

Tax Reform

Adding nuance to point estimates of tax system efficiency

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Agenda

- **Topic 1:** CGE models carry rich detail. Does one variable rule them all?

See:

Nassios, J., and J. A. Giesecke. *Studying the impact of property tax reform on housing prices and efficiency.*



- **Topic 2:** Where should we be focusing our finite energy and political will?

See:

Nassios, J., and J. A. Giesecke. *How low can we go? Assessing welfare costs relative to revenue raising capabilities for Australia's state and federal taxes.*

Topic 1

Where we have come from

- Australian taxation studies using CGE have focused on one metric: **Marginal excess burden.**

$$MEB(t) = -\frac{d_{welfare}(t)}{d_{revenue}(t)}$$

- Does the focus on marginal excess burden allow us to answer all the questions?
- **Short answer:** Not really.

Replace stamp duty with expanded GST, real estate agents say

Michael Bleby and Nick Lenaghan

Nov 4, 2021 - 6:27pm

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Replacing stamp duty with an expanded GST would be the best way to cut the upfront costs that make housing purchases unaffordable for young people, the country's peak body for real estate agents says.

Real Estate Institute of Australia president Adrian Kelly on Thursday told a parliamentary inquiry into housing supply that he was not surprised NSW was cooling on its own proposal to replace stamp duty with a broader land

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Stamp duty, Victoria: Concerns over potential replacement tax



Jayitri Smiles, Real estate editor
Updated 27 Apr 2020, 3:59pm
First published 27 Apr 2020, 2:24pm

Herald Sun

Building housing price responses into CGE theory

Conceptually simple, with devil in the detail

Problem: CGE models do not track housing prices explicitly.
We address this by developing a housing price module for VURMTAX
(Victoria **U**niversity **R**egional **M**odel with **T**ax detail).

Present value (land) Transaction taxes Sale proceeds

The diagram shows the equation $PVL_{i,q,t} = -\frac{RTD_{i,q,t}}{2} \cdot PVL_{i,q,t} + PV_LNDINC_{i,q,t} + PV@SALE_L_{i,q,t}$. The first term is circled in yellow and labeled 'Present value (land)'. The second term is circled in red and labeled 'Transaction taxes'. The third term is circled in green and labeled 'Present-value of income earned after tax over expected holding period'. The fourth term is circled in purple and labeled 'Sale proceeds'. Arrows point from the labels to their respective terms in the equation.

$$PVL_{i,q,t} = -\frac{RTD_{i,q,t}}{2} \cdot PVL_{i,q,t} + PV_LNDINC_{i,q,t} + PV@SALE_L_{i,q,t}$$

Present-value of income earned after tax over expected holding period

Full details:

Nassios, J. and J. A. Giesecke. *Property Tax Reform: Implications for Housing Prices and Economic Productivity*. CoPS Working Paper No. G-330, available at

<https://www.copsmodels.com/ftp/workpapr/g-330.pdf>

With the module in place we can revisit old questions for some property taxes...

Consider four existing property taxes collected in Australia...

...and three hypothetical property taxes not currently collected in Australia.

1	Transfer duty (all property)
1.1	Transfer duty (new and existing homes)
1.1.1	Transfer duty (existing homes only)
1.1.2	Transfer duty (new homes)
1.2	Transfer duty (non-residential property)
2	State land tax (PPR and PPL exempt)
3	Local council rates (land only)
4	Emergency service levy on insurance
5	Unimproved value land tax (no exemptions, uniform rate)
6	Capital-improved value property tax (no exemptions, uniform rate)
7	Capital-improved property tax (PPR and PPL exempt)

Some existing taxes are broken into a series of sub-component channels

...which provide efficiency rankings...

		Welfare benefit or marginal excess burden <i>in cents per dollar when reducing revenue by A\$100m</i>
		<i>Largest benefit (red) to largest cost (green)</i>
1.1.1	Transfer duty (existing homes only)	132
1.1	Transfer duty (new and existing homes)	112
1	Transfer duty (all property)	82
1.1.2	Transfer duty (new homes)	43
4	Emergency service levy on insurance	42
1.2	Transfer duty (non-residential property)	40
7	Capital-improved property tax (PPR and PPL exempt)	14
6	Capital-improved value property tax (no exemptions)	3
5	Unimproved value land tax (no exemptions, uniform rate)	-8
3	Local council rates (land only)	-11
2	State land tax (PPR and PPL exempt)	-15

Transfer duty accounts for around 80% of total transfer costs for housing in some states

Owner-occupied housing exemptions introduce housing tenure distortions, but also bias tax base towards foreign-owned land

...or we can answer some new questions...

	Welfare benefit or marginal excess burden in cents per dollar when reducing revenue by A\$100m	Real average purchasers price change in % when reducing revenue by A\$100m
	Largest benefit (red) to largest cost (green)	Largest rise (red) to largest fall (green)
1.1.1 Transfer duty (existing homes only)	132	0.138
1.1 Transfer duty (new and existing homes)	112	0.104
1 Transfer duty (all property)	82	0.077
1.1.2 Transfer duty (new homes)	43	-0.149
4 Emergency service levy on insurance	42	0.013
1.2 Transfer duty (non-residential property)	40	0.000
7 Capital-improved property tax (PPR and PPL exempt)	14	0.074
6 Capital-improved value property tax (no exemptions)	3	0.072
5 Unimproved value land tax (no exemptions, uniform rate)	-8	0.116
3 Local council rates (land only)	-11	0.094
2 State land tax (PPR and PPL exempt)	-15	0.077

- Purchasers' price rises. Market price rise exceeds transfer duty rate reduction.
- Removing transfer duty and not replacing it with another property tax drives housing price inflation

...add in some compositional change...

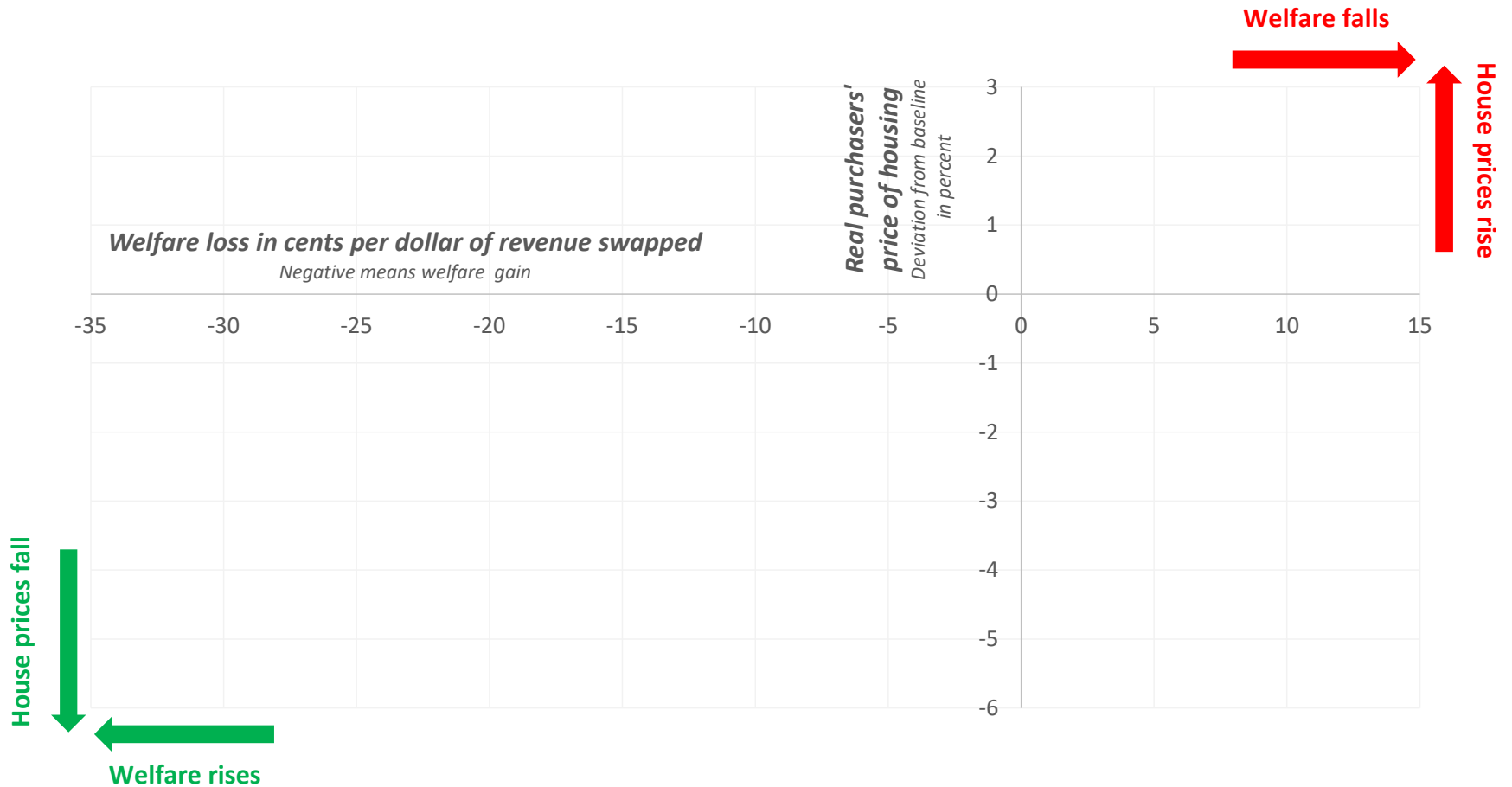
	Welfare benefit or marginal excess burden in cents per dollar when reducing revenue by A\$100m	Real average purchasers price change in % to A\$100m tax cut	Real low-density purchasers price change in % to A\$100m tax cut	Real high-density purchasers price change in % to A\$100m tax cut	
	Largest benefit (red) to largest cost (green)	Largest rise (red) to largest fall (green)	Largest rise (red) to largest fall (green)	Largest rise (red) to largest fall (green)	
1.1.1	Transfer duty (existing homes only)	132	0.138	0.116	0.275
1.1	Transfer duty (new and existing homes)	112	0.104	0.087	0.215
1	Transfer duty (all property)	82	0.077	0.065	0.155
1.1.2	Transfer duty (new homes)	43	-0.149	-0.122	-0.226
4	Emergency service levy on insurance	42	0.013	0.014	-0.003
1.2	Transfer duty (non-residential property)	40	0.000	0.001	-0.013
7	Capital-improved property tax (PPR and PPL exempt)	14	0.074	0.083	0.048
6	Capital-improved value property tax (no exemptions)	3	0.072	0.089	0.029
5	Unimproved value land tax (no exemptions, uniform rate)	-8	0.116	0.135	0.073
3	Local council rates (land only)	-11	0.094	0.110	0.054
2	State land tax (PPR and PPL exempt)	-15	0.077	0.030	0.177

Transfer duty impact is an increasing function of:

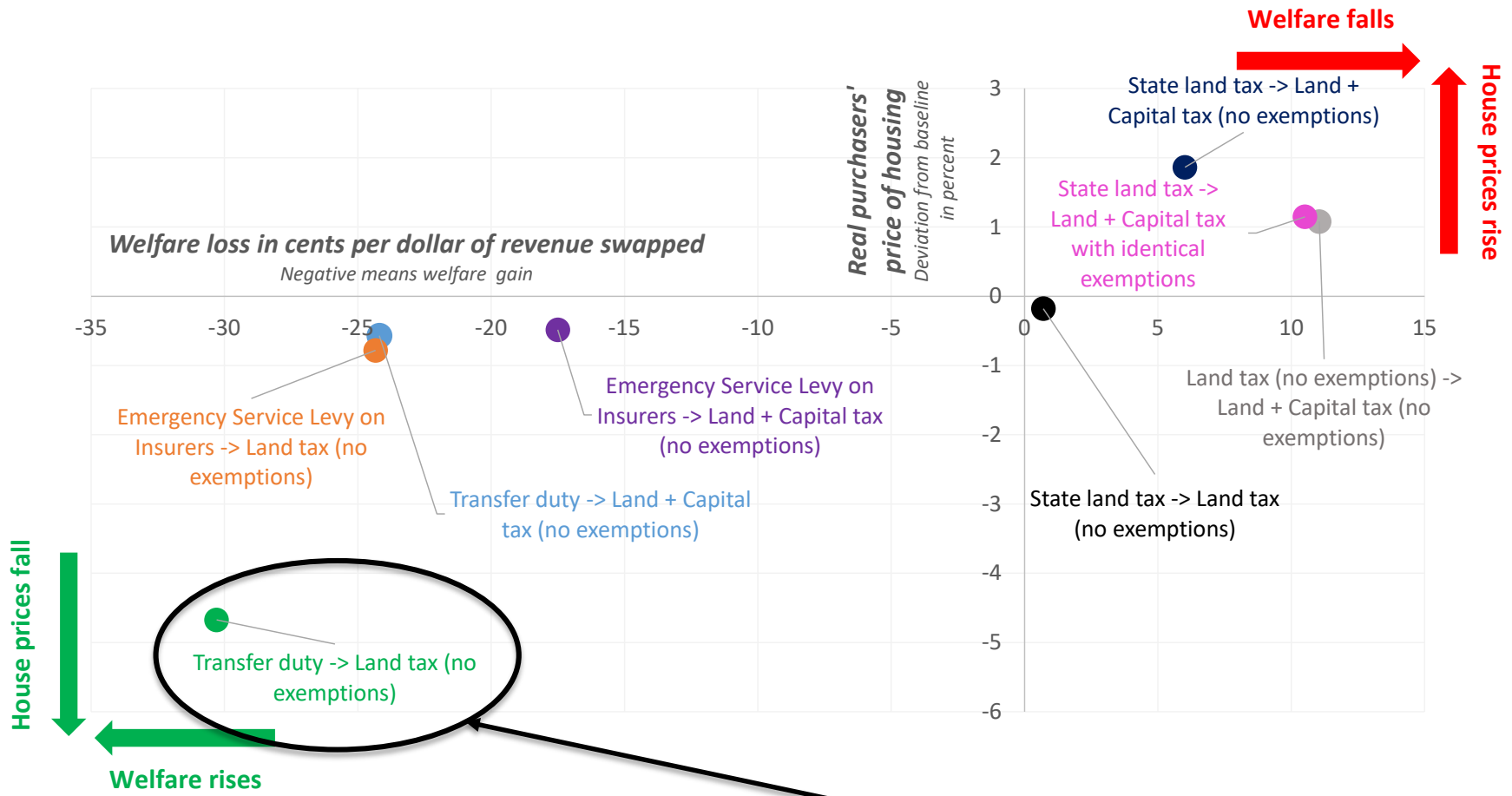
- Land value share (higher for low-density);
- Holding period (lower for high-density).

High-density housing carries low land-value shares, but high rented tenure shares.

...and rank tax reform packages on more than just efficiency.



...and rank tax reform packages on more than just efficiency.

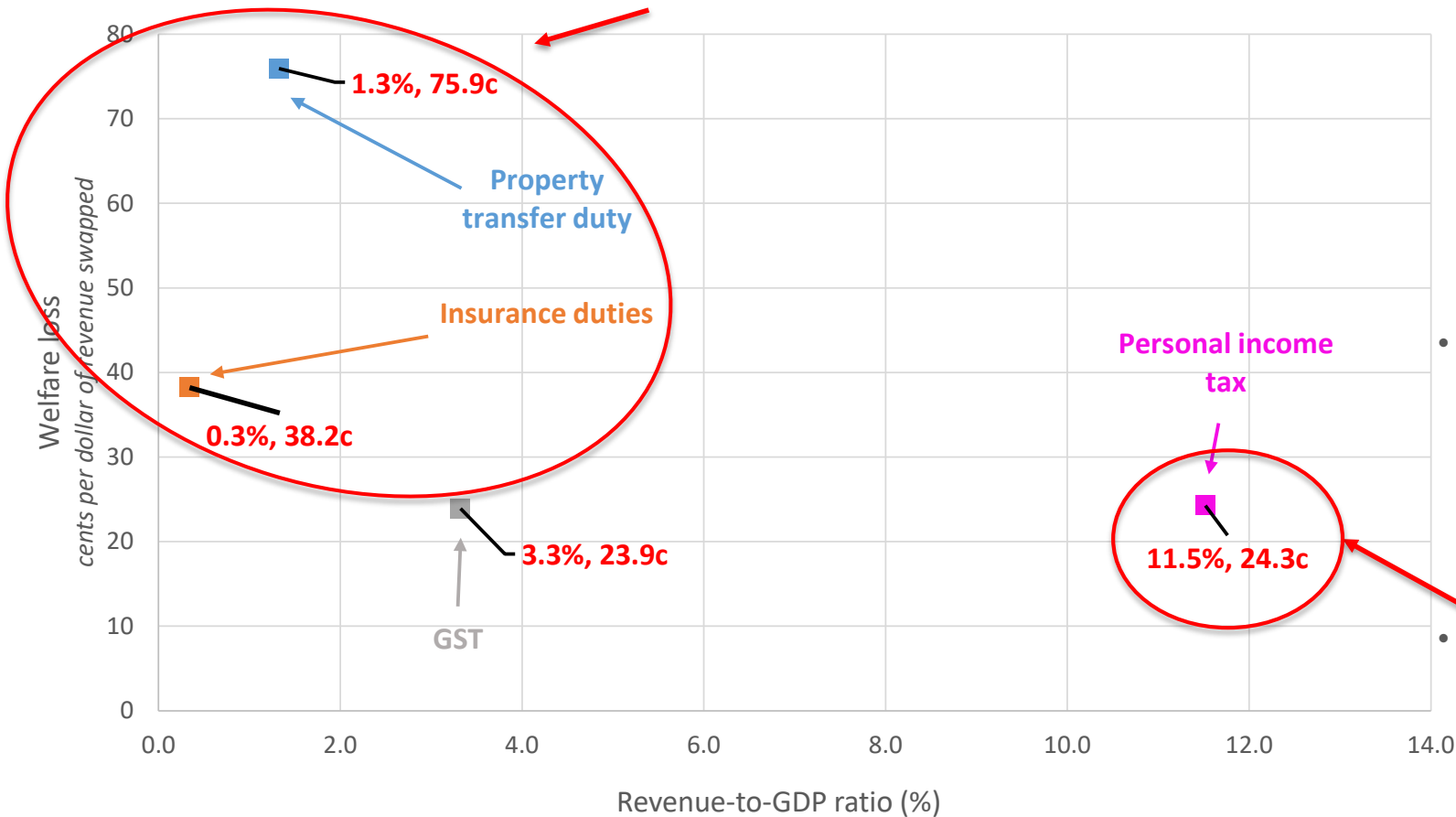


Prices fall on average, but compositional change is evident. In the paper we show why low-density prices fall, yet high-density prices rise.

Topic 2

How low can we go? State tax reform

- If you ask economists about reform priorities:
 - **State taxes.** Marginal excess burdens are large because bases are narrow.

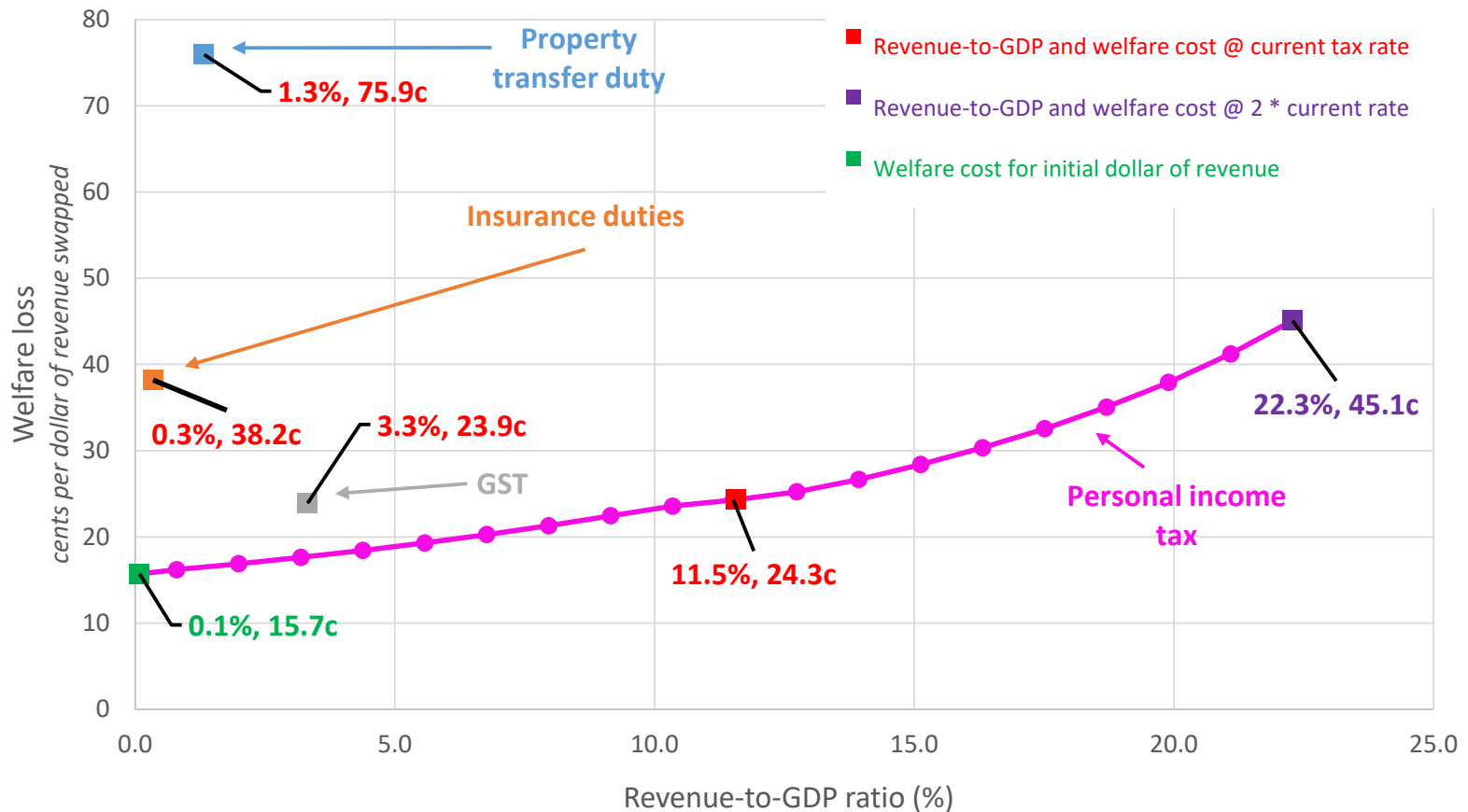


- Bracket creep over 20-years aligned to PBO forecasts.
- Stage 3 tax cuts in baseline forecast.

The blank slate

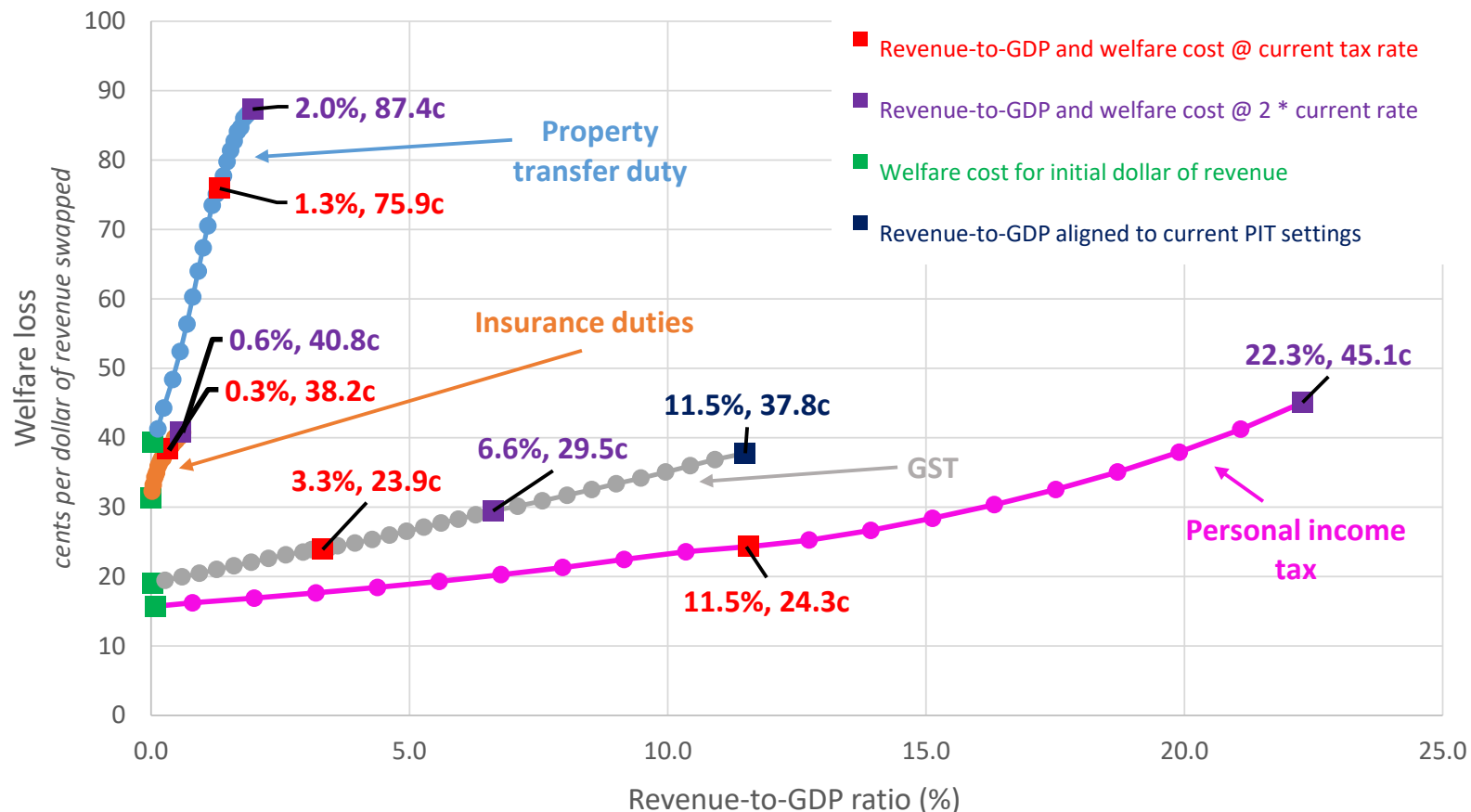
What might Australia's optimal tax system look like?

- Better questions include:
 - **Are personal income tax cuts a priority?**
 - *Answer relies on distribution of MEB as revenue share rises.*



Marginal excess burden distributions for Australian taxes

- Better questions include:
 - **Should state taxes be removed entirely, or just reduced?**
 - *Answer relies on distribution of MEB as revenue share rises.*



Summary and future work

- Setting the reform agenda demands we ask many important questions.
- **Topic and example 1:** Tax reform and housing prices.
 - Higher housing prices have implications for affordability and macro-stability;
 - **Compositional changes are evident:** High-density housing prices more responsive to transfer duty removal because of higher turnover rates.
- **Topic and example 2:** What might Australia's optimal tax system look like?
 - Significant area of future research;
 - Can be estimated by evaluating welfare costs versus tax revenues for all existing (and potential) Australian taxes.