THE LAW SOCIETY OF NEW SOUTH WALES
youngLAWYERS

The NSW Budget 2020-2021 'Buying in NSW, Building a Future' Consultation Paper

Submission on the NSW property tax proposal

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Tax Reform Taskforce

NSW Treasury

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The NSW Young Lawyers Taxation Law Committee (**Committee**) makes the following submission in response to the NSW Budget 2020-2021 'Buying in NSW, Building a Future' Consultation Paper (**Consultation Paper**) in relation to the proposed introduction of a new annual property tax.

NSW Young Lawyers

NSW Young Lawyers is a division of The Law Society of New South Wales. NSW Young Lawyers supports practitioners in their professional and career development in numerous ways, including by encouraging active participation in its 16 separate committees, each dedicated to particular areas of practice. Membership is automatic for all NSW lawyers (solicitors and barristers) under 36 years and/or in their first five years of practice, as well as law students. NSW Young Lawyers currently has over 15,000 members.

The Committee is a representative body within NSW Young Lawyers comprising a diverse membership of are barristers, tax lawyers, non-tax lawyers, professionals from accounting firms, the ATO and other government agencies and law students. Those individuals have joined together to improve their own knowledge of taxation law and to foster increased understanding of this area in the profession. The Committee reviews and comments on legal developments across all federal and state taxation law developments.

Summary of Recommendations

The Committee makes the following recommendations in respect of the NSW Treasury questions on the proposal to replace stamp duty and land tax with a new annual property tax:

1. **Question 1**: The Committee agrees that stamp duty is an inefficient tax however the Committee does not agree that the proposed annual property tax is a better solution.
2. **Question 2**: The Committee does not agree that the annual property tax should be introduced.

   In the event the annual property tax was introduced, the Committee's position is that the tax should be levied on land value, otherwise referred to as "unimproved land value", rather than market value.
3. **Question 3**: The Committee does not consider that it would be attractive for purchasers to choose an annual property tax over the payment of a lump sum stamp duty on the purchase of a property.

The proposed measure creates ongoing tax costs for purchasers. The stamp duty regime, on the other hand, allows purchasers to budget accordingly upfront.

Further, the Committee does not support the implied broadening of the tax net, which would extend the annual property tax to properties currently excluded from the land tax.

4. **Question 4**: The Committee submits that there are difficulties associated with transitioning to a new tax.

   If existing property owners were forced to transition to the proposed new system, the NSW Government should provide a full credit to all existing property owners to account for the stamp duty already paid to prevent double taxation before the owner has disposed of the property. This would result in costs to implement the measure, which do not appear to have been factored into the Consultation Paper.

5. **Question 5**: The Committee is unable to comment on whether home purchases would be delayed if purchasers could opt-in to the annual property tax.

   However, if the annual property tax were to be introduced, the Committee does not recommend that a retrospective opt-in option should apply.

6. **Question 6**: The Committee does not agree that the annual property tax should be introduced.

   Assuming the annual property tax is introduced, the Committee considers farmland (primary production land) properties should receive concessional treatment and residential owner-occupied property should not be subject to the annual property tax.

7. **Question 7**: The Committee is of the view that, as a practical matter, this tax reform is not worth its cost.

8. **Question 8**: The Committee does not recommend using price thresholds to exclude people buying the most expensive properties from being able to choose the property tax, as this would be distortionary.

9. **Question 9**: The Committee submits that no arrangements should be made for residential and commercial tenants. This is due to the fact that rental rates are determined by market forces and are subject to supply and demand.

10. **Question 10**: The Committee submits that the need for hardship relief in particular to residential owner occupied properties indicates that the annual property tax is not suitable. By contrast, a one-off payment of stamp duty ensures the purchaser is aware of their upfront costs and can budget accordingly.

11. **Question 11**: The Committee disagrees with the introduction of the proposed property tax changes. The NSW Government can already address the affordability issue by reducing stamp duty rates.
12. **Question 12**: The Committee recommends consideration of reducing stamp duty and considering the GST. The Committee recommends consideration of stamp duty payment by instalments. Further recommendations have been included below in the section addressing Question 12.

Question 1 – Do you agree that stamp duty is out of date and is a handbrake on the economy?

Stamp duty as an inefficient tax

Stamp duties that are evidenced by a physical stamp affixed to a document are a relic of a bygone era. While traditionally stamp duties were seen as a fee to cover the cost of the paper, and stamping and filing documents that transferred an interest in land, they are perceived as a revenue driver for state and territory governments in Australia, which have relatively few bases upon which to levy taxation.

Stamp duty payable on the purchase of residential property at the median price in Sydney in November 2020 was about $34,000.[1] As property prices have increased dramatically in NSW, particularly in large cities, there have been no significant changes to the rate of tax imposed or indexation of the thresholds at which they are triggered from 1986 to the present.[2] With median house prices increasing at a pace which far outstrips the pace of indexation of the duty threshold more and more homebuyers creep into the higher marginal rates of duty.

The undefined economic impacts of an annual property tax

While stamp duty may be out of date and inefficient, the Committee does not agree that stamp duties can be characterised as a "handbrake" on the economy in the manner represented in the Consultation Paper. While, as the Consultation Paper highlights, the requirement to pay duty may slow down the process of saving for a deposit to purchase a home, the hidden and ongoing nature of an annual property tax has the potential to create issues in the future. An annual property tax may reduce the disposable income especially

[1] As at 30 November 2020, the median price for a residential property in Sydney was $860,967: https://www.corelogic.com.au/sites/default/files/2020-12/201201%20CoreLogicHomeValueIndexDec20FINAL.pdf. The stamp duty payable on this amounts to $34,080, assuming no exemptions or reduced rates apply.
[2] Other than relatively insignificant indexation of the duty thresholds contained in section 32 of the *Duties Act 1997* (NSW), which occurred in 2019, the rate of duty and the thresholds in NSW have remained the same since 1986.

of low income households throughout the course of home ownership (rather than just in the time spent saving for stamp duty leading up to purchasing property).

An annual property tax may have a disproportionately negative impact on low income groups such as retirees. Hypothetically, as the annual property tax becomes more prevalent, then more people will be required to pay the annual property tax after they cease to work and earn remuneration. In order to pay the tax on the property they already own, those individuals who have low or no income will need to fund the tax out of their superannuation or a government pension. While, as the Consultation Paper suggests, the imposition of the annual tax may make older individuals move out of larger homes to downsize and free up supply of these properties in the market, in the long transitional period, it is likely that individuals will remain in their existing properties, rather than choosing between paying stamp duty on a new purchase or the alternative of moving into a property on which annual taxes are applied during a period (i.e. retirement) when their income may be significantly reduced.

Improving efficiency of property ownership

There are some reports that the impact of removing stamp duty from a similar reform in the ACT did not increase the efficient use of land. When the ACT, for example, removed stamp duty for those over 65, it was reported by one commentator that the exemption was utilised by people to buy larger homes, rather than smaller ones until a low value cap was imposed.[3] Dr Murray, a post-Doctoral Fellow at The University of Sydney, postulates that this is because "the distribution of home ownership is not driven by housing need, but primarily by wealth."

Addressing barriers to entry for home ownership

Introducing alternative taxes to stamp duty will not necessarily have a positive impact on housing affordability.

Firstly, some first home buyers, at whom the policy of increasing homeownership is arguably targeted, are currently exempt from paying stamp duty under the first home buyers concessions offered by NSW.[4] While there is a suggestion that a grant will replace the exemptions, ultimately the imposition of the annual property

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[3] Dr Cameron K. Murray, 'Bad economics of the stamp duty discourse', *Fresh Economic Thinking* (Blog Post, 13 November 2018) <https://www.fresheconomicthinking.com/2018/11/bad-economics-of-stamp-duty-discourse.html>.
[4] In NSW first home buyers are currently exempt from duty where the purchase prices is less than $650,000, and discounts on stamp duty apply for properties between $650,000 and $800,000.

tax will mean that the same homebuyers who could increase homeownership will be pulled into the tax net, rather than being exempt from it.

Secondly, removing stamp duty in favour of the annual property tax may in fact have the effect of increasing property prices in the short term and while prospective homebuyers may consider the long-term impact of paying annual property taxes, in the immediate term as stamp duty was a potential cost calculated into the price of properties, the removal of such a cost would increase their purchasing power.

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

This Committee does not agree that the annual property tax should be introduced for the reasons outlined throughout these responses.

Application of unimproved land value

In the event the annual property tax was introduced, the Committee's position is that the tax should be levied on land value, otherwise referred to as “unimproved land value”, rather than market value for the below three key reasons.

For completeness, we note that the Consultation Paper appears to use the terms "land value" and "unimproved land value" interchangeably. The term "land value" as defined in the *Valuation of Land Act 1916* (NSW) has been used below in order to achieve consistency with the legislation. However, the Committee would support inserting a new definition in that Act for “unimproved land value” for the reason that doing so would achieve the fairest outcome for land owners.

1. Land value is an established concept. The *Valuation of Land Act 1916* (NSW) at section 6A(1) defines “land value” as "*the capital sum which the fee-simple of the land might be expected to realise if offered for sale on such reasonable terms and conditions as a bona-fide seller would require, assuming that the improvements, if any, thereon or appertaining thereto, other than land improvements, and made or acquired by the owner or the owner’s predecessor in title had not been made.*" There are commonly accepted valuation methodologies used to calculate the price that the "bona-fide seller would require".

The primary difference between land value and unimproved land value is that the land value includes any service improvements to the land (including water sewerage services, drainage, clearing and removal of stones), whereas the unimproved land value excludes the value of the services to the land.[5]

2. The land value of over 2.6 million parcels of land is calculated by the NSW Valuer General as at 1 July each year.[6] The calculation of market value would likely require additional resources and funding, and would arguably be a more labour-intensive process than the use of mass valuations, as is the current policy of the Valuer General (see comments below). As information on the land values is readily available and calculated under an existing framework, it would be reasonable for this metric to be used in the calculation of the annual property tax. The use of a widely accepted land value, and one which is already calculated annually, would greatly simplify the administrative burden of any transition to the annual property tax.

3. It would be unreasonable to impose the tax based on market value of properties. As is highlighted by the Consultation Paper, the use of market values would require consideration of the value of any buildings, structures and improvements on the parcel of land. Not only would this deviate from existing practices, as above, it would also be a disincentive to development and improvements on existing parcels of land. The use of market valuations would be against the policy proposed in the Consultation Paper to ensure that land is used in the most efficient way and, further, to ensure that barriers to home ownership are reduced.

Issues with using land value

While the metric of land values may be appropriate in circumstances where an annual property tax was imposed, it may be subject to volatility and create uncertainty both for households planning for annual expenditure and for the state government in planning expected collections. Any assessment of the value of land made on the basis of mass valuation methods, as is the methodology applied by the NSW Valuer General for both single residential land[7] and high-density residential land,[8] may be inaccurate to the actual underlying value of the parcel of land, and simultaneously may also be subject to movement where the

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[5] Vince Mangioni, 'Transparency in the valuation of land for land tax purposes in New South Wales' (2011) 9(2) *eJournal of Tax Research* 140, 144.
[6] NSW Valuer General, Land Values, https://www.valuergeneral.nsw.gov.au/land_values.
[7] 'Valuer General's Policy - Valuation of single residential land', *NSW Valuer General* (Web Page, June 2019) <https://www.valuergeneral.nsw.gov.au/__data/assets/pdf_file/0004/198625/Valuation_of_single_residential_land_policy.pdf>.
[8] Ibid.

surrounding areas undergo significant changes or improvements. Homeowners may find themselves subject to increasing annual property tax costs simply as a function of the changing profile of the area where the property is located. If the increase in land values is significant, homeowners, through no action of their own, would be subject to increasing annual property taxes due to development which they did not foresee. Low income homeowners may move from these areas which could entrench existing economic inequalities between suburbs.

It is preferable to retain the current stamp duty regime where, in most circumstances, tax is levied on an actual transaction where market participants have agreed to the value of the property and have accordingly had the opportunity to budget for that cost.

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?

The Committee does not consider that it would be attractive for purchasers to choose an annual property tax over the payment of a lump sum stamp duty on the purchase of a property. The proposed measure creates ongoing tax costs for purchasers. The stamp duty regime, on the other hand, allows purchasers to budget accordingly upfront.

Annual Property Tax not an attractive option for purchasers

No long-term benefit to purchasers

In the long run the taxes paid as annual property tax would eventually surpass any stamp duty on the purchase of the property. There is a likely chance that the annual property tax will become a burden for purchasers and create cash-flow problems. Media sources indicate the break-even point in some areas is at around 12 years,[9] after which the NSW Government will in fact be 'better off'.

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[9] Duncan Hughes, 'Property punters score NSW tax win', *Australian Financial Review* (online, 21 November 2020), <https://www.afr.com/wealth/personal-finance/property-punters-score-nsw-tax-win-20201119-p56g64>, accessed 8 March 2021.

Illustrative example

To better explain the concept of the break-even point, the table below compares costs involved in stamp duty versus annual property tax in an owner occupier scenario:

Property type	**Market value**	**Stamp Duty**	**Unimproved land value**	**Annual Property Tax**	**Break-even**
Unit in Sydney CBD	$1M	$40,335	$291,100	$500 + 0.3% * ($291,100) = $1373.30	$40,335/$1373.50 = Approx. 29 Years 3 months
Land in North West region	$629,000	$23,640	$453,000	$500 +0.3% * ($453,000) = $1859	$23,640/$1859 = Approx. 12 years 7 months

It is evident from the table above that in the case of a unit in the Sydney CBD, any annual property tax paid after 29 years and 3 months would be in excess of the stamp duty otherwise would have been payable at the time of purchase. In contrast, in case of a land purchase in North West region any annual property tax paid after 12 years and 7 months would exceed the stamp duty payable.

Indexation issue

Another important factor to consider with respect to annual property tax is 'indexation'. Indexation "*is all about keeping pace with inflation.*"[10]

Illustrative example

In determining the unimproved land value every year, the Valuer General takes into consideration the indexation factor.[11] The indexation factor for the 2021 land tax year is determined at 3.183%.[12] Taking into consideration the indexation factor in the above example, the annual property tax to be paid for the year 2021 is calculated as:

[10] *The Economist, Meaning of indexation < https://www.economist.com/economics-a-to-z/i#node-21529862>*
[11] *Section 62TBB (3) of the Land Tax Management Act 1956 (NSW).*
[12] *Government Gazette of NSW, No 260 of 09/10/2020, n2020-4212.*

Property type	Market value	Stamp Duty	Unimproved land value in 2020	Annual Property Tax	Breakeven	Unimproved land value in 2021	Annual Property Tax	Breakeven
Unit in Sydney CBD	$1M	$40,335	$291,100	$500 + 0.3% * ($291,100) = $1373.30	$40,335 / $1373.50 = Approx. 29 Years 3 months	$300,365.71	$500 + 0.3% * ($300,365.71) = $1401.09	$40,335/$1401.09 = Approx. 28 Years 7 months
Land in North West region	$629,000	$23,640	$453,000	$500 +0.3% * ($453,000) = $1859	$23,640/$1859 = Approx. 12 years 7 months	$467,418.99	$500 +0.3% * ($467,418.99) = $1902.25	$23,640/$1859 = Approx. 12 years 4 months

As evidenced in this example, as the annual property tax to be paid by the owner occupier increases through the indexation of the unimproved land value, the breakeven period becomes shorter. As such, as unimproved land values are indexed upwards, the period for the homeowner to breakeven between the original stamp duty cost and the annual property tax payments decreases. The NSW Government may in fact, become "better off" far sooner than anticipated in the published examples. Even if indexation was not applied, land values have tended to have an upward trajectory year-on-year, further increasing the annual property tax, and reducing the time where the homebuyer is better off under an annual property tax model.

The false saving measures offered up by not paying stamp duty and rather paying the new annual property tax every year thereafter means those who choose the annual property tax option in purchasing homes for the long-term will be out of pocket in the long run. For those homebuyers who chose the annual property tax because of their inability to afford the upfront stamp duty may be surprised to find the long-term costs of property taxes going far beyond the initial outlay under the current model.

Proposed broadening of the tax net is not supported

Further, the annual property tax broadens the tax net to including non-investment properties (i.e. owner-occupiers) which are currently not subject to land tax. At present, land tax is payable on all investment properties which cross the land value threshold of $755,000 for the year 2021.[13] At present, all owner-

[13] Revenue NSW, *Taxes, duties, levies and royalties* <https://www.revenue.nsw.gov.au/taxes-duties-levies-royalties/land-tax>, accessed 8 March 2021.

occupied properties are exempted from land tax if the property is their principal place of residence. However, if the annual property tax is introduced, it seeks to bring owner-occupied properties into the ambit of the annual property tax at a lower rate. The Committee disagrees with the proposed inclusion of owner-occupied properties in the annual property tax.

Adverse impact on vulnerable and disadvantaged members of the community

The Committee recognises that the imposition of the property tax on all properties could have negative effects on sectors of the Australian community. In particular, the Committee is concerned that the introduction of the property tax could, in practice, force surviving elderly low income spouses to sell after the death of their spouse due to the ongoing costs associated with the annual tax. As this is effectively a forced downsize, the proposal would require those elderly persons to make decisions which may not effectively represent their lifestyle choices or needs. This is not aligned with the policy intent of the proposed reform to empower individual choices of people when buying property to reflect their needs and lifestyle, and runs counter to the policy-driven concessions for inherited dwellings (that is, dwellings inherited when a spouse passes away) provided for in the capital gains tax regime.

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

Opt-in and gradual transition is not appropriate

The proposal in the Consultation Paper allows the future property purchasers to choose between stamp duty and annual property tax. If the property being purchased is a residential investment property or a commercial property, the property tax would replace any applicable land tax as well as stamp duty. However, this is a long-term reform and transition may take many years.[14]

The Consultation Paper specifies that taxpayers would choose to pay stamp duty if they plan to buy their 'forever homes' and intend to live in for decades and people who prefer to move frequently might opt for annual property tax. Firstly, in many circumstances it will be difficult for purchasers to predict whether taxpayers in fact intend to settle in a property for a long period of time or plan to move out in the near future. The recent COVID-19 pandemic has brought to light that circumstances and situations can change quickly in

[14] John Kehoe, 'Our worst tax – opt-in stamp duty in tax overhaul', *Australian Financial Review* (online, 1 July 2020) <https://www.afr.com/policy/tax-and-super/our-worst-tax-opt-in-stamp-duty-in-tax-overhaul-20200531-p54y1n>, accessed 8 March 2021.

a way that is beyond anyone's control. Providing flexibility to choose between stamp duty or an annual property tax, where the latter has the potential to be detrimental to home buyers in the long run, potentially defeats the purpose of attracting young Australians to enter the property market.

Secondly, media reports suggest that the voluntary opt-in as proposed by the NSW Government may ultimately not work to transition the entire property market into the annual property tax and this would “postpone the benefits of moving to a system in which tax doesn’t distort the use of land”.[15] In comparison in 2012-13, the ACT began a 20-year transition to remove stamp duty by the winding back of stamp duty and insurance duty for everyone and replacing those by increases to general rates on land.[16]

Two-tier system creates structural inequity

Furthermore, under the current proposal, once a purchaser of a property has opted-in to the annual property tax, that property would remain subject to the property tax for all subsequent future buyers of that property. There is a concern that this will create a two-tier system in property taxes in New South Wales, with land subject to the annual property tax being viewed as a less lucrative long term investment than land which is subject to stamp duty.

The Committee however acknowledges that existing property owners should not be subject to the annual property tax given that when they acquired their property the tax was not in contemplation.

If existing property owners were forced to transition to the proposed new system, the NSW Government should provide a full credit to all existing property owners to account for the stamp duty already paid to prevent double taxation before the owner has disposed of the property.[17] This would result in costs to implement the measure, which do not appear to have been factored into the Consultation Paper. The flow-on impacts on the capital gains tax treatment on disposal would then also need to be considered.

The Committee submits that there would be substantial difficulties associated with transitioning to an annual property tax.

[15] Axing stamp duty is a great idea, but NSW is going about it the wrong way (web page dated 26 November 2020) <https://theconversation.com/axing-stamp-duty-is-a-great-idea-but-nsw-is-going-about-it-the-wrong-way-150629>.
[16] Ibid.
[17] See, eg, Ibid.

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 Committee is unable to comment on whether home purchases would be delayed if purchasers could opt-in to the annual property tax.

No retrospective opt-in

However, if the annual property tax were to be introduced, the Committee does not recommend that a retrospective opt-in option should apply. Allowing retrospective opt-in would be inefficient and would result in a large outflow for government, in addition to the anticipated $11 billion loss in revenue in the first four years.[18] Retrospective opt-in to the property tax may lead to administrative burdens, since it requires any duty paid by a purchaser to be refunded.

The potential loss in state revenue in the early period of a transitional to an annual property tax would be at a time when the state has a significant deficit, and the ongoing costs of the pandemic are not yet certain.

Assuming the annual property tax and retrospective opt-in window were in fact introduced, the length of the retrospective opt-in period should be short, certainly less than a twelve-month period, to address the risk that some buyers would delay opting-in with a mind to getting a refund on stamp duty paid and limiting the number of annual property tax payments they need to make.

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

Separate rates are necessary for owner-occupiers and primary production land, but increase complexity and create market distortions

The Committee does not agree that the annual property tax should be introduced.

[18] New South Wales Treasury, *Buying in NSW, Building a Future* (Consultation Paper, November 2020) 18.

Stamp duty schedules differ according to whether housing is purchased as a principal residence or rental investment.[19] Annual property taxes would subject landlords to ongoing tax treatment which would arguably be passed on to renters.[20]

An annual property tax could distort the allocation of land between alternative uses if not applied broadly. A property tax that is uniformly applied 'avoids the distortionary effects resulting from the current non-tenure neutral provisions, and leaves tenants unaffected'.[21]

In developments, using differential rates could cause added unnecessary complexity in determining the applicable property tax rates in the case of mixed-use developments. The proposal has also not addressed the interaction of the "opt-in" scheme with zoning laws. Differential treatment of land could cause unnecessary costs where land which has been 'opted-in' to the property tax has its zoning, use or title description changed under the law.

For the reasons discussed above, residential investment properties and commercial properties should not have a different treatment applied. However, the Committee considers that the economic and wellbeing interests of NSW should see farmland (primary production land) properties receive concessional treatment and residential owner-occupied property should not be subject to the annual property tax.

The imposition of an annual property tax would significantly burden farming businesses with a 'disproportionate cost to the business applied annually, irrespective of turnover in a sector subject to the vagaries of weather and markets',[22] especially in the wake of the devastation of the 2019 bushfires, recent drought, challenges presented by the pandemic and the lack of seasonal workers. The Committee notes that NSW Farmers do not support the stamp duty reform to an annual property tax.[23] Similarly, owner-occupied residential properties are currently subject to exemptions from land tax and the Committee supports ongoing carve-outs for this type of property in the event that an annual property tax is introduced.

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[19] Gavin Wood, Rachel Ong and Ian Winter, 'Stamp duties, land tax and housing affordability: the case for reform' (2012) 27(2) *Australian Tax Forum* 331, 333.
[20] Wood, above n 24, 338.
[21] Ibid 337.
[22] Robert Harley, 'Stamp duty choice is seductively simple – or is it?' Australian Financial Review (online, 26 November 2020) <https://www.afr.com/property/residential/stamp-duty-choice-is-seductively-simple-or-is-it-20201125-p56hse>, accessed 8 March 2021.
[23] Ibid.

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

The Committee is of the view that, while the Committee is not in a position to comment on this question in a legal sense, as a practical matter this tax reform is not worth its cost.

Whilst it is true 'house prices and rents have increased ahead of average earnings over the last 25 years tipping more households into housing affordability crisis',[24] replacing stamp duty with an annual property tax is not the way to address this crisis, with potential to worsen affordability and housing equality. This fact was acknowledged by the Henry Review, which contended that 'policy changes outside the tax and transfer systems will be necessary to better match aggregate housing supply and demand if overall housing price pressures are to be alleviated.'[25] In fact, it is possible that abolishing stamp duty would lead to higher property prices, with the incidence of the tax falling on sellers.[26]

Stamp duties are an important source of revenue for the state government, with stamp duty and land tax accounting for 36% of NSW tax revenue.[27] The Committee has concerns about transitional arrangements and their impact on government revenue and debt, as well as the potential financial stress on taxpayers and homeowners with low or fixed incomes and especially asset-rich, income-poor households and retirees, as similarly expressed in a tax reform discussion paper by the South Australian Government.[28]

Stamp duties were introduced as a progressive tax playing an important redistributive role.[29] Duties levied on the sale of residential property like stamp duty are designed to reflect the discounted present value of the consumption of housing services over the life of the house.[30] The OECD considered this taxation to satisfy horizontal equity, neutrality and feasibility criteria.[31] Although higher income households pay more for housing, demand has been seen to become income inelastic with the effect that duties could be regressive.[32] Despite this, an annual property tax with differential rates applied doesn't address this inelasticity and

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[24] Wood, above n 25, 331.
[25] *Australia's Future Tax System Review: Overview* (Final Report, 2 May 2010) xxiii.
[26] *Australia's Future Tax System Review: Detailed Analysis – Volume 2* (Final Report, 2010) 264 citing Andrew Leigh 'What evidence should social policymakers use?' (2009) 1 *Treasury Economic Roundup*.
[27] New South Wales Treasury, *Buying in NSW, Building a Future* (Consultation Paper, November 2020) 8.
[28] Gavin Wood, above n 24, 336 citing Government of South Australia, 'State Tax Review' (Discussion Paper, 2015).
[29] Wood, above n 25, 334.
[30] OECD, *Choosing a Broad Base – Low Rate Approach to Taxation* (OECD Tax Policy Studies No 19) 78 < https://www.oecd.org/ctp/tax-policy/choosing-a-broad-base-low-rate-approach-to-taxation-9789264091320-en.htm>.
[31] Ibid.
[32] Wood, above n 25, 334, citing Gavin Wood, 'Why Stamp Duties are an Increasing Financial Burden on Australian Home Buyers' (1994) 24(1) *Economic Analysis and Policy* 73.

regressive effect of the tax. For this reason, the Committee opposes the introduction of an annual property tax as it doesn't appear that it will provide a benefit from a wealth redistributive perspective.

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

The Committee does not recommend that price thresholds be used to exclude people buying the most expensive properties from being able to choose to opt-in to the property tax, as this would be distortionary. The Committee has concerns that this measure, if introduced, would exacerbate the two-tier system created in the transitional period of the reforms.

The proposal makes no mention of the application of the scheme in the context of property development. If there are no adequate aggregation mechanisms, property developers may be able to avoid price thresholds which are intended to ensure that owners of valuable property pay stamp duty.[33]

The Committee considers that the annual property tax is an unnecessary measure as stamp duty already has the benefit of ensuring less expensive properties are subject to lower duties.

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

No varied arrangements for different types of tenants

The Committee submits that no arrangements should be made for residential and commercial tenants. This is due to the fact that rental rates are determined by market forces and are subject to supply and demand. It is not a matter for the legislature to determine what arrangements exist between a landlord and tenant other than those that already exist.

[33] Cameron Steele, 'State taxes update: What you need to know about the proposed property tax for New South Wales', *Dentons* (Web page, 24 November 2020) <https://www.dentons.com/en/insights/articles/2020/november/24/nsw-tax-reforms>.

The Committee acknowledges that, pursuant to section 40 of the *Residential Tenancies Act 2010* (NSW), landlords must pay all rates, taxes and charges payable under any Act. These charges cannot be passed on to the tenants and in the event that any annual property tax were to be introduced, it would likely be treated in the same manner. Ultimately, however, residential rents would continue to be dictated by market value, noting that landlords are likely to pass on the costs of the tax by increasing rents charged.[34]

The standard-form contracts for commercial and retail leases contain clauses that specify the outgoings tenants are expected to pay. It is not uncommon for commercial tenants to pay land tax; it follows that if the property tax were to be introduced, the incidence of the tax on commercial tenants would be similar. Section 22 of the *Retail Leases Act 1994* (NSW) governs the way in which outgoings are able to be recovered from a tenant in a retail shop.

Comparatively, when GST was introduced there was a prohibition on landlords recovering GST from commercial tenants unless the terms of the lease provided for that.

Risk of overregulation

The foresight by the NSW Government to see a need to control market forces where landlords may pass annual land tax rates onto tenants shows the potential inequality that general property taxes places on society. Regardless of whether a property owner pays a lump-sum stamp duty tax or an annual land tax amount, both can equally be passed on to tenants of an investment property. The NSW Government does not regulate or seek to regulate current market rates on rental properties in relation to stamp duty. It is therefore submitted that no arrangements should be made in the event that rental rates go up due to the proposed property tax.

Suppression of investment incentives

The proposed property tax is unlikely to benefit investors and will discourage investment. Recently, the government has recognised one way to encourage investment by offering tax incentives or reductions. An example of this initiative is the 'Build to Rent Scheme' which offers a reduction in land tax of 50% on eligible land.[35] However, such incentives are not viable as a long term solution and are generally limited in scope.

Risk of double taxation

[34] Prafula Fernandez, 'Specific Implications of GST on Property Transactions' (2000) 2 *Legal Issues in Business* 21, 22.
[35] Rachel O'Donnell, Michael Parker, Jim Koutsokostas, Kitty Vo and Katrina Reye, *NSW: Australia's 'build-to-rent' state* (20 October 2020) Hall & Wilcox <https://hallandwilcox.com.au/thinking/nsw-australias-build-to-rent-state/>.

The Consultation Paper does not suggest that the proposed annual property tax will apply to increase the cost base of the property (resulting in a lower capital gain upon the disposal of the property) in the same way that stamp duty forms part of the cost base and ultimately saves the taxpayer from incurring a ‘double tax’ on the property on disposal.

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

No concessional treatment beyond existing measures but need to consider impact on elderly Australians and on separated couples

The Committee submits that if the annual property tax is introduced and if in particular it applies to residential owner occupied properties, there will be a significant need for hardship relief and this indicates that the annual property tax is not suitable. By contrast, a one-off payment of stamp duty ensures the purchaser is aware of their upfront costs and can budget accordingly.

The threshold to access to existing economic hardship measures is high and it is expected that any similar measures introduced in relation to the annual property tax will be insufficient. In order to be considered eligible for a concession on the grounds of economic hardship, there is a currently a restrictive process in which the ATO requires proof of: official eviction notice; pending disconnection of essential services; notice of impending legal action; overdue medical bills, bank notices, and repossession notices. These are extreme circumstances that would place extra pressure on families. The committee notes that there are very few mechanisms to apply for concessions through Revenue NSW. The process to have the land tax assessment reviewed is cumbersome and time consuming. The annual property tax should not be placing residents under such financial pressure. There is also a significant risk to owners of repossession of the home by a mortgagee as a failure to pay the property tax would equate to a fundamental breach of the loan / mortgage documents.

Australia’s population is ageing. The older members of society are more likely to be asset rich or have access to savings as opposed to a disposable income. Stamp duty is a fairer way for them to ensure they can meet the required payment as opposed to an ongoing tax. The Committee does not support the introduction of the property tax but *if* it were introduced there would need to be mandated concessions for certain groups. For example, many local councils offer a reduced rate for those on the aged pension.

Another situation where stamp duty provides more certainty are those circumstances where current exemptions apply. Two of the main examples are property that passes to a beneficiary pursuant to the terms of a will, and transferring the property to one spouse following a family law property division. It is perhaps less likely in either of these circumstances the person receiving the benefit of the property has established or planned for the longer term affordability of the annual property tax.

One-off stamp duty payment encourages fiscal responsibility

Stamp duty provides surety to the property owner, it is based on the improved value of a property, can be calculated and provided for by loaned funds if required. The proposed property tax does not account for the vicissitudes of life, inflation or market volatility, and would require people to move if their circumstances changed and they could no longer afford the annual tax.

The level of tax one is required to pay should be based on one's resources and ability to pay. There will be an inequity for non-income producing properties where a tax is introduced that is not based on one's income or ability to pay.

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?

The Committee disagrees with the introduction of the proposed property tax changes. The NSW Government can already address the affordability issue by reducing stamp duty rates. The Committee further submits that there is no way of determining this question at the present time as the current modeling is inadequate and further information and modeling will be required before the balance of taxation revenue can be fully appreciated.

The annual property tax will initially not generate the same amount of revenue as stamp duty. If all buyers opt-in for the property tax there will be a loss of 95% from revenue that the government would have made from stamp duty in the same year.[36] It will be considerably less in the short term, with reports suggesting a deficit of 9 to 12 billion dollars in the first 5 years. Then as more properties transition over to the land tax, the

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[36] John Freebairn, *Axing stamp duty is a great idea, but NSW is going about it the wrong way* (24 November 2020) The Conversation <https://theconversation.com/axing-stamp-duty-is-a-great-idea-but-nsw-is-going-about-it-the-wrong-way-150629>.

expected revenue increase is estimated to double in the 50-year trajectory. Note that sources have stated that more economic modeling is required to understand the increase in revenue and at what point the revenue is set to benefit the government. References on these points are not persuasive as most commentators acknowledge the need for more modeling and more information as to the proposed changes.[37]

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

Recommendation 1 – phase out stamp duty, consider GST

Given on one view that stamp duty operates as a duty on the sale of residential property designed to reflect the discounted present value of the consumption of housing services over the life of the home,[38] which is viewed favourably by the OECD,[39] there is a rationale for re-considering the GST consumption tax.

Recommendation 51 of the Henry Review noted that "the removal of stamp duty should be achieved through a switch to more efficient taxes, such as those levied on broad consumption or land bases".[40] The Henry Review identified that stamp duties could be reduced incrementally, including capping the maximum rate.[41] The Committee suggests that there should be consideration of how the GST can be used to create a more efficient tax system.

Recommendation 2 – Stamp duty payment by instalments

The NSW Government could provide flexibility to taxpayers to make payments of stamp duty, for instance, as a lump sum, in 3 or 6 equal instalments or provide an option to pay it over a multi-year period subject to

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[37] Brendan Rynne, Jodie Patron, *Economic Modelling of Property Tax Reform Options* (February 2016) KPMG report produced for NSW Business Chamber (http://www.nswbusinesschamber.com.au/NSWBC/media/Policy/Thinking%20Business%20Reports/FINAL-NSWBC-NCOSS-Taking-on-Tax-Report.pdf) pg.16. (accessed on 28 February 2021). See also comments made by REINSW CEO Tim McKibbin in website material published on REINSW Website (18 November 2020), *REINSW: The unintended consequences of the NSW Government's Property Tax Reform*. <https://www.reinsw.com.au/Web/News/Media_Releases/2020/11._November/REINSW_The_unintended_consequences_of_the_NSW_Governments_Property_Tax_Reform.aspx>.
[38] OECD, *Choosing a Broad Base – Low Rate Approach to Taxation* (OECD Tax Policy Studies No 19) 78 < https://www.oecd.org/ctp/tax-policy/choosing-a-broad-base-low-rate-approach-to-taxation-9789264091320-en.htm>.
[39] Ibid.
[40] Commonwealth, *Australia's Future Tax System Review* (Final Report, 2010) 90.
[41] Commonwealth, *Australia's Future Tax System Review* (Final Report, 2010) 264.

indexation, to assist in meeting affordability needs. This maintains the NSW Government's objective of reducing barriers to home ownership without increasing ongoing taxation into the long term future.

Other matters

Property development

The proposal should provide further information on how the Government expects the new annual property tax to affect property developers in both the conventional build-to-sell and the more recently emerging build-to-rent sectors. The proposal appears to consider the main taxpayers as owner-occupiers or as individuals who own investment properties, but does not address the impact of this proposal on property development by medium and large-scale property developers.

Deductibility issues

The Consultation Paper does not confirm whether the proposed annual property tax expense would be deductible on investment properties. Currently, stamp duty is an element of the cost base of the property for capital gains tax purposes. Stamp duty therefore reduces the amount of the capital gain upon the disposal of the asset. This has the benefit of ensuring that double taxation does not occur.

The Committee considers that, if introduced, the annual property tax should be recognised as a specific deduction for investors for the purposes of section 8-5 of the *Income Tax Assessment Act 1997* (Cth).

Concluding Comments

NSW Young Lawyers and the Committee thank you for the opportunity to make this submission. If you have any queries or require further submissions please contact the undersigned at your convenience.

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