be supported to ensure there is a good supply of purpose-built seniors housing.

Research commissioned by the Property Council uses official government data to demonstrate that retirement villages are directly responsible for saving Australian governments at least $2.16 billion each year through delayed entry of residents to aged care and through residents requiring fewer hospital and GP visits and shorter hospital stays. This research specifically identifies Australian Institute of Health and Welfare data, which has been backed by independent analysis, showing retirement village residents enter aged care on average five years later than those going from a family home.

Under the existing land tax rules, land which has a retirement village or a land lease community on it is exempt from land tax in NSW. We note that states such as Victoria also provide the land tax exemption while the village is being developed. Residents moving into a retirement village do not typically trigger a stamp duty liability and their ability to pay any annual property tax would be very restricted.

A 0% property tax rate would be appropriate for retirement village operators given the current land tax exemptions in place. This ensure the reform does not result in any increase in operating costs which would have significant detrimental impact on the market and operators could not reasonably be expected to opt-in to such a regime.

Purpose built Build-to-Rent housing

Purpose built Build-to-Rent housing delivers much needed housing supply, increases diversity of housing choice, is good for renters and keeps jobs in construction. However the emergence of Build-to-Rent housing in Australia has been impeded by significant policy barriers and disincentives.

In recognition of these benefits and barriers, the NSW Government has recently implemented specific Build-to-Rent policies for planning purposes (State Environmental Planning Policy Amendment (Build-to-rent housing) 2021), and tax purposes (Treasurer's Guidelines for the reduction in land value for certain Build-to-rent properties).

The Build-to-Rent tax regime facilitates a 50% discount on land tax until 2040 for eligible investments as well as exemptions from the foreign investor surcharges. To qualify for the new Build-to-Rent framework, the development must be purpose built, consist of more than 50 dwellings, be unable to be subdivided for at least 15 years amongst other criteria. This creates a distinct and separate housing typology, separate to other forms of housing developed for ownership or rental purposes.

The Build-to-Rent sector is at a formative stage with only a few pilot projects committed. It will be important for early pilot projects to be successful in demonstrating what is possible in order to keep existing investment in the sector, demonstrate the benefits of the product and service to the community and encourage new capital and commitment to projects. It is absolutely critical that the first generation of projects are given every chance of success.

An additional property tax category would be the preferred approach for Build-to-Rent housing to ensure the same or similar stimulatory tax outcomes are able to be achieved. In addition, certainty post the existing legislation's 2040 horizon must be addressed to inform decisions that are being made today and also to preserve the legislation's intended benefit which would otherwise be discounted and eroded by the time limit which is likely an unintended consequence of the legislative drafting.

Question 7: Given this tax reform is an investment into our future, do you think it is worth the cost?

Stamp duty has produced significant revenues for the government in the past decade with minimal reforms or changes to the tax rates, apart from the recent indexation changes.

The NSW financial position has been severely constrained as a result of the COVID-19 pandemic and this reform is expected to put significant pressure on the budget in the near term.

In determining whether the benefits are worth the cost, we would be very keen to better understand the calculation of the $11 billion benefit that is expected to arise from the reforms over the next four years. What are these benefits, what assumptions underpin this modelling and how has this figure been calculated?

We understand that there can be significant benefits from greater mobility and rightsizing, however, the potential benefits across all sectors, especially the non-residential sector, is not clear from the Consultation Paper and should be articulated prior to any decisions to proceed with the reforms.

As noted in our response to question 4 above, we are also concerned about the open-ended nature of the transition process and how this uncertainty impacts individuals, businesses and government revenues going forward.

Recommendation 11: Government to provide further details on how the economic benefits of the reform have been calculated, across all sectors, and what assumptions underpin this modelling.

Question 8: Should price thresholds be used to exclude people buying the most expensive properties from being able to choose the property tax?

If the aim of these reforms is to allow as many people as possible to move away from an inefficient transaction tax towards a more stable annual property tax, then the starting principle should be to not have any price thresholds.

Similarly, if one of the fundamental tenets of the plan is to provide absolute choice for purchases, then the only way to absolutely meet that test is through the implementation of no threshold.

Thus, we assume that the primary reason for a threshold is to mitigate the short term financial impact of the tax reform plan.

Where price thresholds are required to be set to alleviate the budget impacts of the reforms, we are concerned this could lead to significant distortions or pricing impacts for those properties that are just below or just above the price thresholds.

This could particularly be the case for the residential market, especially for new dwellings or dwellings in certain geographical locations which are typically higher in value than the median dwelling price generally. A residential price threshold that resulted in significant numbers of new dwellings, or dwellings in certain geographical locations, being ineligible to opt-in to the regime, could result in detrimental impacts for housing supply, construction and jobs.

If a price threshold is to be set, there must be a clearly legislated timetable setting out when the thresholds will be increased to the point where all properties will be eligible to be within the regime. A clear and fixed legislated timetable would reflect the government's commitment to abolish stamp duty, and ensure we are not sitting here 10, 20 or 30 years down the track with no clarity on when certain properties will be able to opt-in to the regime.

Recommendation 12: Government should adopt an "open to all" model with no price threshold to ensure all purchasers have a real choice, market distortions are minimised and the transition occurs in a reasonable time frame.

If a price threshold is included in the final model to alleviate the short-term budget impacts of the reforms:

- ***there should be no threshold for new dwellings to boost velocity of transactions, facilitate new housing supply and drive economic activity and jobs;***
- ***the threshold for existing residential dwellings should be set as high as possible to capture the bulk of the market (including Sydney metro) to maximise the mobility and economic efficiency impacts of the reform;***
- ***there should be no threshold for commercial property to best allow the market to respond to economic settings and ensure there are not distortive impacts on price, values and investment; and***
- ***there should be a clearly legislated timetable setting out when the thresholds will be increased to cover all properties.***

Question 9: What arrangements should be made for residential and commercial tenants if their landlord chooses to pay the property tax?

We understand the *Residential Tenancies Act 2010* contains specific provisions requiring landlords to pay rates, taxes or charges relating to residential premises being leased. We do not have any specific comments on these requirements but support further consideration on what would be the most appropriate outcomes under a property tax regime.

For non-residential tenancies, there are no legislative restrictions on the ability of landlords and tenants to reach agreement on which party will bear the cost of outgoings such as land tax. This forms part of the commercially negotiated terms between a landlord and a tenant. We would not support any proposal to prohibit the recoverability of the property tax.

Recommendation 13: There should not be any restrictions or prohibitions introduced for commercial property owners that would limit recoverability of property taxes where they do opt-in to the regime.

Question 10: What should happen for people who have chosen the property tax but then can't afford it?

We acknowledge the Consultation Paper discussion on providing a hardship scheme for owner occupiers facing difficult financial circumstances and would support the proposed approach to allow landowners to defer their liabilities until their financial circumstances improve or until they eventually sell or transfer ownership of the property. We also support the proposal to apply a commercial rate of interest to deferred liabilities to ensure the hardship scheme is not utilised as a cheap source of finance.

Question 11: What is the best way of ensuring that the property tax remains affordable for taxpayers while generating the same amount of long-run revenue as stamp duty and land tax?

This is a critical question that will influence decisions to opt-in to the regime or pay stamp duty.

Land values can go up or down, but typically move at a rate higher than wages growth or inflation. This has resulted in significant year on year increases in land tax payments for those currently subject to land tax and could result in similar uncertainty for those subject to the property tax regime.

There can also be scenarios where a rezoning triggers a significant upward revaluation of the land, even where there is no sale and no intended change to the use of the land to reflect the rezoning.

We support further consideration on the ideas put forward in the Consultation Paper to cap the annual property tax revenue target in line with an appropriate measure, such as household income or nominal Gross State Product. We would need to understand the implications this would have across the different property categories and for individual properties.

Recommendation 14: Modelling should be produced which outlines the impacts of the various 'capping' options to generate the same amount of long-run revenue as stamp duty and land tax – this should be done across different property classes to reflect the intention for revenue neutrality across property categories.

Question 12: Is there a specific aspect of our proposed reform you would change to help make the proposal better?

We applaud the Government for taking on this bold reform initiative and acknowledge the significant financial burdens this will place on the State's budget in the short to medium term during the transition.

We would expect that this pressure could be alleviated – or the reform plan could be undertaken differently – if there was a broad Commonwealth-led tax reform initiative that brought along other state and territory governments, or there was better clarity on the GST redistribution implications of the Government 'going alone' on this reform plan. We acknowledge that a national-led tax reform approach is not currently on the agenda.

As we have discussed above, while we understand there are potentially benefits that arise from the proposed reforms, particularly for home owners, there are significant unknowns and critical risks that should be addressed to ensure the reforms achieve their intended outcomes and unintended ones are avoided. As such, the NSW tax reform model should reflect the following principles:

1. **Genuine opt-in choice** – this is crucial to ensuring there is no 'double tax' where a taxpayer is subject to both stamp duty and property tax (as is the case in the ACT currently) and allows taxpayers to determine which regime best suits their circumstances. It is not always the case that an annual property tax will be the better outcome.
2. **Reform does not result in higher taxes for commercial property sector** – the experience in the ACT has unfortunately resulted in a disproportionate share of the tax reform burden resting with commercial property owners, which is bearing a stamp-duty like rate of property tax payable every year. Capital is highly mobile and can be invested in other jurisdictions which would have detrimental impacts for NSW businesses and investment.
3. **Recoverability of property tax for commercial property owners** – there should not be any restrictions or prohibitions introduced for commercial property owners that would limit recoverability of property taxes where they do opt-in to the regime.
4. **No increase in cost of housing development** – the setting of the property tax rate that applies for residential developers should not increase the cost of housing development or reduce housing diversity and choice – this would be counter to the objective of improving housing affordability and mobility.
5. **An 'open to all' reform model – no transition thresholds** – an 'open to all' reform model would ensure all purchasers have a real choice, market distortions are minimised and the transition occurs in a reasonable time frame. If price thresholds are included in the final model to alleviate the short-term budget impacts of the reforms, then the following additional principles should be considered:
   - There should be no thresholds for newly constructed residential dwellings – this is critical to boosting velocity of transactions, facilitating new housing supply and driving economic activity and jobs.
   - The threshold for existing residential dwellings should be set as high as possible to capture the bulk of the market (including Sydney metro) to maximise the mobility and economic efficiency impacts of the reform.
   - There should be no threshold for commercial property to best allow the market to respond to economic settings and ensure there are not distortive impacts on price, values and investment.
   - There should be a clearly legislated timetable setting out when the thresholds will be increased to cover all properties – this ensures we are not sitting here 10, 20 or 30 years

down the track with no clarity on when certain properties will be able to opt-in to the regime.

6. **Tailored approach for property types that do not fit clearly within the residential or commercial categories**– assets that are currently exempt from land tax such as retirement villages, emerging asset classes such as purpose-built Build-to-Rent housing, and charitable institutions currently exempt from stamp duty and land tax should maintain their current concessional treatments. These property types should not be worse off under the property tax option which would mean additional tax rates would be required in the reform model.
7. **Underpinned by a robust valuation framework based on unimproved land value** – we support basing the property tax on unimproved value of an individual property as this ensures the property tax is not a tax on capital and removes the current distortions that arise due to the aggregation rules. It will also be critical to develop a principles-based valuation framework to underpin the annual valuation process that provides certainty to taxpayers and integrity to the system.

We are also concerned about the administrative complexity of having a stamp duty/land tax regime and a property tax regime running concurrently for many decades to come, particularly for taxpayers that may own properties within both regimes. How the 'property tax' is drafted will have significant impacts on ease of understanding the new regime and compliance costs.

We also note that the Consultation Paper does not address the following key items:

- Interaction with foreign investor stamp duty and land tax surcharges
- Landholder duty
- Confirmation of the income tax treatment, including deductibility of the property tax

In relation to the foreign investor taxes, rather than devising a new regime for foreign investors (with all its complexity), now is the time to remove counter-productive foreign tax surcharges on residential property. The economic and housing landscape has changed markedly since the measures were introduced, and the surcharges simply add costs to new housing and jeopardise viability of new projects. Removing the foreign investor surcharges would send the right signal to global capital and investors that NSW is open for business and will kickstart our COVID recovery.

Recommendation 15: Government to work with industry on unresolved technical, implementation and compliance implications.