State-based Property Taxes

An inefficient system stymieing housing availability

A Discussion Paper

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Aim of this discussion paper

The aim of this discussion paper is to provide a point of reference for the discussion of the issues surrounding property taxation, and in particular, stamp duty. The information provided within this paper is a critique of extant, publicly available literature. The paper highlights the logic and rationale behind a transition towards a more efficient means of raising government revenue, necessary for provision of services to our community, however the funds are allocated.

To achieve the aims of this paper, an extensive review of government literature, industry and academic publications and consultant reports that discussed various forms of taxes relating to land, including transfer taxes, were sourced, and studied. The output of this study was to identify themes and analyse the strengths and weaknesses of state-based land tax with a particular focus upon transfer tax, namely stamp duty.

Background

Tax is, and has been, a necessary burden for the betterment of society. Adam Smith (1776) in his treatise the “Wealth of Nations” argued tax should have four key elements, these are: fairness, certainty, convenience, and efficiency. These elements are believed to hold true today and should be aimed for in all forms tax, including land related tax. Distortions ought to be highlighted and where possible removed. Distortions in any tax system create imbalances in gathering of tax monies and ultimately distribution of same. A consistent theme that has appeared in the evaluation of Australia’s tax system, is the distortion created by stamp duty tax on land transfers. While a number of publications evaluating tax systems and in particular, stamp duty, refer to all forms of duties, this discussion will focus upon taxes related to land and land transfers within Victoria.

In Victoria, stamp duty equates to approximately 22% of state and local government revenue. Nationally, all forms of property tax raised state and local governments has increased from approximately 31% in 1998-99 to 52% in 2020-21. This highlights a significant increase in the reliance on land related taxes by governments. Reasons for such increases can only be speculative but given the natural forces that are exerted upon property markets, and the resulting fluctuations, this cannot be considered a reliable source of revenue generation for the provision budgeting.

In developing this discussion paper, the argument for the removal of stamp duty in favour of more reliable and sensible revenue streams, is not aimed at reducing land related tax, but rather, redistributing the generation of the revenue in more balanced and functional manner.

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Research to date

Considerable effort has been given to effectiveness and efficiency of stamp duty. These have not only originated from industry-based sources but also government. For example, the Henry review of 2009 (p48-49) stated, "*Stamp duties are a highly inefficient tax on land, while land tax could provide an alternative and more stable source of revenue for the States.", and "Conveyance stamp duty is highly inefficient and inequitable. It discourages transactions of commercial and residential property and, through this, its allocation to its most valuable use. Conveyance stamp duty can also discourage people from changing their place of residence as their personal circumstances change or discourage people from making lifestyle changes that involve a change in residence. It is also inequitable, as people who need to move more frequently bear more tax, irrespective of their income or wealth."*

These comments are presented here as they crystalise much of the findings and opinions of subsequent research examining the topic of land taxes. More recent publications have taken the position that the removal of stamp duty should no longer be debated, but rather, efforts should be made to examining how to best transition to other land tax arrangements. Governments that continue to look towards transfer taxes such as land stamp duty, are not acknowledging the fundamental flaws of the tax and are therefore not earnestly seeking to address the housing issues highlighted by Henry.

As a collective, a resounding message given by researchers is the continuance of transfer taxes unquestionably inhibits governments' ability to provide appropriate social and affordable housing to those who need it and is precluding access to suitable housing from growing families as we age in place.

Issues of state-based stamp duty

Tax is necessary. Efficient tax that is balanced across society and is predictable, enables responsible planning by governments to meet the needs of the society it serves. It is well established in economic literature that stamp duty is one of the most inefficient taxes with an estimated welfare cost of 35 cents lost for every dollar raised (HIA 2011). This loss, referred to as welfare loss, refers to the decrease in social and economic well-being caused by imposition of the transfer of purchasing power from the taxpayer to the taxing authority.

The following is a summary of the issues regarding stamp duty that have been frequently raised in publications. Stamp duty is:

- An inefficient tax,
- Levied at a time when buyers are most financially stretched,
- Inhibiting house market movement, thereby reducing the availability of suitable and needed houses to home buyers. This is because of older people “sitting” on their large houses as it is too expensive to move creating a mismatch of housing,
- Creating house price issues through affecting supply,
- Further creating inequality throughout the spectrum of society,
- Affecting job mobility due to moving costs,
- Probably avoiding because transitioning from transaction-based tax to recurrent tax is considered difficult.

These points are discussed in detail throughout the publications and meticulous reproduction of such narratives here would serve little purpose. However, to assist with the understanding of the rationale behind these important considerations, Table 1 provides a concise critique of the main points raised.

Another little-known housing fact is that liquidity has fallen while stamp duties as a proportion of median house prices and average earning has risen. Liquidity is defined as the proportion of houses that are on the market as a proportion of housing stock. SQM Research (2021) found in 2012, 3.2% of Melbourne detached housing stock was available for sale. In 2021, this proportion fell to 1.5%. When considering all housing stock, liquidity fell from 3.4% in 2012 to 2.1% in 2021. Over the period 2011-2021, stamp duty as a proportion of median house price rose from 3.2% to 4.2%. As a proportion of annual average earning in Melbourne, stamp duty currently sits at 48.9%. This is up from around 30% some nine years ago. The impact of stamp duty on households at a time of financial vulnerability is obvious. Numerous academic papers have found a link between the existence of stamp duty and the reduction of property turnover. The extent that the removal of stamp duty would have on property markets is subject to modelling but that it will have a positive impact is considered to be established.

Table 1: Issues raised in previous publications

Stated issue	Rationale
An inefficient tax,	Stamp duties are an inefficient tax because they are narrow based, meaning they infrequently target a small component of society, thereby moving monies away consumption-based taxes. Additionally, they distort the market by adding a significant burden to market participants. Participants may avoid market transactions by renovating, not moving, or not entering the property market. Such options are available to second and subsequent homeowners who may hold onto housing that would otherwise benefit first home buyers.
Levied at a time when buyers are most financially stretched,	The net effect of taxing at the point of purchase is that buyers consider the “entire” cost of acquisition. This has a negative affect on house prices and causes further financial vulnerability upon the buyer. Removal of stamp duty is likely to attract further investment into housing.
Inhibiting house market movement, thereby reducing the availability of suitable and needed houses to home buyers. This is because of older people “sitting” on their large houses as it is too expensive to move creating a mismatch of housing,	Modelling has shown stamp duty reduces mobility. Existing homeowners are discouraged to transact and typically contrast the option of renovation to the cost of moving. In doing so, when renovation is chosen, housing supply to buyer categories is further limited. This in turn can prevent the efficient up-sizing or down-sizing of housing across the market.
Creating house price issues through affecting supply,	Inelastic markets are one where the supply and demand of goods and services are not significantly affected by price changes. Tax structures should aim to ensure minimal impact on markets. Stamp duty has been shown to significantly impact property prices and therefore is seen as a hinderance to market activity.
Further creating inequality throughout the spectrum of society,	The burden of transfer stamp duty is not equally shared across housing markets. Stamp duty, as a proportion of wages has risen. In 2012, Stamp duty as a proportion of the average earnings was 30.5%. In 2021, this rose to 48.9%. This further exacerbates the buying burden and availability of housing.

Affecting job mobility due to moving costs,	Stamp duty increases the cost of moving. This can reduce labour mobility as people may chose to remain in place in favour of further job opportunities due to the costs associated with relocation, of which stamp duty is a significant component. This has a negative effect on productivity within the economy
Probably avoiding because transitioning from transaction-based tax to recurrent tax is considered difficult.	Literature has acknowledged the difficulties in transitioning from a transaction based to a broad-based taxation framework. However, it is generally agreed that this should not deter governments from making such a move as the long-term benefits notably outweigh the ephemeral concerns.

Alternatives to stamp duty revenue

Having reviewed the issues regarding stamp duty, it is important to discuss the alternatives. Any transition away from stamp duty should be revenue neutral. Any shortfall in revenue, whether long-term or in transitory period, can only be supplemented through debt, clearly an undesirable strategy. If a revised taxation framework results in additional funds, then a commitment that those funds be directed back to their origin, namely land and its uses should be sought. As properties other than the principal place of residence are already subject to land tax (the $300,000 threshold acknowledged), any transition away from stamp duty must inherently mean taxing the principal place of residence and/or lowering the threshold, although the latter is unlikely to have the same level of revenue to replace the lost income stream.

In June 2022, the NSW government announced it was moving towards the removal of stamp duty. The federal government Treasurer, Dr Jim Chalmers, stated he would not agree to compensate the NSW government for loss of revenue, highlighting the importance of developing a revenue neutral transition for states. The policy states this option is only available to first home buyers and allows these buyers to choose between paying up front stamp duty or ongoing land tax. All other buyer categories are still required to pay stamp duty. Such an arrangement is somewhat of a “half hearted” attempt to address the recognised issues of stamp duty. The scheme commences in January 2023.

Alternatively, the ACT has chosen to make a stated policy to phase out stamp duty over a 20-year transition period in favour of a broad-based land tax. The aim was to soften the tax revenue loss to the government through the transition. This change has been progressing over a 10-period with government authorities claiming it has a successful progression. The arguments presented by the government for the removal of stamp duty are those stated within this discussion paper, namely to recognise the inefficiencies of stamp duty and implement a tax framework that creates stability, efficiency, equity and simplicity.

Arguments forwarded in literature consistently identify one of two possible replacements to stamp duty. These are adjusting the GST rate or “leveling” the land tax platform to include all property, irrespective of its use. Unlike stamp duty, both are efficient taxation methods and overcome the volatility created by market fluctuations. The merits of each are summarised below.

Goods and Services Tax

The argument to replace stamp duties in favour of a broad-based land tax, aka, GST, is a strong one. At 10%, Australia has one of the lower GST rates in the world. One key characteristic of GST is its transparency and in economic terms, efficiency. Also recognised in previous studies is, it is also likely to increase market activity through the removal of the barriers presented by stamp duties. The amount of increase would require modelling but should include such an amount that would create budgeted sums of money for social and affordable housing. Consultancies such as Deloitte's argue strongly for this approach.

In its 2009 Discussion paper- Re-Think, the REIA, noted "*The Centre of International Economics in its report, State Business Tax Reform in 2009 showed that the required increase in the GST rate under the reform of abolition of stamp duties on residential and non-residential property, removal of insurance duties and reform of land taxes and payroll taxes would be 0.45 percentage points. That is, the Australian Government could fund State tax reform by raising the GST rate from 10 per cent to around 10.45 per cent. This calculation takes into consideration the positive flow-on impacts on the economy that would result in higher revenue collection from other revenue sources as well as the GST through increased consumption."* (pg. 4)

While any increase in GST will attract significant public interest, it is believed the time now right for the debate. The pressure on global economies is significant with unstable geo-political events and the Australian economy is not exempt from these instabilities. The expected benefits that will flow from the removal of inefficient taxes, such as stamp duties, will "loosen" the economic constraints and enable greater activity.

A counter argument to this strategy would be that lower paid people are being taxed unfairly. As more highly paid workers tend to spend more, this argument doesn't carry a great deal of validity. Also, the argument that low paid workers and those on social benefits are subsidising wealthier can be offset by the fact that additional revenue can, and should, be directed to providing lower cost housing. As tax is raised to provide social benefits and amenity, arguments against more efficient tax revenues are rather weak.

A potentially held view of state governments is the loss of control over a revenue and the inherent trust that must be given to the federal government. There is no getting around the fact that such an objection would be simply political. For the purpose of transparency, it is plausible to legislate an allocation of the increase to the provision housing and this, given to states to administer. As it is very likely that state governments use a proportion of stamp duty tax revenue for purposes other housing or associated needs, this also can be documented as a form of guarantee for the states. Nothing is insurmountable if the parties are willing augment their views.

Land tax

An alternative view for the replacement of stamp duty tax revenue is a broad-based land tax that does not exempt any form of land use. This option has been widely discussed in literature. Arguments for the expansion of such a tax are largely centred around its equity and ease of introduction, namely through the use of municipal rating valuation for its calculation. The transition, however, has confounded officials for some time. The issue that arose from the transition away from stamp duty to land tax was the potential “double hit” for recent house buyers. That is, those who paid stamp duty would potentially become liable for land tax the following year and thereafter.

The ACT and New South Wales have both recently moved to phase out stamp duty and enact a broad-based land tax. To overcome this, the ACT government has implemented a 20-year transition period where a progressive removal of the requirement to pay stamp duty is replaced with payment of a broad-based land tax. This overcomes the effect of “double dipping” where a household pays stamp duty and is then also required to pay land tax. As is often the case, the transition has required refinement, but there is general acceptance of the need for such a move away from transfer taxes.

A recent NSW Treasury report (2022) modelled the removal of stamp duty in favour of broad-based land tax that levied a tax on the unimproved value of land on all property, including residential. The modelling showed an increase in long-run home-ownership rates would be seen. The report also highlights the importance of broad-based land land tax that is structured in favour of owner-occupiers. This would enable households to shift from rental accommodation to their own homes. Doing so would assist in the reducing the demand for social housing. Yet another very important pressure point in Australia’s housing landscape.

Another noted issue with the adoption of broad-based land tax is the potential of increasing taxes upon retired and/or poorer households who are landowners. Such a situation may be addressed through the use of means testing, but this would increase burdens upon the system when one aim is to implement efficiency. However, once again, people who are in these situations are likely to have their records within Centrelink and with appropriate security measures, may be made available to taxing authorities for assessment. Such a proposition is really one of least impact on the public purse and society.

The REIV’s position on stamp duty

The REIV is committed to:

- The removal of stamp duty in favour of a broad-based tax framework
- Equitable tax arrangements that serve the societal needs of Victoria
- Tax collection and distribution that is efficient and provides certainty of revenue income for the provision all housing needs
- Efficient market structures that enable households’ opportunity to access housing that meets their needs
- Tax reform that removes a significant cost obstacle for people wising to “right size” their homes

Summary

The arguments regarding the removal of stamp duty as a form of taxation are well established and, due to the population sizes that inherently lead to more property transactions, has particular relevance in Victoria. Such a form taxation is argued to lead to inefficient and detrimental effects upon the economy and should be replaced with a more equitable and efficient form of taxation. That taxation is required for sustained social amenity is acknowledged in this debate. The question of stamp duty removal really centres around with what to replace it with, and how to make the transition. This is where politics has the potential to interfere with good outcomes.

Key arguments for the removal of stamp duty are:

- Reduced purchase costs
- Enhanced mobility of skilled people via the reduction of transfer costs that in turn aids better economic outcomes
- Likelihood of older people moving to more appropriate accommodation and thereby releasing suitable housing stock for younger families
- Increase in taxation transparency
- Improved housing affordability through decreased purchase costs and greater housing liquidity (supply of existing house stock)
- With appropriate measures and intent by governments, increased availability of funds to meet social and affordable housing needs
- Greater stability in tax revenue modelling for governments

In conclusion, the REIV strongly advocates the removal of stamp duty as a source of taxation revenue. How the removal of this revenue stream is replaced, is open for responsible modelling and debate. The benefits are both obvious and extensive and with proper consideration and implementation, the potential of increase funds for allocation to social and affordable housing will provide more equitable and social outcomes for Victorians.

The REIV urges the Victorian government to invite stakeholders and experts to contribute to a road map that supports home ownership while maintaining an important tax income stream for the state.

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