PROPERTY COUNCIL of Australia

PROSPERITY | JOBS | STRONG COMMUNITIES

Submission to the Re:think Tax Discussion Paper

Prosperity and fairness: using tax reform to grow the economy

1 June 2015

Foreword

The Property Council strongly welcomes the Government's decision to embark on this tax reform white paper process.

With an economy in transition, anaemic productivity growth and long term fiscal pressures from demographic change, it is more urgent than ever that Australia adopts a tax system which facilitates growth and investment.

In addition, Australian families are labouring under a great housing affordability burden. We should not miss the opportunity to address this issue of fundamental fairness and make our housing more affordable for all Australians.

The property industry is the nation's largest collective tax payer, contributing around $72 billion across the three tiers of government. Property accounts for nine per cent of Australia's total tax take, compared to an OECD average of just five per cent.

This submission offers a suite of recommendations supported by extensive research commissioned from ACIL Allen Consulting.

We believe a fundamental objective of tax reform should be to grow the economy. This means reshaping Australia's tax mix to remove our most distorting taxes.

The Federal Treasury identifies conveyancing stamp duty as the tax with the highest "cost to living standards and economic growth". Stamp duty distorts business decisions, locks families out of housing choices, worsens housing affordability, suppresses economic activity and leaves governments with highly volatile revenue streams.

It is a tax that is a relic from our colonial past, representing a stamp of the state’s authority over property transaction that has absolutely no economic relevance in our modern Australia.

This submission sets out a plan to grow the economy by replacing conveyancing stamp duty with more efficient revenue sources. It is a plan which will require the close cooperation of federal, state and territory governments.

The Property Council looks forward to working with Australia's governments to promote prosperity and fairness in our tax system.

Ken Morrison
Chief Executive

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1. Executive Summary

The Property Council strongly welcomes the Government's decision to embark on a tax reform white paper process. The tax reform process provides the ideal opportunity to reform our most distorting taxes, and create a strong platform for growth and prosperity.

Australia's property industry will be a key driver of the nation's economic growth over the next decade and beyond.

In 2013-14, the property industry:

- directly contributed $182.5 billion to Australia's GDP, one ninth of economic output;
- directly employed 1.17 million full time equivalent employees, almost 12% of the Australian workforce; and
- contributed a further $279.7 billion to GDP, and supported an additional 1.54 million jobs, through flow-on activity[1].

Property is currently a highly taxed asset class.

The Australian tax system raises nine per cent of its total tax revenue from property, compared to an OECD average of just five per cent[2]. Property taxes make up to 46% of state, territory and local government budgets[3]. No other asset class is subject to such a high level of taxation.

This makes Australian property owners the country's largest collective taxpayer.

According to the most recent ABS data, Australia's property owners contributed some $40 billion in real estate specific taxes alone for the 2013-14 financial year[4]. Our research puts the industry's tax bill at $72.1 billion if you include company tax, GST and capital gains paid by property owners[5].

Excess taxation makes homes less affordable. Stamp duties, land taxes, GST and large development levies can make up as much as 26% of the total cost of a finished house, and up to 21% of the total cost of a finished apartment[6]. Many of these taxes are inefficient, discourage investment and create a drag on our economic growth.

While land may be an attractive tax target because it cannot be moved, investment in land is increasingly mobile. We compete with countries around the world for investment in world-class commercial, retail, industrial and leisure facilities, and in the homes Australians need.

Our tax system should be encouraging investment and activity, to generate jobs and boost our economy.

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[1] AEC group, *Economic Significance of the Property Industry to the Australian Economy*, 2015 (AEC report)
[2] Treasury, Re:think *Tax Discussion Paper*, 2015 (Tax Discussion Paper)
[3] ACIL Allen Consulting, *Modernising Australia's Tax System*, 2015 (AAC Tax report)
[4] ABS, *Catalogue 5506.0 Taxation Revenue, Australia*, 2013-14 (ABS Tax Revenue 2013-14)
[5] AEC report (op cit)
[6] AAC Tax report (op cit)

In this submission, the Property Council is putting forward a plan for major reform of the tax system to act as a catalyst for both economic and revenue growth.

A fairer and more efficient tax system will:

- ☑ **grow the economy and create jobs**
- ☑ **make homes more affordable**
- ☑ **provide more stable and reliable income streams for government to fund essential community services**

1. **Abolish Australia's most distorting tax, conveyancing stamp duty, and replace it with more efficient revenue sources for the states and territories to boost economic growth.**

   The Government's Tax Discussion Paper identifies stamp duty as the tax with the highest cost to economic growth and living standards[7]. Stamp duty does the very thing taxes are not supposed to do – it changes decisions of businesses and individuals, deters transactions, and slows economic activity to the detriment of all Australians.

   High stamp duty costs, with rates ranging from 2% to 6% for a median home across the states and territories, leaves people living in homes that are too big or too small for their needs, job seekers not taking jobs where they are available, and first home buyers being shut out of the housing market.

   The cyclical and volatile nature of stamp duty revenues – which can vary as much as 60% in one year[8] – makes stamp duty highly unsuitable as a reliable source of state revenue.

   The Property Council also believes that community attitudes are hardening against the imposition of stamp duty, with it largely being seen as an opportunistic tax grab raising on average $20,000 to $40,000 per housing transaction in our major capital cities. The tax offers no services, lacks accountability, and the community is increasingly questioning where the funds are being spent.

   The whole economy would benefit if we were to replace stamp duties with a more efficient tax. That's why abolition of commercial conveyancing stamp duty was part of the original GST agreement in 1999.

[7] Tax Discussion Paper (op cit)
[8] AAC Tax report (op cit)

The Property Council recognises that states and territories would require a replacement revenue source. Increasing the rate and/or broadening the base of the GST is the most logical option. The Tax Discussion Paper specifically emphasises the efficiency, simplicity and transparency of the GST, and points out that Australia's GST rate is substantially lower than OECD nations, with our close neighbor New Zealand currently at 15%.

Both the GST rate of 10% and the current exemptions have not been reviewed since the tax was introduced in 1999, which has led to an increasing reliance on stamp duties and other inefficient state taxes at a time when Australia needs to create an environment that delivers new growth opportunities.

We are also interested in working with governments on other potential pathways to achieving this reform. An alternative revenue source that has been canvassed by state governments such as ACT and South Australia is the imposition of a broad based low rate land tax. We are open to working with governments that currently have land tax regimes on this alternative revenue source. However, any such reform would need to be carefully planned, and be revenue neutral (i.e. tied into the abolition of stamp duty) to cut the current unreasonable property tax burden.

Critically, our research on a broad based low rate land tax indicates that:

- shifting the revenue burden to commercial property owners, as has been the case in the ACT, will simply discourage investment and lead to a shortage in critical infrastructure and property investment; and
- broad based land taxes are extremely unlikely to generate sufficient revenue to retire stamp duties on their own. Conveyancing stamp duties raises more than twice as much revenue as land tax. The land tax rates on residential and commercial properties needed to generate three times the current land tax revenue take would be politically and economically unacceptable.

2. **Maintain negative gearing to ensure average Australians are able to invest and save for their retirement, and maintain the 50% CGT discount as it is designed to remove the impact of inflation.**

Negative gearing is nothing more than the ability to deduct legitimate expenses against income. It has been part of our tax system for 100 years.

The Tax Discussion Paper acknowledges that the tax treatment of property (except owner-occupied housing) is "the same as" other assets that give a mix of current income and capital gains.

The ability to gear and use debt for all asset classes is a crucial part of investing and fostering economic growth.

Negative gearing in Australia is primarily used by average workers, 73% of whom own only one investment property. These are ordinary Australians saving for their retirement.

The 50% CGT discount ensures that governments only tax real gains – it is designed to remove the impact of inflation. Instead of calculating inflation impacts for each year of ownership (which was considered to be administratively complex), the discount was set at a rate of 50%.

The fundamental principle of not taxing inflation needs to be retained in any review of CGT.

Any wholesale removal of negative gearing or the CGT discount that discriminates against property would significantly harm investment, diminish rental supply and ensure that in the short to medium term, rents and property prices will increase.

The key to making homes more affordable is to increase the supply of new housing stock to better meet demand, and any move to restrict the current tax arrangements would be disastrous, particularly for rental supply.

3. **Maintain tax flow-through for real estate investment vehicles to strengthen our attractiveness as an investment destination.**

Nearly 18 million Australians are investors in property trusts, either directly or indirectly through their retirement savings[9].

Tax flow-through treatment for property trusts puts beneficiaries in the same tax position as if they had invested directly in the property – it is designed to help Australians invest in property assets they could not afford to own outright themselves, and is consistent with globally accepted principles for collective investment vehicles.

Australia can strengthen its attractiveness as a destination for long term patient capital by:

- maintaining tax-flow through treatment for real estate investment vehicles;
- developing a robust and globally competitive tax regime for managed investment trusts;
- broadening the range of collective investment vehicles that can be offered by Australian fund managers; and
- ensuring our withholding tax rates remain competitive.

[9] AEC report (op cit)

4. **Harmonise state tax calculation methodologies to reduce complexity and cut red tape.**

   Any business that competes nationally is required to comply with up to 150 individual state taxes[10]. This is a significant cost to conducting business in Australia.

   Adopting consistent definitions and tax calculation methodologies for state taxes, such as stamp duty, payroll tax and land tax, would boost investment across state and territory lines. We recommend that a priority initial reform be the landholder stamp duty harmonisation project, preceding the abolition of stamp duty.

   States could continue to compete on the rate at which the taxes are imposed, but there would be consistent application on how the rules are applied.

5. **Reshape land tax to have less impact on investment by having a single flat rate land tax structure for all existing land tax payers.**

   The Tax Discussion Paper describes land tax as a theoretically efficient form of taxation, but excessively high land tax rates, poorly structured land tax regimes or incorrect valuation methodologies all have a punitive impact on investment.

   Australia competes in a global market for capital and higher land taxes encourage potential investors to shift their investments to other asset classes or geographical locations.

   Critically, current land tax systems are extremely inefficient due to aggregation and their tiered land tax structure, which means that taxable property (such as commercial buildings) held within larger portfolios pay higher rates of tax.

   This means that the land tax burden falls in a punitive fashion on a small number of property owners. These established property groups, who have the expertise, resources and economies of scale to develop and manage large scale projects, are therefore discouraged from investing in the critical infrastructure needed to build Australia's future.

   For those states and territories with an existing land tax regime (i.e. all but Northern Territory), land tax could be made to be more efficient for existing land tax payers by moving towards:

   - a single flat rate land tax structure for all existing land tax payers,
   - with a common valuation basis based on unimproved capital values for land tax and council rates.

   The Property Council does not support the introduction of a land tax for the Northern Territory as this will further deter critical investment and infrastructure in northern Australia.

[10] AAC Tax report (op cit)

6. **Shift away from ad-hoc and inequitable infrastructure charges to more sustainable models for infrastructure funding**

   The Tax Discussion Paper does not contain any discussion on infrastructure charges and developer levies, a significant omission.

   Infrastructure charges and developer levies are not generally recognised as a head of tax in state budget papers, but these are in fact taxes that materially increase the cost of new development.

   There is little consistency between local councils and state governments on how these charges are levied, and even less certainty and transparency on how much is raised and whether the funds are actually used for infrastructure.

   While we support the need for greater infrastructure planning and funding to make our cities more liveable, it is critical that this the cost burden does not rest solely with purchasers of the homes and business premises we need.

   The Henry Tax Review flagged significant problems with how infrastructure charges are currently levied and recommended a review by COAG, which has not occurred.

   We need to replace the current complex, ad-hoc and inequitable infrastructure charging regimes with more sustainable models for infrastructure funding that do not add to the cost of housing or new commercial construction.

Our submission also provides industry's views on a range of technical questions raised in the Tax Discussion Paper (see Attachment A).

Pathway to reform

We need commitment from federal, state and territory governments to reform our tax system.

Our population will double in 40 years time[11], and we need stable revenues to provide the services and infrastructure to maintain our living standards.

More fundamentally, we need the right tax policy settings to improve housing affordability and encourage businesses to invest in Australia and boost jobs and economic growth.

Substantive tax reform will mean there will be winners and losers in the short-term. However, having the right tax mix will ensure all Australians are ultimately better off.

[11] Treasury, Intergenerational Report, 2015

2. Summary of recommendations

1. Ensure this national tax reform opportunity encompasses reforms to federal, state and local taxes that achieve clear tax reform principles.

2. Abolish conveyancing stamp duty, Australia's most distorting tax, and replace it with more efficient revenue sources to boost economic growth.

3. Maintain negative gearing for all forms of investment to ensure average Australians are able to invest and save for their retirement.

4. Maintain 50% CGT discount for all forms of investment as it is designed to remove the impact of inflation.

5. Strengthen Australia's attractiveness as an investment destination for long term patient capital by:

   - maintaining tax flow-through for real estate investment vehicles;

   - developing a robust and globally competitive managed investment trust regime;

   - broadening the range of collective investment vehicles that can be offered by Australian fund managers; and

   - ensuring our withholding tax rates remain competitive.

6. Harmonise tax definitions and calculation methodologies for state taxes, such as the existing stamp duty, land tax and payroll tax regimes, to reduce complexity and cut red tape.

7. Boost investment by replacing the current land tax rules with:

   - a single flat rate land tax structure for all existing land tax payers, to make the land tax regime fairer; and

   - a common valuation basis for land tax and council rates based on unimproved capital values to reduce complexity.

8. Replace the current ad hoc and inequitable infrastructure charges levied by state and local governments, with a more sustainable model for infrastructure funding that does not add to the cost of new development.

3. Property industry's economic contribution

The property industry creates the homes we live in, the offices in which we work, the industrial premises that underpin our economy, and the shopping centres and recreational areas where we spend our leisure time.

It has a larger footprint on the Australian economy than any other industry[12].

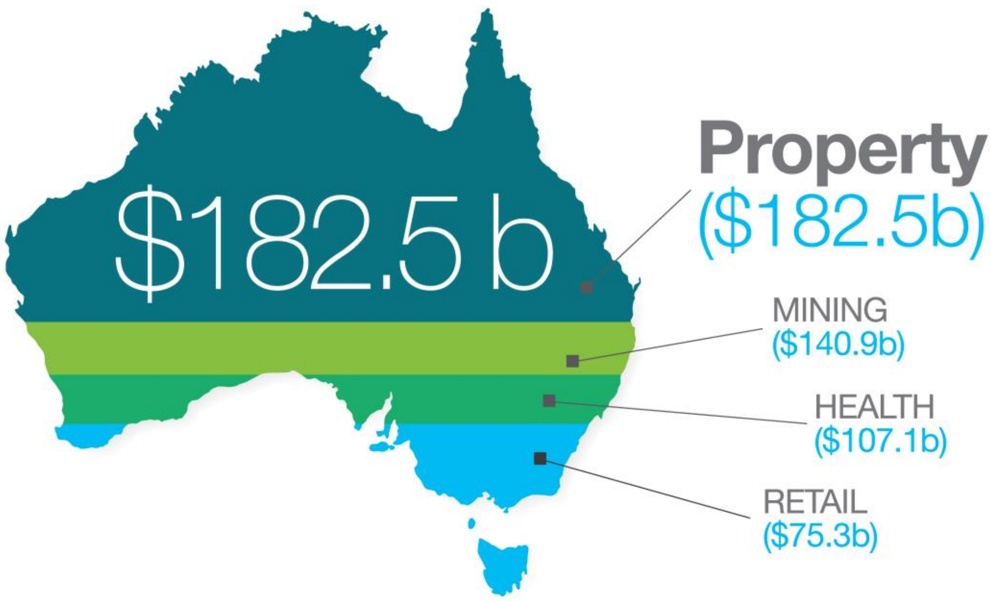
The Property Council commissioned the AEC group to undertake a comprehensive analysis of the property industry's contribution to the Australian economy. Their findings in relation to the property industry's contribution to gross domestic product, employment and household wealth are summarised in this chapter. The AEC group's analysis on the property industry's contribution to government tax revenues is discussed at chapter 4.

3.1 Contribution to Gross Domestic Product (GDP)

The property industry directly contributed $182.5 billion to GDP in 2013-14, representing 11.5% of total GDP, one ninth of economic output. This is greater than the contribution from the mining sector, health sector and retail sector (see Figure 1).

The property industry is estimated to have contributed a further $279.7 billion to Australian GDP through flow-on demand for goods and services.

Figure 1: Property industry's direct contribution to GDP



[12] Unless otherwise referenced, all the statistics in this chapter are sourced from the AEC report (op cit)

3.2 Contribution to employment

The property industry directly employed 1.17 million full time equivalent (FTE) employees in 2013-14, representing 11.8% of the Australian workforce.

The industry also supported some 1.54 million FTE jobs through flow-on activity.

One in four wages in Australia is supported by the property industry, directly or indirectly.

3.3 Contribution to household wealth

Property investment represents a significant contribution to the wealth and prosperity of everyday Australians.

Home ownership represents 43% of total household assets [13].

There are approximately 7.8 million private dwelling households in Australia:

- 5.3 million are owner occupiers (either outright or with a mortgage);
- 2.3 million are renters; and
- 0.2 million are in alternative forms of housing such as public housing.

In addition to investment in the family home or residential investment properties, 17.65 million Australians (99.95% of people aged 18 or over) have an investment in property through their superfund.

Of the $1.78 trillion in total assets held by super funds at the end of 2013-14, it is estimated that approximately $182 billion was held across property assets.

[13] Tax Discussion Paper (op cit)

4. Taxing the property life cycle

Property is currently a highly taxed asset class.

In addition to the research commissioned from the AEC group (discussed at chapter 3), the Property Council also commissioned ACIL Allen Consulting to undertake a comprehensive review of tax reform, with a particular focus on property related taxes.

The ACIL Allen research encompassed detailed modelling of the tax burden on the property sector and typical property assets (discussed in this chapter), an assessment of Australia's major federal and state taxes against tax reform principles (discussed in chapter 5), and analysis of the economic and revenue benefits of a tax mix switch (discussed in chapter 6).

4.1 Contribution to government revenues

The Tax Discussion Paper notes that the Australian tax system raises nine per cent of its total tax revenue from property, compared to an OECD average of just five per cent[14].

However, these figures only encompass real-estate specific taxes such as stamp duty and land tax, and ignore the property industry's contribution to the tax system through corporate tax, capital gains tax, GST and payroll tax.

In fact, the property industry's actual tax contribution is significantly greater than the Government's reported figures.

The property industry contributed approximately $72.1 billion in tax revenues across all governments in 2013-14 (not including income tax paid on property related activities such as rental income)[15]. This represents 16% of total Australian government tax revenues for 2013-14.

The amounts of tax revenues paid to each level of government is set out in Table 1.

[14] Tax Discussion Paper (op cit)
[15] AEC report (op cit)

Table 1: Property industry contribution to government revenues, 2013-14

Level of Government	Tax	Amount
Federal taxes[16]	Company income tax (excluding capital gains)	$8.2 billion
	Capital gains tax	$6.4 billion
	GST	$6.4 billion
	Total federal taxes	**$21.5 billion**
State taxes	Transfer / Stamp duties	$15.7 billion
	Land tax	$6.4 billion
	Payroll tax	$2.3 billion
	Other property related taxes	$3 billion
	Total state taxes	**$27.4 billion**
Local taxes	Rates, fees and charges	$23.2 billion
	Total local taxes	**$23.2 billion**
Total taxes	**Total federal, state and local taxes**	**$72.1 billion**

Source: AEC group, 2015

4.2 Taxes on property compared to taxes on other sectors

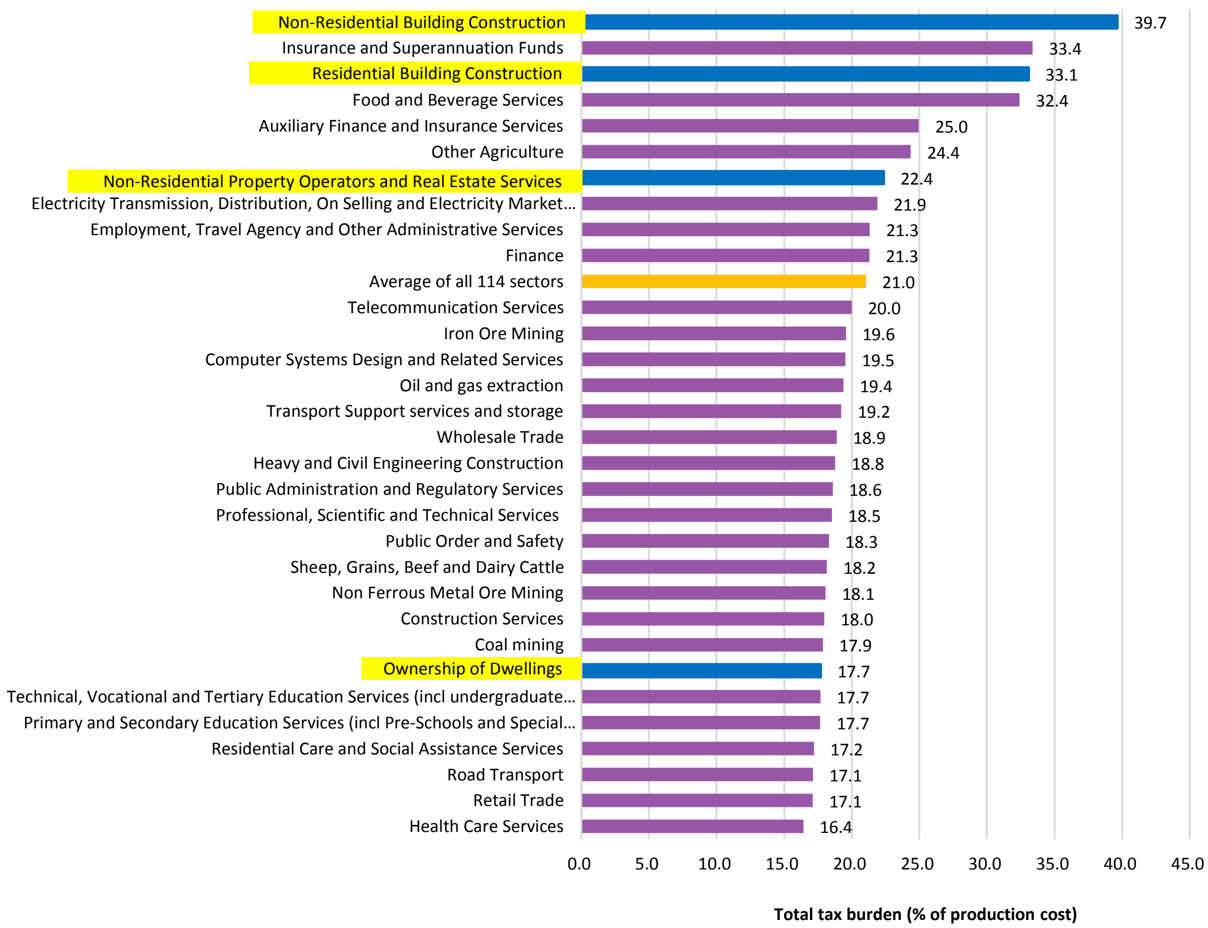
According to ACIL Allen's research, the property industry is one of the most heavily taxed sectors of the Australian economy.

Figure 2 below estimates the total (direct and indirect) tax burden on particular industries, as a percentage of production cost by sector. This includes all taxes that directly impact the production of goods and services (e.g. net taxes on products, income taxes on labour and income taxes on capital), indirect taxes paid in producing the good or service (e.g. taxes embedded in the supplies used by the sector), and taxes charged on the industry and final use of the product (e.g. in the case of commercial building construction, this would include stamp duty and GST).

The "leader board" highlights that commercial building construction is the most heavily taxed sector of the economy, while residential building construction is ranked third highest. Commercial property operators and real estate services are ranked seventh highest.

[16] The amount of income tax derived from property related services, such as rental income, is unable to be readily calculated as the Government does not release any data to enable a breakdown of personal income tax, company tax and income tax paid by superannuation funds.

Figure 2: Tax burden as a percentage of production cost of selected sectors, 2009-2010



Note: Sectors were selected with value added higher than $10 billion from 113 sectors in the ABS input-output tables. Total tax burden includes direct and indirect taxes and net taxes on use.

Source: ACIL Allen Consulting, 2015

4.3 Taxes on property life cycle

Property is taxed throughout its life cycle – property is taxed when it is purchased (stamp duty), taxed while it is held (income tax, land tax, council rates, fire and emergency levies), and taxed when it is sold (capital gains tax).

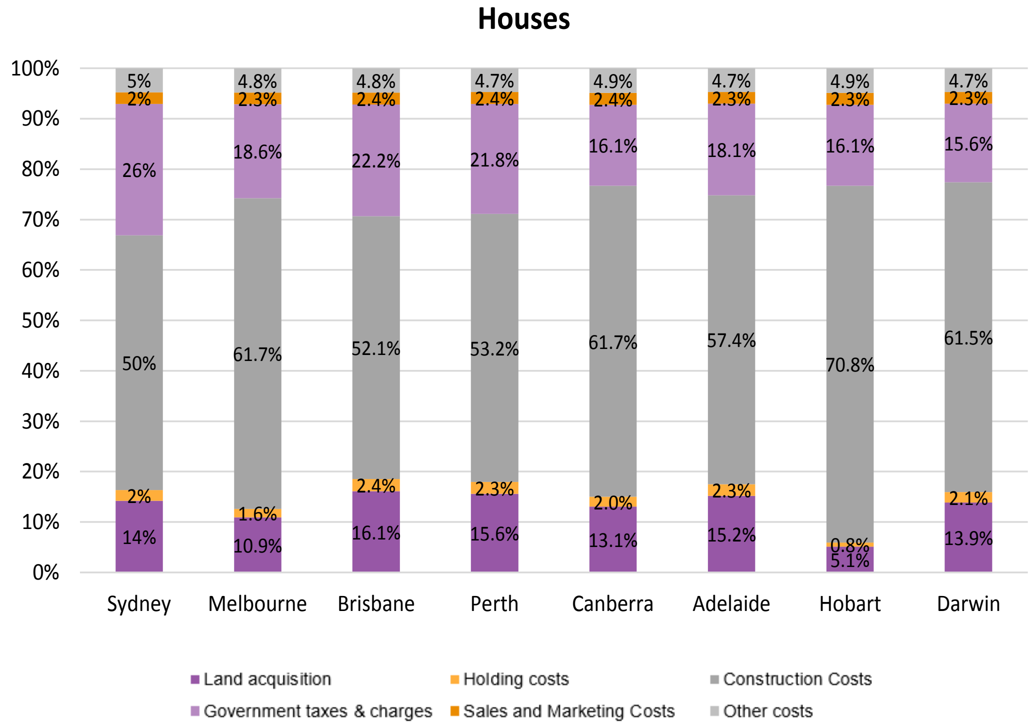
To illustrate the magnitude of these taxes during the development phase of new properties, ACIL Allen produced case studies showing the main components of a typical house, apartment and office building in the capital cities (Figure 3).

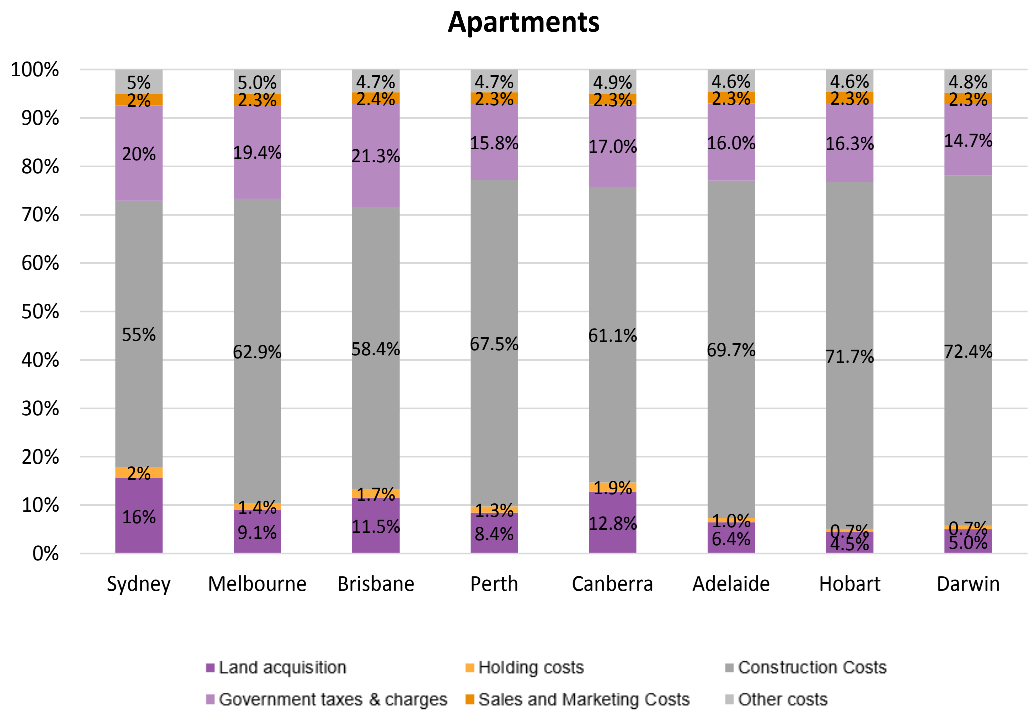
The case studies show, for example, that taxes represent around:

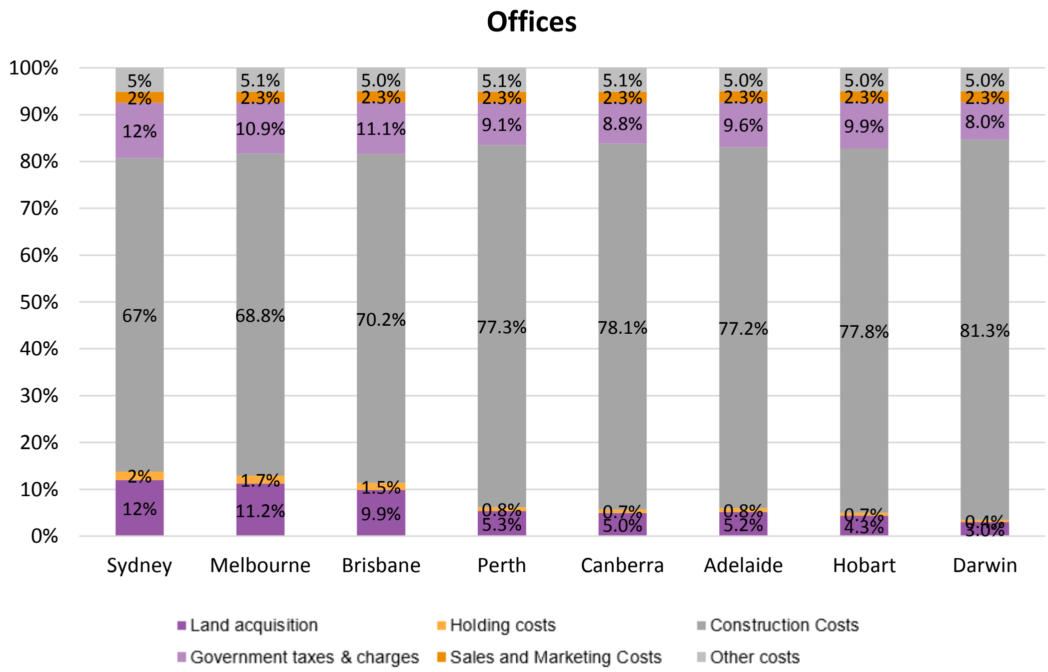
- 26% of the cost of acquiring a new house in Sydney ($175,000 of a $670,000 house),
- 20% of acquiring a new apartment in Sydney ($108,000 of a $546,000 apartment), and

- 12% of the cost of acquiring a new office building (around $720 per square metre of net lettable area of a $6,100 per square metre lettable area office space).

Figure 3: Comparison of development costs for houses, apartments and offices across Australia's capital cities, share of final building acquisition cost (per cent, 2014)







Note: Other costs include legal fees and developer margins.

Source: ACIL Allen Consulting, 2015

5. Principles for tax reform

Australia's current tax system is mired with inefficient, complex, opaque and inequitable taxes. Our over-reliance on inefficient taxes is holding back the economy and national productivity.

As mentioned in chapter 4, the Property Council commissioned ACIL Allen Consulting to undertake a comprehensive review of Australia's current tax system, and put forward a set of reform principles to guide tax reform.

According to ACIL Allen, a tax system should be efficient, equitable, stable, simple and competitive, while ensuring that adequate revenues are collected in order to meet the needs and expectations of the community[17].

It is pleasing to see these reform principles largely being reinforced in the Tax Discussion Paper.

Assessing our current taxes against these individual design principles will clearly highlight which taxes should be reformed, and the priorities for an optimal tax reform package.

A fairer and more efficient tax system will:

- create economic activity and jobs by encouraging investment in Australia;
- make homes more affordable for everyday Australians; and
- provide more stable and reliable income streams for government to fund the critical infrastructure and community services we need for our growing and ageing population.

5.1 A more efficient tax system

An efficient tax system minimises the distortionary effects of taxes on the behaviours of businesses and consumers.

All taxes change behaviour. The greater the change in behaviour, the more the tax distorts the economy. Taxes that are levied on a narrow base at a higher rate are more distortionary than broad based low rate taxes.

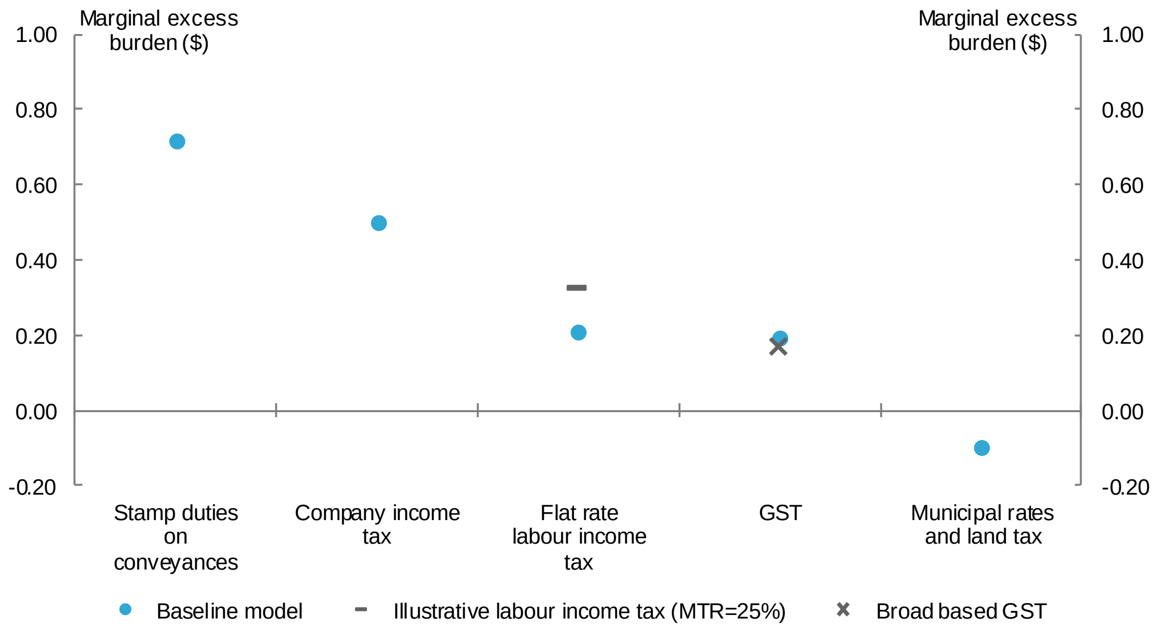
Treasury modelling contained in the Tax Discussion Paper confirms that stamp duty on conveyances is one of Australia's most inefficient taxes as it has the highest long-term cost to economic growth and living standards (measured as the 'marginal excess burden', see Figure 4 below).

Treasury ranks stamp duty as being a more distorting tax than company tax. Stamp duty on conveyances holds back investment and slows down the economy by inhibiting transactions and movement of people.

A broad based single rate consumption tax, like the GST, is one of the most efficient taxes available to Government.

[17] AAC Tax report (op cit)

Figure 4: Long-run modelling estimates of the marginal excess burden of some of Australia's taxes



Source: Treasury estimates, Tax Discussion Paper

5.2 A more equitable tax system

Taxes can either be horizontally equitable or vertically equitable.

Horizontal equity is achieved by taxing people in similar financial circumstances in the same way. An example of such a tax would be the GST which applies to all consumers.

Vertical equity is achieved through a progressive tax system that levies higher tax rates on individuals with greater wealth or income. An example of such a tax would be the personal income tax system.

However, the trade-off between horizontal and vertical equity does not always work.

For example, existing land tax systems across the various states and territories apply aggregation (where land holdings of each land owner is taxed as a single amount) as well as a progressive tax rate scale. The combined effect means that the average rate of land tax on a portfolio of land can be much higher than if each property were taxed separately. In the pursuit for vertical equity over horizontal equity, the land tax system ends up distorting the market and discouraging investment.

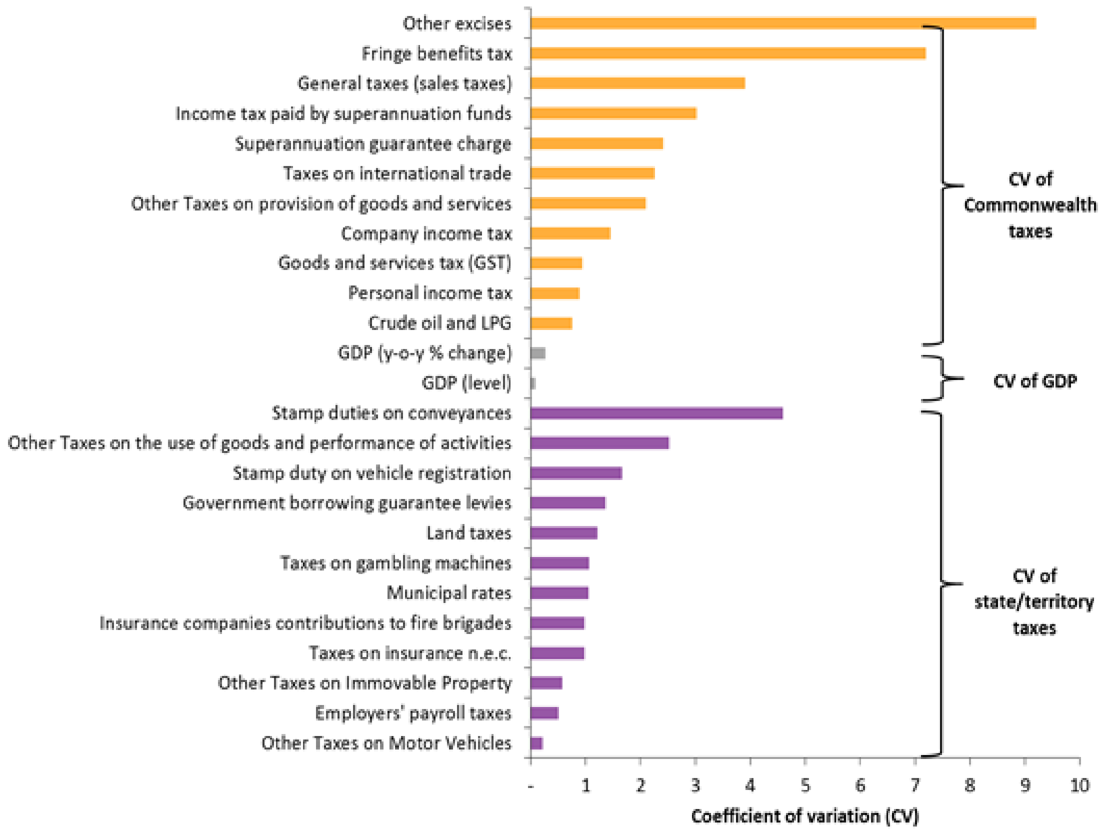
According to ACIL Allen, the trade-offs between horizontal and vertical equity highlight that equity cannot be solved through the taxation system alone. Supplementary policy tools such as transfer payments are critical to creating a fairer and equitable system.

5.3 A more stable tax system

Governments need consistent and predictable revenue sources that encourage investment and productivity to be able to plan policies and deliver effective services to the community.

Figure 5 below ranks federal and state taxes from most volatile to least volatile. This shows that taxes with broader bases such as the GST and personal income tax are more reliable than taxes with narrower bases such as stamp duties on conveyances.

Figure 5: Variance in growth of tax revenue collection by type of tax, 2003-04 to 2012-13



Note: The stability of a tax is measured by looking at its variability using the coefficient of variation (CV) of annual tax revenue growth – that is, the change in revenue growth from one year to another. The higher the CV, the higher the volatility of the tax base.

Source: ACIL Allen calculations based on ABS Catalogue 5506.0 Taxation Revenue, Australia, 2012-13

5.4 A simpler tax system

Taxes should be simple, transparent, practical and enforceable, with minimal administration and compliance costs.

Different tax definitions and methodologies from state to state lead to unnecessary costs for businesses operating in more than one jurisdiction.

5.5 A more competitive tax system

Taxes impact the attractiveness of Australia as an investment destination for international capital. High corporate tax and withholding tax rates can act as a disincentive for investors to invest in Australia. Complex systems that differ to global norms can also act as a barrier to investment. Taxes can also have a detrimental impact on Australian businesses looking to expand offshore.

5.6 A tax system that provides adequate revenues to meet community needs

Revenue raised from the tax system needs to be sufficient to meet government's funding requirements.

Given our federal system, meeting the revenue adequacy principle is virtually impossible if each of the Commonwealth and state/territory governments is considered in isolation.

It is critical that we have inter-governmental collaboration in designing a sustainable and optimal tax system that will drive our economy, and meet the current and future needs of Australia.

5.7 Benchmarking current taxes against the tax reform principles

ACIL Allen benchmarked each of our major taxes against the tax reform principles discussed above. A maximum score of five indicates that the tax meets the reform principle very well, while a minimum score of zero means it does not meet the principle at all.

Amongst the major Commonwealth taxes, ACIL Allen concluded that GST performs relatively well compared to the other federal taxes in relation to stability, efficiency, competitiveness and simplicity (see Table 2).

Table 2: Assessment of Commonwealth taxes

Tax/Modernisation principle	Stability	Efficiency	Equity	Competitiveness	Simplicity
Personal income tax	4.0	3.0	4.0	3.0	3.0
Company income tax	2.5	1.0	2.5	1.0	3.0
Consumption tax (GST)	4.0	4.5	2.0	3.5	4.0
Alcohol taxes and wine equalisation tax	3.0	4.5	3.0	2.0	3.0

Source: ACIL Allen Consulting, 2015

Amongst the major state taxes, gambling tax is the best performing tax, while stamp duties on conveyances is the worst performing tax (see Table 3).

Table 3: Assessment of State taxes

Tax/Modernisation principle	Stability	Efficiency	Equity	Competitiveness	Simplicity
Stamp duties on conveyances	0.5	1.0	1.0	1.0	3.5
Land tax	2.0	3.0	2.0	2.0	1.5
Payroll tax	4.0	3.5	2.5	2.0	1.5
Insurance taxes	3.0	0.5	1.0	2.0	3.5
Taxes contributing to fire and emergency services	3.0	1.5	2.0	2.0	1.0
Gambling tax	3.0	5.0	4.0	n/a[a]	3.5
Taxes on motor vehicles	1.5	1.0	3.0	2.0	4.5
Developer charges	1.5	2.0	2.0	2.0	1.5

[a] The principle of competitiveness has limited relevance for gambling tax.

Source: ACIL Allen Consulting, 2015

The above tables highlight that state taxes do not perform as well compared to Commonwealth taxes as they have a narrow base, and taxes such as conveyancing stamp duty are highly distortive.

5.8 Recommendation

Ensure this national tax reform opportunity encompasses reforms to federal, state and local taxes that achieve clear tax reform principles.

6. A plan to grow the economy by phasing out conveyancing stamp duty, our most distorting tax

Chapter 6 of our submission puts forward a plan for growing the economy by abolishing our most distorting taxes, and moving towards more efficient broad based taxes.

The Government's Tax Discussion Paper names stamp duty as the tax with the highest cost to economic growth and living standards. Stamp duty distorts decisions, imposes a high tax cost on housing, and is an unstable and volatile revenue stream.

The whole economy would benefit if we were to replace stamp duties with a more efficient tax. State governments would get a more stable revenue base, investment decisions could be made on the basis of real fundamentals, and families would have one less cost locking them out of their housing aspirations.

6.1 The real cost of stamp duty

Stamp duty is a highly inefficient tax as it changes the behaviour of businesses and individuals. It creates and magnifies a drag on our economy, holding back the ability to respond to markets and making it harder for Australia to be nimble in the face of economic challenges.

Stamp duty on conveyances leads to:

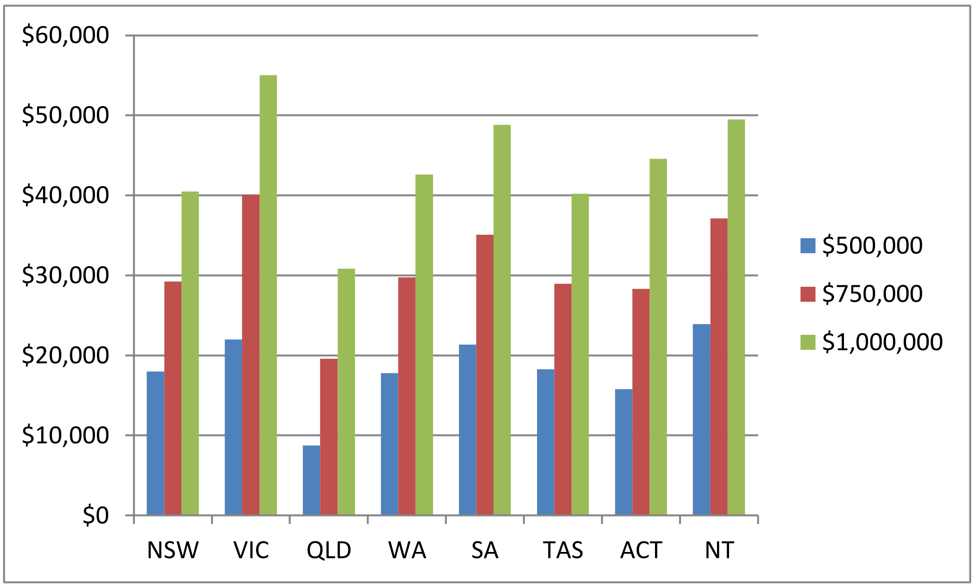
- misallocation of housing, with households living in homes that are too big or too small for their needs;
- inefficiencies in the labour market, as job seekers choose not to take jobs where they are available because of the high transaction costs of buying a new home;
- home buyers being shut of the housing market, as the cost of stamp duty erodes their savings;
- tens of thousands of dollars of extra mortgage costs for households, with purchasers generally adding stamp duty costs to their mortgage; and
- businesses not being able to be flexible and adjust to market conditions by moving or expanding their locations.

6.2 Rising stamp duty costs for a median home

Stamp duty rates vary from state to state, but generally range from 2% to 6% on a median home.

Put in other terms, stamp duty can range from $8,750 (in Queensland) to $23,929 (in Northern Territory) for a $500,000 home (Figure 6).

Figure 6: Stamp duty payable on residential property, 2015



Source: State revenue office websites (stamp duty calculators) for each state and territory

Bracket creep has also resulted in the cost of stamp duty rising rapidly for ordinary Australians (see Case study 1 below).

Case study 1: Bracket Creep in NSW

The current NSW stamp duty rates were introduced in 1986, and the higher rate thresholds (applying for homes above $300,000) were not intended to affect the average home purchaser (per the Second Reading Speech to the *Stamp Duties Further Amendment Bill 1986*).

In 1986, stamp duty on a median home would have been approximately $1,931 or 1.96% of the house price.

The stamp duty rate thresholds have not changed in NSW since 1986.

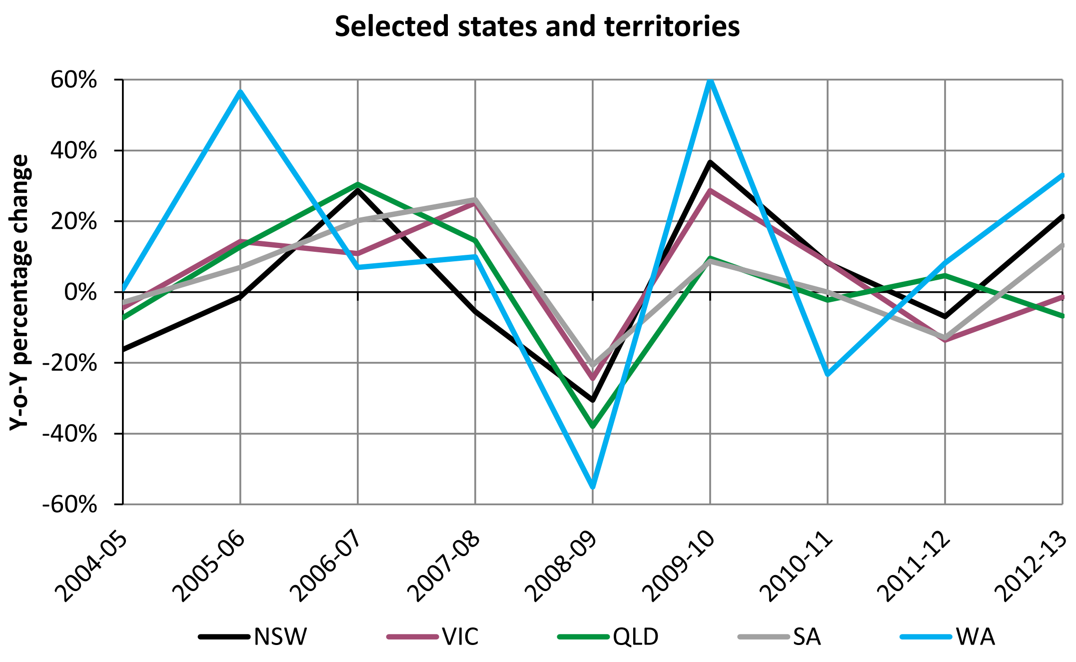
As a result, stamp duty on a median home in 2014 was $33,470 or 3.97%.

6.3 A highly volatile tax

Stamp duty revenues are determined by the value of the property and the volume of transactions, both of which are driven by prevailing market conditions and can change dramatically year to year.

Year on year stamp duty revenues can fluctuate significantly. Western Australia's revenue from stamp duties on conveyances has fluctuated by as much as 60% (both positive and negative) on a year to year basis, while New South Wales and Queensland have seen fluctuations in excess of 35% over the past decade (Figure 7).

Figure 7: Revenue from stamp duties on conveyances, annual percentage change (2004-05 to 2012-13)

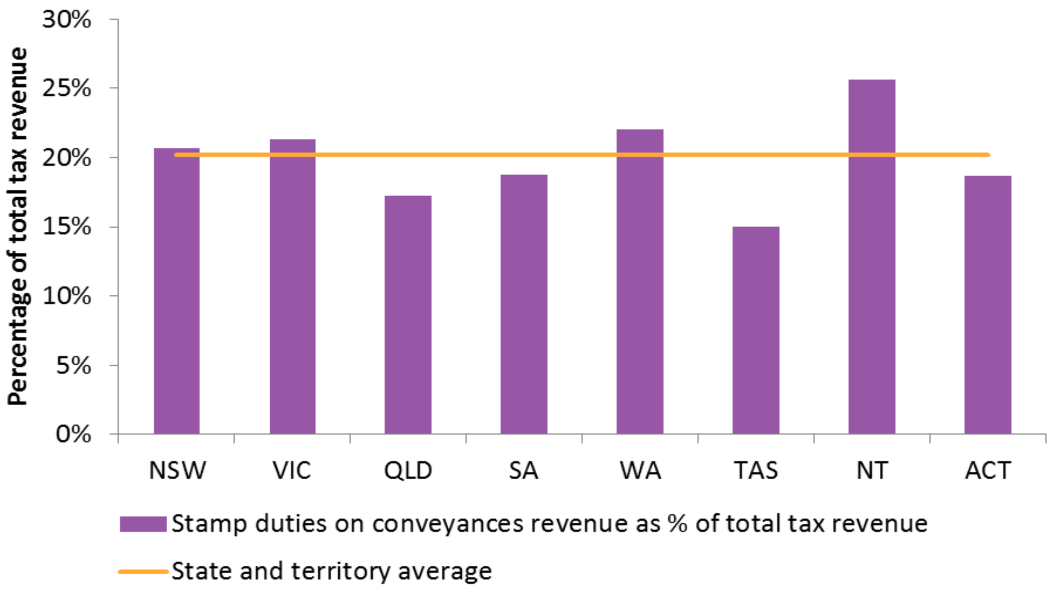


Source: ACIL Allen Consulting 2015 based on ABS 2014a

6.4 Replacement revenues

State and territory governments currently rely heavily on stamp duty to help them balance their budgets, ranging from 11.1% of total revenues in Tasmania to 21.5% in the Northern Territory (Figure 8).

Figure 8: Stamp duties on conveyances revenue as percentage of total tax revenue by state and territory, 2012-13



Note: Nominal values

Source: ACIL Allen Consulting 2015, based on ABS 2014a

The Property Council recognises that states and territories would require a replacement revenue source were conveyancing stamp duty to be abolished.

We are interested in working with governments on potential pathways to achieving this reform. The Henry Tax Review recommended 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. We briefly discuss each alternative below.

6.4.1 A stamp duty / GST tax mix switch

Increasing the rate and/or broadening the base of the GST is the most logical option for a more stable and efficient source of tax revenue for the states and territories.

As noted in the Tax Discussion Paper, Australia's GST rate is one of the lowest amongst developed countries, and is roughly half of the average rate for OECD countries.

The paper also notes that GST was only paid on 47% of consumption in 2012, as a result of GST exemptions currently in place. This compares to New Zealand which taxes 96% of all goods and services (at the rate of 15%), and the OECD average of 55%.

Both the GST rate of 10% and the current exemptions have not been reviewed since the tax was introduced in 1999, which has led to an increasing reliance on stamp duties and other inefficient state taxes at a time when Australia needs to create an environment that delivers new growth opportunities.

6.4.2 A stamp duty / broad-based low rate land tax mix switch

The South Australia government is currently canvassing replacing stamp duty with a broad-based low rate land tax (although media reports suggest that the SA Treasurer has subsequently ruled this out).

We are open to working with governments on the option of a broad-based, low rate land tax on currently exempt properties in jurisdictions where land tax is already in place, providing it is preceded by abolishing stamp duty to cut the current unreasonable property tax burden. However, it must be noted that all stamp duty revenues could not be shifted to a land tax base without land tax rates being unacceptably high.

In 2012-13, state and territory governments raised a total of $12.8 billion in stamp duty on conveyances and $6.2 billion through land taxes[18]. Were governments to impose a universal land tax, with the aim of revenue neutrality, an extra $12.8 billion would need to be raised from land tax.

This would mean land tax rates on residential and commercial properties would need to be set at a high enough rate to generate at least three times the current land tax revenue to fully offset stamp duty revenues foregone.

In short, it is unlikely that a new universal land tax could be introduced at a politically or economically acceptable level that would enable it to raise sufficient revenue to fully offset the abolition of stamp duty.

Critically, any move to impose higher land tax rates on commercial property owners will discourage investment and economic activity, as experienced in the ACT (see case study 2).

[18] AAC Tax report (op cit)

Case study 2: ACT's stamp duty / land tax switch

The ACT's recent reforms to phase out stamp duty and move towards a broader based land tax has resulted in the commercial property sector being faced with exorbitant rate increases.

Table 4 below illustrates the level of statutory rate increases that have been faced by office and retail property owners in the ACT over the past several years, with cumulative increases of between 40-60%.

Higher land tax costs for the commercial property sector discourages investment in a jurisdiction that desperately needs private investment.

It is also noted that in the first year of the ACT Government's tax reform process, the top rate of stamp duty actually went up, in addition to the increase in statutory charges.

The ACT experience is a pertinent example of poor implementation of a tax reform process.

Table 4: Increases in ACT statutory rates from 2011-12 and 2014-15

ACT - Statutory Outgoing Increases* 2011/12 - 2014/15						
Location	**Brief Description**	**2011/12**	**2012/13**	**2013/14**	**2014/15**	**Cumulative**
Mid-City	2 Level - mixed com/retail	98.90%	103.30%	127.50%	109.70%	142.89%
Civic	10 Level Office	98.80%	103.20%	124.10%	114.00%	144.25%
Suburban Shopping Centre	14 Shops	110.10%	104.30%	126.20%	113.50%	164.49%
Greenway Office Building	2 Levels	99.20%	104.60%	124.50%	111.50%	144.04%
Woden Office Building	10 Levels	100.40%	104.40%	125.40%	112.10%	147.35%
Figures are based on previous year i.e. 104.4% represents an increase of 4.4% over the previous year.						
*Incudes General Rates, Land Tax, Fire Levy and City Centre Marketing Levy (if applicable)						

6.5 Recommendation

Abolish conveyancing stamp duty, Australia's most distorting tax, and replace it with more efficient revenue sources.

7. Federal taxes

Chapter 7 of our submission focuses on the federal tax issues that impact greatest on the property industry, being negative gearing, the capital gains tax (CGT) system, and the treatment of property investment vehicles.

Some further specific responses to issues raised in the Government's Tax Discussion Paper are provided at Attachment A to this submission.

7.1 Negative gearing and 50% CGT discount

Negative gearing and the 50% CGT discount apply to all forms of investment, including property investments, share investments and business ventures.

Negative gearing in Australia is primarily used by average workers. 72.8% of investors own only one investment property, while an additional 18% own two properties[19]. These are ordinary Australians saving for their retirement. The ability to gear and use debt is a crucial part of investing and fostering economic growth.

The 50% CGT discount ensures that governments only tax real gains – it is designed to remove the impact of inflation. Instead of calculating inflation impacts for each year of ownership (which was considered to be administratively complex), the discount was set at a rate of 50%.

Any wholesale removal of negative gearing or the CGT discount would significantly harm investment, diminish rental supply and ensure that in the short to medium term, rents and property prices will increase.

The key to making homes more affordable is to increase the supply of new housing stock to better meet demand. Even the Henry Tax Review acknowledged that any changes to the tax treatment of investment properties should only be implemented after other housing supply constraints are resolved.

7.1.1 Negative gearing is not a special concession for property

The ability of investors to borrow to finance their investments is essential to ensure that Australia's capital markets operate efficiently and allocate funds to those investments that generate the highest rates of return for a given risk[20].

Loans allow investors to add to their own savings by borrowing from the savings of other individuals. This means that investors can access funds to purchase investments they would otherwise not be able to afford using their savings alone.

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[19] ACIL Allen Consulting, *Australian Housing Investment*, 2015 (AAC Housing Investment report), based on ATO Taxation Statistics 2010-2011

[20] AAC Housing Investment report (op cit)

The ability to offset losses from one activity against the income or profits from another activity (i.e. the ability to negatively gear), is part of the normal operation of the Australian tax system[21]. It is not a special concession for property investments.

7.1.2 Middle income Australians also benefit from negative gearing

Negative gearing benefits a range of Australian households by providing all individuals with an opportunity to invest in property, and save for their retirement.

Two thirds of property investors who benefit from negative gearing earn around or under $80,000p.a[22].

42,000 nurses, midwives and aged care workers, 62,000 teachers and child carers, 12,300 emergency service workers and 83,000 clerical staff, who all earned around or under $80,000pa, negatively geared a property in the 2012 financial year[23].

Negative gearing is predominantly used by young people and 91% of people who declare a net rental loss own only one or two properties.

7.1.3 Negative gearing contributes to the provision of new housing

It is often claimed that negative gearing does not contribute to the production of new housing because the bulk of properties invested in are existing properties.

This claim presupposes that the purpose of negative gearing is to produce new housing. As discussed above, negative gearing is merely the hundred year old principle that legitimate expenses can be deducted from income.

Leaving this to one side, the claim is not true. Around 27% of all loans, by value, for the construction of new housing in 2014 were to investors (Figure 9).

While data is not available, it is reasonable to presume that the bulk of these would involve negative gearing at least in their early years.

Negative gearing in fact supports an outcome where 27% of newly developed housing stock is purchased by investors. Without this investment, the supply of new housing would drop very substantially. Given that investors are more likely to purchase off the plan, this would have an even bigger supply impact as new projects are able to achieve required pre-sale levels to proceed to construction.

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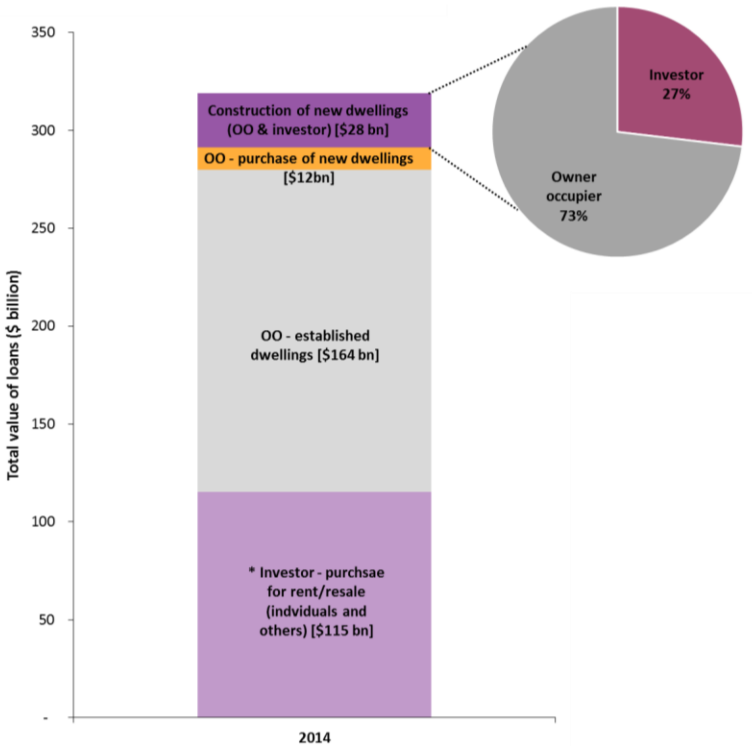
[21] AAC Housing Investment report (op cit), based on Reserve Bank of Australia, Submission to the Productivity Commission Inquiry on First Home Ownership, 2003
[22] AAC Housing Investment report (op cit), based on ATO Taxation Statistics 2012-13
[23] ATO Taxation Statistics 2011-12

Figure 9: Housing finance commitments in 2014 (value of loans)



*Note: OO stands for owner occupier. *ABS does not separately report investors' loans for purchase of new and existing dwellings.*

Source: ACIL Allen Consulting 2015, based on ABS cat. 5609.11

As multiple commentators have stated (including RBA Governor, the Federal Treasurer, housing affordability inquiries and the Grattan Institute), the biggest issue affecting the supply of new housing is planning systems.

As recommended in the Property Council's 2015 Development Assessment Report Card, we encourage a far stronger focus on reforms to:

- zone more land for housing;
- introduce simpler planning and faster approval processes;
- lower taxes on the production of housing;
- link housing and jobs; and
- incentivise reforms.

7.1.4 Many factors other than negative gearing and the CGT discount influence house prices

The cost of housing is determined by a range of factors influencing demand and supply.

Housing supply is driven by factors such as land availability, construction costs, profitability for developers and infrastructure costs such as water, power, sewerage and public transport.

Housing demand is driven by factors such as the number and types of households looking for housing, household income and preferences (such as size, location and tenure type), investor demand and interest rates.

Over the longer term, it is the rate of housing supply that determines the extent to which additional demand results in higher prices over time[24]. Recommendations on how to boost overall housing supply have been set out above.

Negative gearing and CGT discount regimes actually encourage supply into the market at a more affordable price. This in turn helps reduce the cost of housing through the critical lever of supply.

7.1.5 CGT discount is designed to remove the impact of inflation

From 1985 (when the CGT rules were introduced) to 1999, an indexation system applied so that only real gains were subject to tax.

Taxing real, rather than nominal, capital gains is important to ensure tax is not paid on inflation. This would reduce the investor's purchasing power, and discourage investment (Case study 3).

Case study 3: Real vs nominal gains

An investor purchases an asset for $100, and sells it a year later for $106.

During this period, the rate of inflation is also 6%. This means that a bundle of goods that cost $100 last year would now cost $106.

The investor has made a nominal gain of $6, and a real gain of $0.

If the investor is required to pay tax on the $6 nominal gain, he or she will no longer be able to buy the same bundle of goods.

Source: Henry Tax Review, 2010

The indexation system was considered administratively complex, and replaced with the 50% CGT discount in 1999. According to Treasury, indexation and the 50% discount method result in

[24] AAC Housing Investment report (op cit), based on RBA speech, Opening remarks to Inquiry into Affordable Housing, 2014

broadly similar amounts being taxed, assuming annual CPI increases of 2.5% and annual asset prices increases of 5.25%[25].

Were the 50% CGT discount provisions to be reviewed, the principle of not taxing inflation needs to be retained.

7.1.6 CGT discount benefits all Australians

Individuals across all income ranges benefit from the CGT discount in relation to all types of investment. In fact, 57% of taxpayers who paid capital gains tax earn taxable income of less than $80,001[26].

There is no public data on the distribution of capital gains by asset class and income, so it is not known, for example, whether individuals with high incomes receive their capital gains mostly from shares or properties.

ATO data indicates that capital gains from real estate investments for individuals represented 41% of all capital gains in 2012-13[27]. Put another way, more than half of all capital gains do not relate to property investments.

7.1.7 Australia is not the only country with negative gearing or CGT concessions

The ability to deduct expenses or have tax concessions on capital gains is a common feature of tax systems in other developed countries, and is not unique to Australia (Table 5).

Table 5: Housing concessions in selected countries

	Owner occupier housing			Investment housing				
	Imputed rent taxation	**Interest deductibility**	**CGT**	**Negative gearing**	**Ability to carry back losses**	**Ability to carry losses forward**	**Ring fencing of losses**	**Capital gains concessions**
Australia	No	No	No	Yes	No	Yes	No	Yes
Canada	No	No	No	Yes	Yes	Yes	Partial	Yes
France	No	No	No	Partial	Yes	Yes	Partial	Yes
Germany	No	No	No	Partial	Yes	Yes	Partial	Yes
Japan	No	No	Yes	Partial *	Yes	Yes	Partial	No
Netherlands	Yes	Yes	No	No	Yes	Yes	Partial	Yes
NZ	No	No	No	Yes	No	Yes	No	Yes
Sweden	Yes	Yes	Yes	Partial	No	Yes	Partial	Yes
UK	No	No	No	No	Partial	Yes	Partial	Partial
US	No	Yes	Partial	Partial	Yes	Yes	Partial	Partial

*Source: Ernst and Young, 2006 and *Property Council of Australia, 2015*

[25] AAC Housing Investment report (op cit), based on John Clark, Economic Roundup Issue 2, 2014
[26] AAC Housing Investment report (op cit), based on ATO Taxation Statistics 2012-13
[27] ibid

7.1.8 Impact of removing negative gearing or CGT discount

The Henry Tax Review noted that any changes to negative gearing or the CGT discount could reduce residential property investment which in a market facing supply constraints would place further downward pressure on the availability of affordable rental accommodation.

Removing negative gearing or the CGT discount altogether for property will dampen investment, diminish rental supply and make it more likely that in the short to medium term, rents and property prices will increase, as investors seek to recover their after-tax rental returns by increasing their before-tax returns (noting that the average rental loss for tax purposes in 2012-13 was $9,500 across all taxable income groups)[28].

7.1.9 Recommendations

Maintain negative gearing for all forms of investment to ensure average Australians are able to invest and save for their retirement.

Maintain 50% CGT discount for all forms of investment as it is designed to remove the impact of inflation.

[28] AAC Housing Investment report (op cit), based on ATO Taxation Statistics 2012-13

7.2 Tax flow-through for real estate investment vehicles

Australia's property market relies heavily on patient, long-term global capital to finance major investments, including residential developments, world class office buildings and regional shopping centres.

Australia has been an attractive destination for global capital because of our relatively solid and stable economic growth since the Global Financial Crisis and the transparency of our markets and legal system.

Maintaining property trust rules in line with international norms for collective investment vehicles is critical to remaining competitive and securing global capital for our economy.

7.2.1 Tax flow-through for real estate investment vehicles

Nearly 18 million Australians are investors in property trusts, either directly or indirectly through their retirement savings[29].

Property trusts largely invest in property for the purpose of earning rental income (passive activities) on behalf of collective investors who pay tax on their share of the net income. Trading activities are taxed at the 30% company tax rate, and are typically undertaken by companies in a property group.

Property trusts do not normally conduct trading activities – if the trust carries on a trading business, *all* profits of the trust are taxed at the company tax rate, not just the profits from the trading business.

Tax flow-through treatment for property trusts puts trust investors in the same tax position as if they had invested directly in the property – it is designed to help people invest in property assets they could not afford to own outright themselves.

This approach to tax is in line with the current government policy settings, which have been extensively reviewed by the Board of Taxation in numerous reports.

Australia's tax treatment of property trusts is also consistent with international guiding principles for collective investment vehicles. In 2010, the OECD issued a report on the Tax Treaty Treatment of Collective Investment Vehicles which said:

> *"Most countries have dealt with the domestic tax issues arising from groups of small investors who pool their funds in collective investment vehicles (CIVs). In general, the goal of such systems is to provide for neutrality between direct investments and investments through a CIV."* (at para 6.8)

In many overseas jurisdictions, collective investment vehicles are technically companies for tax purposes. However, the tax regimes in these jurisdictions operate in a way to effectively treat the company as a tax flow through vehicle.

[29] AEC report (op cit)

For example, the United States "Real Estate Investment Trust" (REIT) regime achieves neutrality between direct investments and collective investments by giving the REIT a tax deduction for distributions of its income, and requiring that it distributes virtually all of its taxable income. Therefore, tax on passive rental and other income is paid at the investor level, not the REIT level.

For Australian unit trusts, the investor (foreign or domestic), must pay tax on their share of the trust's taxable income.

Further, both the Johnson Report and the recent Murray Financial System Inquiry have recognised, and championed, the critical importance of having tax flow through collective investment vehicles to attract international capital to Australia.

Collective property investment in Australia, from superannuation funds right through to managed investment trusts, use property trusts that are in line with globally accepted principles.

7.2.2 A robust and competitive managed investment trust regime

Australia's property managed investment trusts (MITs) provide investors with the opportunity to:

- invest in large scale real estate assets they could not own directly;
- diversify their investment portfolio to reduce the risk from market down turns; and
- benefit from the market experience and insights of professional asset managers.

However, Australia's current tax laws for MITs are out of date and have not kept pace with developments in the property industry, which unnecessarily restricts appropriate growth opportunities.

Developing and maintaining a robust and globally competitive tax regime for MITs (which include property trusts) is essential to attracting global capital for the future prosperity of the Australian economy. The Federal Government is currently working in collaboration with industry to refine Australia's MIT rules to enshrine industry practice, provide more certainty for investors and help cut the red tape burden for MITs and government.

7.2.3 Collective investment vehicles

Australia's attractiveness as a funds management hub relies on a simple, functional collective investment vehicle (CIV) regime that encourages risk-averse international investors to invest in or through Australia.

Australia's financial system is an outlier in the global funds management world in its reliance on trusts rather than corporate or limited partnership structures. This provides a competitive advantage to other financial centres competing with Australia for investment in the Asia Pacific region.

Australia does not have a specific tax regime for CIVs.

The focus of a CIV regime should not be on the type of entity, but rather the nature of the activity and income arising from that activity.

While trusts are reasonably well understood in Australia, they are not the CIV of choice in other countries. Corporate and limited partnership CIVs are common internationally.

Which legal entity a CIV uses will depend on a number of considerations, including the type of investors and where they are based. This choice should be tax neutral in line with revenue principles.

A more universal CIV regime in Australia will align us globally with standard investment practices, minimise structuring to fit investment activities to particular vehicles and promises to reduce unnecessary and costly compliance.

The Board of Taxation report on CIVs was given to Government in December 2011, but has not yet been released. This results in confusion and costly delay for international investors. The Property Council encourages Government to release this report and begin the reform process.

7.2.4 Competitive withholding tax rates

Australia competes with more than 24 property investment markets for international capital. Many of these markets have lower withholding tax rates including Hong Kong (0%) and Singapore (10%).

The Board of Taxation has stated that the purpose of the MIT withholding tax regime is to collect an appropriate amount of revenue, without discouraging or creating tax impediments to foreign investment in Australia.

With the US and many European economies recovering at the same time Australia's mining boom is tapering, Australia needs to ensure our withholding tax rates remain competitive, so we can continue to attract patient long term international capital that will is also in demand to reboot these recovering economies.

7.2.5 Recommendation

Strengthen Australia's attractiveness as an investment destination for long term patient capital by:

- maintaining tax flow-through for real estate investment vehicles;
- developing a robust and globally competitive managed investment trust regime;
- broadening the range of collective investment vehicles that can be offered by Australian fund managers; and
- ensuring our withholding tax rates remain competitive.

8. State, territory and local taxes

Chapter 8 of our submission focuses on the critical state, territory and local tax reforms needed to achieve boost investment, reduce complexity and ensure we have a more sustainable funding model for the infrastructure and community services provided by state, territory and local governments.

8.1 Inconsistent state tax methodologies

Australian businesses have up to 150 individual state taxes they need to comply with, if they are operating on a national level[30]. This is a significant cost to conducting business.

Adopting consistent definitions and tax calculation methodologies for state taxes, such as stamp duty, payroll tax and land tax, would boost investment across state and territory lines. It will also reduce compliance and complexity for overseas businesses looking to enter Australia.

We recommend that a priority initial reform be the landholder stamp duty harmonisation project, preceding the abolition of stamp duty, as discussed at chapter 6 of our submission.

States could continue to compete on the rate at which the taxes are imposed, but there would be consistent application on how the rules are applied.

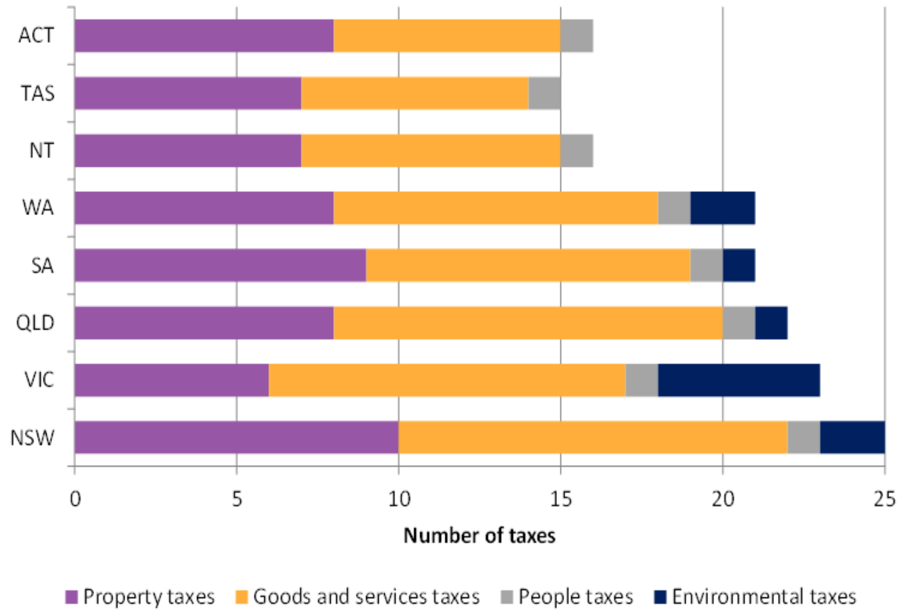
8.1.1 Our state business tax landscape

As shown in Figure 9, five out of the eight jurisdictions have more than 20 different taxes, while the remaining states/territories have at least 15.

Whilst many of these taxes are similar in nature (i.e. payroll tax, stamp duty on conveyances, land tax, and so on), the specifics of the taxes such as marginal tax rates, thresholds and exemptions varies across jurisdictions, making Australia's state taxes unduly complex[31].

[30] AAC Tax report (op cit)
[31] ibid

Figure 9: Australia's business tax landscape



Source ACIL Allen Consulting 2015, BCA and CTA 2007

8.1.2 Harmonising landholder stamp duty

As discussed at chapter 6, the abolition of stamp duty is an absolute necessity if we are to move towards a more efficient tax system that encourages economic activity and investment.

Equally important in the short term is a need to harmonise our stamp duty laws.

Stamp duty is collected by all states. However, the definitions and application of stamp duty are different in each jurisdiction. These differences mean that the same business transaction can result in stamp duty being levied at different amounts and sometimes multiple times across Australia.

The current landholder stamp duty provisions unnecessarily hold back transactions. They:

- impose high compliance and structuring costs and significant red tape that substantially reduce money that could be invested directly in that jurisdiction; and
- inhibit investment – investors will not proceed where compliance costs are prohibitively high or where there is double duty.

The Property Council has developed a landholder stamp duty model that is based on best practice around Australia. The model has already been adopted by New South Wales, ACT and Western Australia. Our recommendations will not adversely impact government budgets – they have been designed to be revenue neutral.

There are two aspects to the proposed model:

- ensure landholder stamp duty operates fairly and encourages business investment; and

- ensure entities can restructure to operate efficiently without being unfairly penalised with additional stamp duty.

Fair, Optimal Landholder Stamp Duty

Currently many of the country's stamp duty regimes discourage investment in trusts which are the main vehicle for investing in property.

The major changes needed to harmonise stamp duty rules and increase efficiency are:

- ***treat all trusts the same as companies within the landholder provisions*** – to remove an arbitrary structural discrimination against the most common property investment vehicle that is blocking deals;
- ***increase the threshold to $2 million*** – this will align these states with New South Wales, ACT and Western Australia that have adopted the 'best practice' model and exclude "nuisance transactions" from stamp duty;
- ***remove taxation on listed entities*** – to comply with the 1999 intergovernmental agreement;
- ***remove double duty on sale of land and sell-down of units by unitholders*** – this is inequitable as duty has already been paid – it simply blocks deals; and
- ***provide a general rule that excludes custodians from the provisions*** – only the underlying owners (rather than bare trustees), should be taxed.

Encourage Corporate Restructures to Increase Business Efficiency

New South Wales, ACT and Western Australia have freed up reconstruction for business by adopting the Property Council's recommended model. This is critical to help businesses remain nimble and respond to changing market conditions. The remaining states and territories have failed to modernise their corporate reconstruction exemptions.

The major changes required to harmonise the corporate reconstruction exemption are:

- ***ensure subsidiaries (50% or more control) can access the exemption*** – to be consistent with the land rich provisions (i.e. taxing change of control) and ensure subsidiaries are treated as part of the group;
- ***make relief available for all dutiable transactions*** – there is no policy justification for limiting relief to only particular kinds of dutiable transactions; and
- ***limit post-association requirements*** – post-association unnecessarily hinders efficient group restructuring as groups simply avoid those transactions during the post-association period, or are precluded from further transactions during the clawback period.

This important and significant reform will deliver substantial cost savings to the industry without eroding Government revenues.

8.1.3 Harmonising land tax

Land tax regimes vary from state to state, particularly in relation to the application of aggregation rules, and different land valuation methodologies.

The existing land tax regimes could be significantly improved through adoption of the Property Council's recommendation (as discussed at 8.2 below) to move towards a single flat rate land tax structure for all existing land tax payers based on unimproved land values.

8.1.4 Harmonising payroll tax

Payroll tax rules differ considerably from state to state. There are different payroll tax rates, methods of calculation, thresholds and concessions.

This gives rise to unnecessary compliance costs for businesses operating in multiple jurisdictions, and is a disincentive to business expansion and the creation of new jobs.

8.1.5 Recommendation

Harmonise tax definitions and calculation methodologies for state taxes, such as the existing stamp duty, land tax and payroll tax regimes, to reduce complexity and cut red tape.

8.2 Land tax

Land tax is imposed predominantly on commercial and residential property investment in all states and territories except the Northern Territory.

The current land tax systems are extremely inefficient due to aggregation and their tiered land tax structure, which means that property held within larger portfolios pays higher rates of tax.

Reforming the land tax system by moving towards a single flat rate land tax structure for all existing taxpayers will improve the efficiency of the current rules, and unlock greater investment and economic activity.

In considering any potential reforms to land tax, the Property Council does not support the introduction of a land tax for the Northern Territory as this will further deter critical investment and infrastructure in northern Australia.

8.2.1 The real cost of land tax

The Tax Discussion Paper describes land tax as a theoretically efficient form of taxation, but this can only be possible if land tax is applied at a low flat rate, across a broad base.

Instead, current land tax regimes are mired with excessively high land tax rates, poorly structured aggregation rules or incorrect valuation methodologies.

ACIL Allen conducted an analysis of land tax against the tax design principles for the Property Council. Key take outs from their assessment are:

- Efficiency – land tax is currently inefficient due to the existing exemptions, aggregation principles, and the prohibition on passing through of the tax to tenants.
- Equity – land tax is not considered to be equitable due to the number of land owners who are currently exempt.
- Stability – revenue from land tax has a moderate degree of volatility, as governments change the amount of taxable land each year (through land releases or rezoning), and the value of land changes from year to year.
- Simplicity – high marginal rates, thresholds and exemptions, combined with aggregation principles and inconsistencies in land valuation methodologies, all lead to high compliance costs for the current land tax regimes.
- Competitiveness – taxing the unimproved value of land is less distorting than taxing investment and innovation on the use of land, however, the overall level of tax on land has to remain competitive as Australia competes globally for capital.

All of these factors have a punitive impact on investment.

Imposing a high flat rate of land tax across a broad base is also not an efficient form of tax. This is because when land is taxed at a relatively high rate compared to other forms of investment, investors will be discouraged from investing in land. These investors will simply invest in other asset classes or geographical locations (including outside of Australia altogether).

8.2.2 Progressive land tax rates and aggregation

As noted above, current land tax regimes have aggregation provisions which operate to combine land holdings together when calculating an owner's land tax liability.

This, combined with the progressive tax rate system, means different property owners can be taxed at significantly different rates in respect of the same investment (see Case studies 4 and 5 below).

Case study 4: How does aggregation work?

A NSW property investor who owns a piece of land worth $250,000 pays no land tax.

However, if that same property investor held two pieces of land, each worth $250,000, the investor would have to pay land tax of $1,188.

Owning four pieces of land, each worth $250,000 (combined value of $1,000,000), would result in a land tax liability of $9,188.

Case study 5: Aggregation and commercial investments

Many commercial property lease agreements will allow the property owner to pass on land tax costs to the tenant.

However, the lease agreements will usually calculate this land tax cost on the value of the building on a stand-alone basis.

If the commercial property owner has many buildings, and is forced under the aggregation rules to pay a higher rate of land tax, this higher land tax cost cannot be passed onto the tenant under the lease agreement. This acts as a deterrent to further investment in that particular jurisdiction.

Table 6 below shows the variability in land tax payable from state to state, under the current marginal tax rate regimes. For example, South Australia varies from imposing nil land tax on a $250,000 property to almost $83,000 on a $3 million property.

Table 6: Land tax payable on taxable property, 2015

Table 3

INTERSTATE COMPARISON OF LAND TAX PAYABLE(a)

Unimproved Land Value	WA Current $	WA New $	NSW $	VIC $	QLD $	SA $	TAS $	ACT $
100,000	-	-	-	-	-	-	463	1,328
200,000	-	-	-	-	-	-	1,013	1,873
300,001	-	300	-	375	-	-	1,563	2,638
400,000	110	300	-	575	-	420	2,588	3,867
500,000	220	500	1,188	775	-	920	4,088	5,097
1,000,000	770	1,750	9,188	2,975	4,500	9,447	11,588	11,247
3,000,000	19,810	30,550	42,624	24,975	37,500	82,771	41,588	35,847
5,000,000	50,010	66,550	82,624	69,975	62,500	156,771	71,588	60,447
10,000,000	138,560	166,550	182,624	182,475	150,000	341,771	146,588	121,947
15,000,000	263,360	293,350	282,624	294,975	237,500	526,771	221,588	183,447

(a) The Northern Territory does not levy land tax.

Source: WA State Budget Papers 2015-16

8.2.3 Valuation methodologies

Land tax should only be imposed on the unimproved value of the land, and not the value of the buildings and improvements built on top of the land.

Taxing the improved value of the land actually taxes the labour and capital used to drive productivity, rather than the government's "economic rent" from the land itself.

From a practical point of view, this would discourage investment, distort the efficient use of land, and adversely impact the overall productivity of the economy. This effectively discourages any business activity that has intensive land use or involves significant factors of production, such as manufacturing.

There is currently significant inconsistency between state governments and local councils as to how land tax is calculated from area to area (for example, some councils use improved land value rather than unimproved land value).

This increase complexity, results in disputes over valuations, and discourages investment in certain areas, which distorts productivity.

Applying the same valuation methodology for both land tax and council rates will significantly decrease the administrative costs for government (i.e. removing the need for duplication in valuations), and provide greater certainty and consistency for property owners.

8.2.4 Recommendation

Boost investment by replacing the current land tax rules with:

- a single flat rate land tax structure for all existing land tax payers, to make the land tax regime fairer; and
- a common valuation basis for land tax and council rates based on unimproved capital values to reduce complexity.

8.3 Infrastructure charges

Since the 1980s, it has become increasingly prevalent for state and local governments to impose "infrastructure charges" or "developer levies" on the development of new residential and commercial property, for the purpose of funding infrastructure[32].

This has become a significant source of revenue for state and local governments. Unfortunately, the Tax Discussion Paper does not contain any discussion on infrastructure charges and developer levies. Similarly, state budgets also fail to recognise infrastructure charges and developer levies as a separate head of tax.

The reliance on development contributions, rates, levies and state taxes to fund infrastructure is inefficient and unsustainable. These charges add significantly to the cost, and therefore purchase price, of new dwellings, offices, shopping centres and industrial premises. The high costs also act as a barrier to investment for smaller property developers, exacerbating supply shortages.

There is little consistency between local councils and state governments on how infrastructure charges are levied, and even less certainty and transparency on how much is raised and whether the funds are actually used for infrastructure.

While we support the need for greater infrastructure planning and funding to make our cities more liveable, it is critical that this the cost burden does not rest solely with purchasers of the homes and business premises we need.

If levied, it must be clear that infrastructure charges are a contribution to the cost of providing infrastructure – they should not be used to fully fund the infrastructure that is the responsibility of state and local governments to provide.

The Henry Tax Review flagged significant problems with how infrastructure charges are currently levied and recommended a review by COAG, which has not occurred.

8.3.1 What are infrastructure charges

An infrastructure charge is a contribution paid by the developer to a state/local government towards the cost of providing the necessary infrastructure to support the development. They are a producer levy.

Infrastructure charges can be set at a flat rate, negotiated between the state/local government and the developer, or take the form of a transfer of land or works in kind[33].

As shown in Table 7, there are a myriad of different mechanisms and regimes that apply in each state and territory. The array of different names and forms that infrastructure charges take,

[32] Henry Tax Review, 2010
[33] AAC Tax report (op cit)

combined with the range of government agencies that levy them, means they are not transparent, can be challenging to calculate, and difficult to clearly identify what they will be (or have been) used for[34].

Table 7: Overview of mechanisms used for infrastructure charges and restrictions

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
Mechanisms for charges								
State government charges for specific regions	✓	✓					✓ (a)	
Contributions plans & other mechanisms within local area planning schemes	✓	✓	✓ (b)	✓	✓ (c)	✓		✓
Conditions in local councils' development permits	✓	✓		✓	✓ (c)	✓	✓ (d)	✓
Voluntary agreements between developers & planning bodies	✓	✓		✓	✓	✓	✓ (e)	
Informal arrangements					✓			
Restrictions & influences on charges								
State legislation or policy specifies/mandates the infrastructure that can be charged by local councils.				✓	✓	✓		✓
State legislation or policy guides local council policies and charges		✓	✓	✓	✓			
State legislation or policy caps the charges and levies set by local councils	✓	✓	✓					

Note: (a) Change of use/lease variation charges are levied by the ACT Planning Authority. Some regions are subject to predetermined charges, other regions to a valuation regime. (b) Despite the limited mechanisms for charges, local government Priority Infrastructure Plans provide significant flexibility in the type and value of contributions charged. (c) Local councils can levy fixed charges and proportionate contributions, but it is unclear which mechanisms are used. (d) Conditions are placed in leases granted by the ACT government. (e) For rural leases only, entered into by the ACT Planning and Land Authority.

Source: ACIL Allen Consulting, 2015

8.3.2 The real cost of infrastructure charges

Infrastructure charges are a tax on labour and capital, and therefore have a significant distortionary effect on investment decisions.

The inefficiency of the tax is exacerbated where the funds raised are not used for the specific purpose for which they are raised (or to fund any infrastructure at all).

Infrastructure charges add significantly to the cost of developing a property, however much of that cost is ultimately borne by the consumer (home buyer) by way of higher prices for homes. For example, for a typical Sydney development, infrastructure charges can amount to around $20,000 for a new home (apartment or house) in existing areas, and up to $30,000 for greenfield areas.

Developer charges, infrastructure charges, levies – whatever the terminology, they are an inefficient tax that further reduces housing affordability for ordinary Australians and distorts investment and development activity.

[34] AAC Tax report (op cit)

8.3.3 Tax increment financing

Tax increment financing has been used in the US for over 50 years with great success, and has a real potential to fund infrastructure provision for our states and territories.

Tax increment financing works as follows:

- a suitable area for development or urban renewal is identified and defined;
- a growth plan for the area is prepared, outlining infrastructure needs and anticipated costs;
- the current property tax revenue for the area is calculated;
- bonds are issued to fund the proposed infrastructure works;
- the bonds are repaid from the incremental increase in property taxes above the existing baseline generated by the new infrastructure in the area; and
- once the bonds are repaid, all further property tax revenue for the area returns to the Government.

8.3.4 Recommendation

Replace the current ad hoc and inequitable infrastructure charges levied by state and local governments, with a more sustainable model for infrastructure funding that does not add to the cost of new development.

8.4 Local government / municipal rates

The Tax Discussion Paper describes municipal rates as a theoretically efficient tax. Importantly, the paper notes that there are concerns about how land values are determined and rates are set.

In particular, it is acknowledged that determining land value on the basis of improved value, rather than unimproved value, discourages capital investment.

This is consistent with the discussion above on land tax valuations, and our recommendation to have a common valuation basis for land tax and council rates.

8.5 Variable road user charging

The Tax Discussion Paper briefly discusses the possibility of user charges being used instead of taxes to fund the provision of services.

We note the work undertaken by Infrastructure Partnerships Australia and the automobile associations on road pricing and transport infrastructure funding[35] which indicates that there could be substantial benefits in moving away from current fairly ad hoc motorway tolling arrangements to a more widespread variable road user charging system.

The potential benefits and costs of such a system should be explored further, and we are keen to work with Government on this initiative.

[35] Infrastructure Partnerships Australia and Deloitte report on behalf of Transport Reform Network, *Road Pricing and Transport Infrastructure Funding Discussion Paper*, March 2014

9. Pathway to reform

There are clear economic gains to be delivered from moving away from inefficient taxes and adopting a well-designed and targeted tax system.

Based on lessons learnt from previous reforms, the tax reform package should:

- establish a joint governmental agreement where necessary that aligns reforms to timeframes and objective measures of success
- prioritise tax reforms that will have the largest economic benefits;
- be fully funded;
- where possible, enhance the efficiency of existing taxes (for example, through harmonisation of methodologies and definitions);
- phase in tax reform to ease transition;
- be associated with a compensation package designed to neutralise the adverse consequences of tax reform; and
- provide commitment to further longer term reforms[36].

Implementation of such a holistic tax reform package will require commitment from federal and state governments.

Putting in place the right tax policy settings will improve housing affordability and encourage businesses to invest in Australia. This will in turn boost jobs and economic growth.

Substantive tax reform will mean there will be winners and losers in the short-term. However, having the right tax mix will ensure all Australians are ultimately better off.

[36] AAC Tax report (op cit)

Attachment A: Discussion paper questions

Set out below are industry's views on issues raised in the Tax Discussion Paper that have not already been addressed in the submission.

Dividend imputation

The current dividend imputation system is designed to remove double taxation.

Any decision to revert to the old pre-imputation system will simply re-introduce unfair and unnecessary double taxation.

It is far more productive for government to focus on what the fair, equitable and innovative approach will be to ensure there is no double taxation or disincentives to investment – the integrity of the system will flow from there.

The property industry struggles to see that there is any material benefit to changing the current imputation system. We are keen however to engage in a frank discussion on the options.

Capital allowances

Australia's capital allowance rules could be simplified – for example, we currently have tables with effective lives for over 2,000 different asset types. The system should allow for a much smaller number of effective lives which apply across asset classes.

Industry would not support any proposal to align the tax deprecation rules with the accounting deprecation rules. In particular, there is no depreciation for property assets under accounting standards.

Tax losses

Our tax loss rules are very complicated, and not as generous as many overseas jurisdictions (for example, other countries allow the carry back of losses).

Critically, Australia's trust loss rules are more complicated and restrictive than the company loss rules. This means that corporate restructures involving trusts tend to result in the forfeiture of losses, while the same transaction involving a company would allow the losses to be carried forward.

For example, developers often use unit trusts as joint venture development vehicles. Tax losses can be forfeited where one joint venture partner exits. This is a more penal result than for companies in similar situations, as they can rely on the same business test (which is not available for trusts), to utilise carried forward losses after a change in ownership.

The tax loss regime for unit trusts, managed investment trusts and collective investment vehicles should be aligned with the company loss rules.

Thin capitalisation

Australia has amongst the toughest thin capitalisation rules in the world. The thin capitalisation safe harbour limit has been recently reduced from 75% to 60%. In addition, our thin capitalisation rules exclude investments in foreign companies from the Australian safe harbour calculation, and apply to all debt, not just related party debt.

The property industry does not see practical merit in revisiting the rules so soon after major amendments have been implemented.

Controlled Foreign Company (CFC) rules

Australia's CFC rules hinder foreign investment by Australian based entities.

While we acknowledge the OECD is considering the scope of CFC rules in a global context as part of the current BEPS work, the CFC framework should be updated having regard to the Board of Tax recommendations.

Aligning accounting and tax concepts

There are a number of areas where accounting and tax concepts are aligned. These do produce compliance savings.

However, there should not be a complete alignment of the concepts. For example, tax correctly relies on a realisation basis for taxing gains and losses on property investments.

The taxation of unrealised gains would be an unfair and unwarranted step backwards for our tax system.

Revenue / capital distinction

The revenue capital distinction in Australian taxation law is outdated and creates unnecessary complexity. The rules should provide for two classes – trading stock and capital assets.

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