

Land tax reform for affordable housing

Land tax is an important source of NSW State Government revenue. Land tax also has the potential to improve housing affordability for purchasers and renters, and economic activity generally. Our present system of land tax does not realise this potential, and should be reformed.

The TU supports a broad-based land tax applying to all land, including land used for owner-occupied housing. Exemptions should be few and for the purpose of well-defined public policy benefits.

The rate of land tax should be set so that it replaces other taxes – particularly stamp duties, and possibly taxes on incomes too.

Land tax basics

Land tax is tax, levied annually, on the value of land.

Properly, land tax is levied on the 'unimproved' value of the land – that is, not including the value of improvements, such as buildings, added by the owner.

Land tax is quite different from stamp duty ('transfer duty'), which is levied upon sale or transfer of a property, not annually.

Each Australian State and Territory, except the Northern Territory, levies land tax. New South Wales has levied land tax since 1956; before that, the Commonwealth levied land tax.

In New South Wales, land tax on the total value of assessable land owned by a person, at a rate of 1.6 per cent on value above a threshold of \$412 000, and 2 per cent on value above a premium threshold of \$2.519 million. In 2013-14, land tax raised

\$2.4 billion in revenue for the New South Wales State Government (10 per cent of total State tax revenues; transfer duty raised \$5.9 billion (24 per cent)).¹

Advantages of land tax

As taxes go, a broad-based land tax has many advantages.

In principle, land tax is a **fair tax**, because:

- The value of land does not derive from the work of its owner. Instead, land values reflect the economic development of the community generally. It is fair to return a share of this value, through tax, to the community.
- Taxing the unearned rewards of land ownership means that the tax burden on work and enterprise can be reduced.

Land tax is an **efficient tax**, because:

- Land tax does not reduce the supply of land. It encourages productive land use.
- Land tax does not discourage dealings in land that are to the advantage of the parties (contrast transfer duty, which can discourage owners from transferring to more suitable housing and penalise frequent movers).
- Land tax is simple to administer and pay.

Land tax contributes to the affordability of land and housing, because it discourages speculative land holding. Instead, the land tax liability motivates owners to put land its best use, or sell it to someone else. In this way it also encourages the development of improvements to land, such as new housing, and allows greater rewards for work and enterprise – and so **contributes to economic growth**.

Land tax has practical advantages as a source of revenue for government, because **land tax cannot be evaded** (by its nature, land cannot be hidden or taken out of the jurisdiction) and is **less volatile** than transfer duty.

Problems with the present system

In principle, land tax is simple, fair and efficient, contributing to affordability and productivity. In practice, our present system is defective and does not realise all the advantages of land tax.

The present system is too narrow, because:

- **Owner-occupied housing is exempt from land tax.** The exemption of owner-occupied housing removes 60 per cent of the potential tax base, and encourages speculative holding of land for owner-occupied housing. Because

¹ NSW State Budget 2014-15, Budget paper No 2.

land in other uses may be turned to owner-occupation, the exemption encourages speculative holding even where land tax presently applies.

- Other uses of land – **primary production, retirement villages and residential parks for retired persons** – are exempt, which similarly detracts from the advantages of land tax without delivering some other public policy benefit. Two exemptions – for low-cost boarding houses and low-cost inner-Sydney rental housing – do deliver a public policy benefit, because they are available only where the owner provides low-cost housing. The exemptions for retirement villages and residential parks are not subject to such a requirement.

The present structure of land tax rates is also problematic:

- **The threshold is too high** – \$412 000 is too high to be justified as an exemption for low-cost housing.
- Levying land tax on an owner's **total land values at an increasing marginal rate** discourages large institutions, such as superfunds, from owning residential rental properties. These institutions may otherwise be better able to offer long-term affordable tenancies, and more professional management, than are individual landlords operating on an amateur, speculative basis.

A reformed system of land tax

The TU supports reforming land tax according to the following principles:

- **Broaden the base** – in particular, to include land used for owner-occupied housing.
- **Provide few exemptions, for well-defined public policy benefits.** The current exemptions for low-cost boarding houses and low-cost inner-Sydney rental properties should be retained. Other exemptions – if any – should be similarly narrow and well-defined.
- **Reform the rates structure.** This may be done in either of two ways. The threshold could be reduced and a single rate applied to the total value of properties owned. Alternatively, land tax could be levied on properties separately, at increasing marginal rates according to the value per square metre of the land. (This is the method recommended by the Henry Review.)
- **Replace other taxes** – in particular, transfer duty. Consideration should also be given to using land tax to reduce or replace taxes on work and enterprise.

Land tax reform can be implemented equitably, by allowing owners who have recently paid transfer duty to credit those payments to their new land tax liabilities. Provision could also be made for low-income owners to avoid hardship by deferring their land tax liabilities to such time as their property is transferred.

Support for land tax reform

Reform for a broad-based land tax is supported by:

- The Australia's Future Tax System Review (**the Henry Review**) – which recommended a broad-based land tax levied at increasing marginal rates on land values per square metre.
<www.taxreview.treasury.gov.au/content/FinalReport.aspx?doc=html/publications/Papers/Final_Report_Part_2/chapter_c2-1.htm>
- Research by the **Australian Housing and Urban Research Institute** (AHURI) – which modelled the impacts of the Henry Review land tax recommendations, and estimated that average lot values would decline by 5 per cent, and inner city values by 12 per cent.
<www.ahuri.edu.au/publications/projects/p80647>
- **Prosper Australia** – a non-government organisation inspired by economic justice and leading advocate for land tax reform. <www.prosper.org.au>

Tenants and land tax

Land tax is payable by the owner of land. The *Residential Tenancies Act 2010* (NSW) provides that taxes payable on a rented property must be paid by the landlord (section 40).

Landlords sometimes claim that they pass land tax onto tenants by charging higher rents. This is a dubious claim. Generally speaking, landlords charge what the market will bear. It is unlikely that landlords would charge any less than market rents if land tax were not levied.

It is also unlikely that market rents are pushed up by land tax. Because land tax is payable regardless of whether rental premises are let, the liability tends to encourage landlords to find a tenant and meet the market, and discourage them from holding out for a higher rent. (Contrast a sales tax, which is payable only when an item is sold, and so which permits holding out for a higher price, in effect passing that tax onto the buyer.)²

It is true that during the period of a tenancy the operation of market forces may be inhibited by the large costs faced by tenants on moving out. As a result, a landlord may be able to increase the rent above the general market level. The *Residential Tenancies Act 2010* (NSW) provides that a tenant may take proceedings to challenge a rent increase because it is excessive, considering the general market level of rents and other factors (section 44). The TU supports strengthening this provision, to provide that where the increase is greater than the increase in the Consumer Price Index

² G R Putland, 'Why land tax can't be shifted onto tenants', Land Values Research Group blog <<http://blog.lvrg.org.au/2011/08/why-land-tax-cant-be-shifted-onto.html>>

Rents series for the relevant period, the landlord bears the onus of proving that the increase is not excessive.