

# Design Options for Reform of State Property Taxation

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John Freebairn

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# Outline

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- Current state taxes on property
- Efficiency and equity arguments for reform
- Some issues and options for “devil in the details” of a reform package
  - Tax base
  - Rate schedule
  - Transition options
  - Liquidity constraint

# Current State Taxes on Property

## Conveyance duty on transfer of property

- Base: Value of improved property on purchase
- Progressive rate scale. Some exemptions and loadings
- Inefficient (distorts transfer of property)
- Horizontal inequity

## Narrow base land tax

- Narrow tax base: Exempts owner occupied and primary production
- Progressive rate scale

## Property insurance

- Flat rate on gross premium
- Distorts insurance purchase

## Local government rates

# Ideal Reform Package for Efficiency and Simplicity

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- Replace conveyance duty, current land tax and property insurance taxes with an annual flat rate land tax to generate similar revenue
- However, relative to the current taxes, this reform package is
  - Regressive, as flat rate replaces progressive rates
  - Effective tax rate increase for owner occupied housing and fall for investment property and commercial property
  - Perception of “double taxation” for recent payers of conveyance duty also to pay replacement annual land tax
- Suggests consider compromises of some efficiency loss trade-off for reduced redistribution

# Reform Annual Property Tax Base Options

- Land or improved value
  - Land wins on efficiency. Supply of land less elastic than supply of buildings
  - Some redistribution concern with land base relative to improved property value of current conveyance duty. While the two bases are positively correlated, coefficient less than unity.
- Local government rate base varies across the different states

# Reform Annual Property Tax Rate Schedule Options

- Flat or progressive rate?
  - Flat for efficiency and simplicity
  - However, replacing progressive rates for conveyance and land taxes suggests a progressive rate to approximate current vertical equity effects
- Given current the mix of taxes, including the narrow base land tax, and variation of the frequency of property transfer across user categories, suggests different rate schedules to reduce redistribution effects for
  - owner occupied property
  - rent accommodation property
  - commercial property,
  - primary production

# Transition Path Options for Replacement of Conveyance Duty Include

- Cold turkey, or once only reform for all
  - Grandfather, or change to reform package at next sale of property
  - ACT gradual decrease of current taxes and increase replacement tax
  - Limited concessions, or some offset for recent paid stamp duty
  - NSW grandfather model with voluntary choice
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- The options have different implications over the medium term for revenue over the transition period, efficiency and redistribution relative to the current taxation effects

# Cold Turkey Transition Path Effects

- Revenue neutral
- Maximum efficiency gains
- Results in “double taxation” for recent buyers. Just paid conveyance duty and now pay annual property tax.



# Grandfather Transition Path Effects

- Removes “double taxation” and perceived adverse redistribution effects
- Maximum efficiency gains
- Very large revenue cost for many years. For example, for average turnover of 20 years: first year revenue shortfall of 95%, by 10 years of 50%
- The NSW version is restricted to first home buyers and adds the option to continue with conveyance duty or choose the annual property tax. The later ensures all are perceived winners, adds horizontal inequity, and drags out the transition period.

# ACT Transition Path Option

(A 20 year period, but could be shorter or longer)

- Revenue neutral
- Substantially reduces concerns of redistribution effects of “double taxation”, but not completely
- Slow path to reap the long term efficiency gains of the reform package

# Partial Credit for Recent Paid Conveyance Duty Transition Option

- Example. Offset annual property tax by 50% if conveyance duty last year, 40% if conveyance duty two years back, etc
- Revenue cost of offset over transition period. A suggested offset is to load the replacement annual property tax rate over the medium term to cover the short term revenue loss.
- Reap efficiency gains of reform
- Cushions redistribution effects of “double taxation”

# Summary of Effects of Different Transition Options Relative to Current Taxation

	Revenue	Efficiency gains	Redistribution
Cold Turkey	Neutral	Maximum	Large
Grandfather	Large loss	Maximum	Negligible
Grandfather – NSW	Large loss	Some loss	Some winners
ACT	Neutral	Loss over transition period	Small
Partial Credit	Short term loss	Maximum	Small

# Concessions for the Liquidity Constrained

- Provide option for the liquidity constrained to carry forward the replacement annual property tax to time of sale or property transfer, as now available for local council rates. Index by government borrowing rate for revenue neutral and horizontal equity.
- Potentially includes: “asset rich and income poor”; short term loss of employment, adverse health and other circumstances

# A Potential Reform Package Involves Trade-offs

- Tax base favours land, but improved value OK
- To minimise tax redistribution, different rate schedules for different categories of property
- Progressive rate schedules for each category of property
- Transition path. Difficult trade-offs with ACT model and partial credit model better balances of revenue, redistribution and efficiency effects
- Offer carry-forward payment option for the liquidity constrained