



Analysis ACT Tax reform Initiative

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This paper analyses the economic effects of the first five-year stage of reform across key variables of the housing market – prices, turnover and residential construction – and the effects on territory government revenues.

We conclude that the ACT Government's tax reform is likely to have supported elevated levels of residential construction for both new home building and renovations activity.

Critical to this analysis is the finding that the reforms in this first stage consisted of an increase in general rates with no material reductions in stamp duty. The effects of bracket creep exceeded the planned reduction in stamp duty rates resulting in a windfall gain for government revenues.

Collectively, the switch from stamp duty to land tax in the ACT has resulted in additional property taxes of \$196.5 million. This is an increase of 38.0 per cent over four years.

Summary of ACT Tax Reform Initiative

In its 2012-13 Budget, the ACT Government announced an ambitious 20-year program to reform the territory's property taxation system. While the government set out a range of reforms, the focus of these was the abolition of stamp duty and a change in the way general rates are levied on both residential and commercial properties.

The phasing out of stamp duties and the phasing in of the new general rates system has been set out to coincide over 20 years (across four, five-year plans) to avoid a shock to the property market and to allow the policy to be 'revenue neutral'.

The figure below sets out the phasing-out of stamp duty and phasing-in of higher land tax during the first five-year period. The emboldened elements of the tables represent where the most change has occurred.

Lower-value homes (under \$300,000) are the cohort that has experienced material stamp duty reductions, while the increases in general rates for these lower-value homes has been relatively modest. At the same time, higher value homes in the ACT have seen the applicable rates of stamp duty fall only modestly and general rates obligations increase substantially.

The average house price in Canberra exceed \$670,000 in January 2018. The average price of units exceed \$431,000. The majority of homes are also likely to have an unimproved land value exceeding \$300,000.

Consequently, from the perspective of the overall market, the structure of the reform can more accurately be described as a process of first phasing in the new rates system and then phasing out stamp duties. The former has occurred (although not concluded) during this first stage of the reform program, while the latter has yet to occur in a material way.



Stamp Duty

1. Duties, %

Home value	2012/13	2013/14	2014/15	2015/16	2016/17
Up to 200,000	2.40	2.20	2.00	1.80	1.48
200,001 - 300,000	3.75	3.70	3.50	3.00	2.50
300,001 - 500,000	4.75	4.50	4.15	4.00	4.00
500,001 - 750,000	5.50	5.00	5.00	5.00	5.00
750,001 - 1,000,000	6.50	6.50	6.50	6.50	6.50
1,000,0001 - 1,454,999	7.25	7.00	7.00	7.00	7.00
1,455,000 and above			5.25	5.17	5.09

2. General rates, %

Unimproved land value	2012/13	2013/14	2014/15	2015/16	2016/17
Up to 150,000	0.2336	0.2306	0.2547	0.2746	0.2746
150,000 - 300,000	0.3136	0.3241	0.3571	0.3857	0.3900
300,000 - 450,000	0.3736	0.3876	0.4287	0.4629	0.4800
Above 450,000	0.4136	0.4312	0.4873	0.5339	0.5400

The economics of stamp duties and land tax ¹

Stamp duty is an inefficient tax. It impedes the smooth flow of the workforce to locations of high employment and restricts the opportunity for seeking education or health services. It hampers the ability for the population to move to alternative housing that suits their needs such as downsizing, or moving to housing that suits those in need of better care and support in their later years.

The inequity of stamp duty falls upon a relatively small cohort of taxpayers who need to move to find employment, training, health or for financial reasons. Consequently, stamp duty has a disproportionately high impact on households that are vulnerable due to changes in their circumstances including employment, health or other family related matters.

Stamp duty is also a volatile source of tax revenue as demonstrated after the economic shock in 2007/08. Across Australia, total stamp duty fell from \$14.3 billion in 2007/08 to just \$9.5 billion the following year – a fall of some 33.6 per cent in the space of 12 months. The ACT is not immune from these national trends or from its own isolated price corrections such as that experienced in the late 1990's when cuts to employment affected population growth and house prices.

Stamp duty is also notoriously bad for bracket creep. House prices rise over time therefore raising more revenue. In NSW, for example, the stamp duty rate structure has not been adjusted to take account of any house price increases since 1985 – a time when the average Sydney house was worth about \$80,000.

In contrast, land tax is an efficient tax base because the asset being taxed – land – is deemed to be immobile. An increase in land tax does not provide an incentive to change behaviour (i.e. avoid buying or selling a home) to avoid the tax as this is not possible without relocating to another tax jurisdiction. A landowner can either pay the annual actual tax bill or sell the property.

As a consequence, if applied broadly and to the unimproved value of the land (not discriminating between different owners or uses), a land tax represents a relatively stable source of government revenue.

As stamp duty is an inefficient tax and land tax is a considerably more efficient tax with fewer distortions, the ACT Government's policy has been supported in principal by HIA. This progressive reform has the ability to lead to better economic outcomes over the long-term.

¹ The ACT's new general rates system is in effect what economists typically refer to as a broad-based land tax. From here on the paper uses these terms interchangeably.



Stamp Duty

Home prices

An increase in land tax will result in the price of a home being lower than what it otherwise would have been. This statement cannot be tested in an isolated environment, but the impact can be inferred from a wider sample across the market.

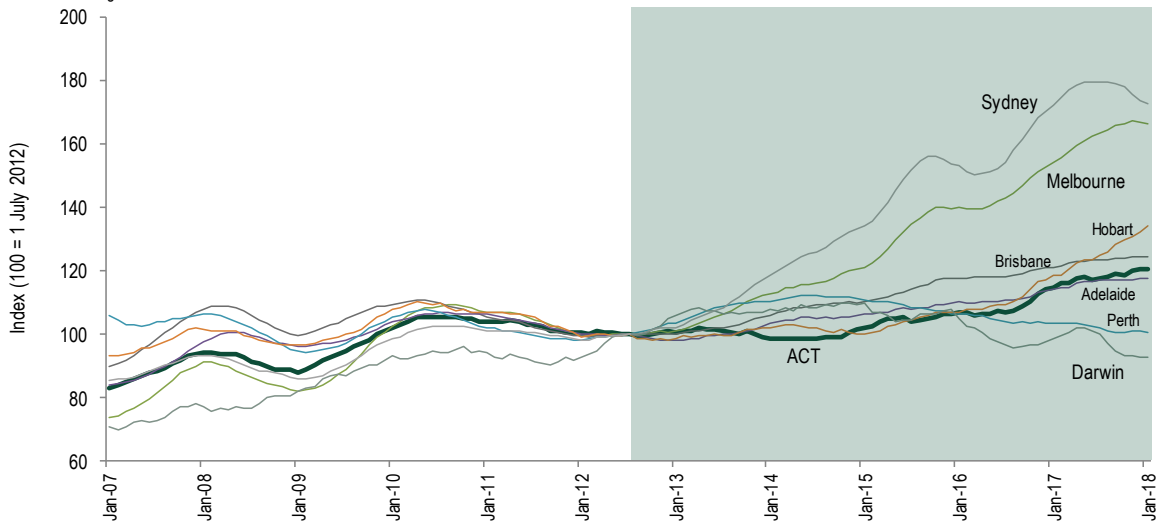
The analysis of home price data provides evidence that prices have been affected by the ACT tax reform in its first stage. Namely, during this stage home prices are likely to have grown at a slower pace than what they otherwise would have.

The charts below show that for houses in particular, prior to the reform, prices grew at around the national average. After 1 July 2012, the ACT becomes conspicuous for some years in the slow rate of price increase compared with most other capital cities. The changes in tax arrangements are not the only causal factors for this outcome.

Reductions in stamp duty would be expected to place upward pressure on home prices – buyers can pay more for a given home by the amount of the reduction in stamp duty. There is little if no evidence of such price pressures, given the narrow application of the stamp duty reductions in the first stage of reform.

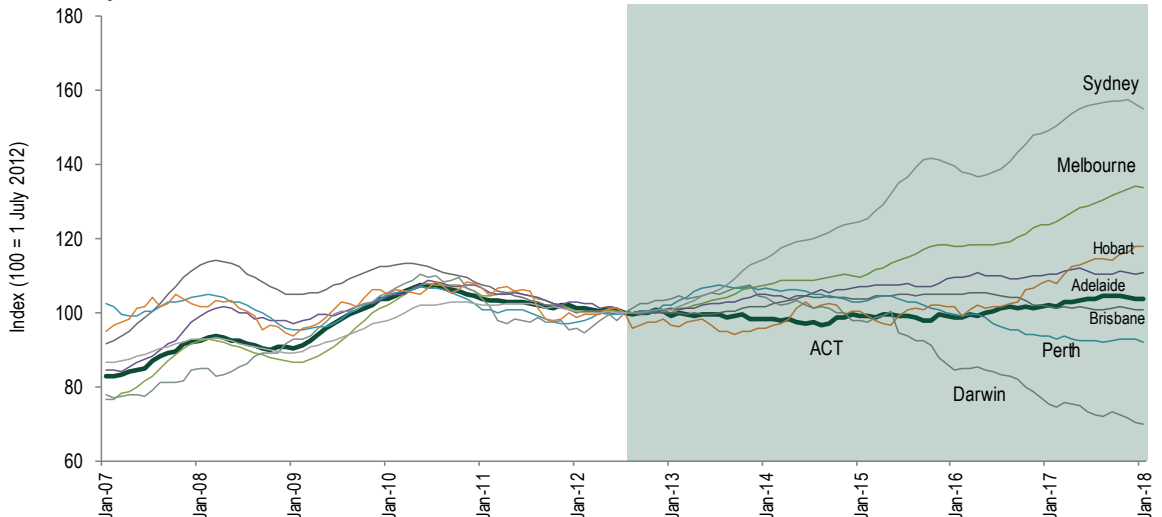
Capital city house prices, indexed to 100 = 1 July 2012

Source: CoreLogic Hedonic Price Index



Capital city unit prices, indexed to 100 = 1 July 2012

Source: CoreLogic Hedonic Price Index





Stamp Duty

Housing market turnover

The ACT Government's stamp duty/land tax switch should, at least in theory, result in higher turnover of houses as the abolition of stamp duty will allow people to move houses more freely without the burden of a transfer tax.

This outcome is not evident in the ACT, at this stage of the reform process.

The volume of houses turned-over in the ACT was in decline for two years prior to the start of the tax reform initiative. The volume continued to decline for a further nine months after the start of the reform process. In fact, turnover reached a record low of just 19 dwellings per 1000 persons during the year to September 2014, a lower level of activity than in the immediate wake of the GFC when housing markets around the country temporarily froze.

The continued trend decline in turnover in the ACT is evident because of the narrow application of material stamp duty reductions in stage 1, which incurs predominantly on dwellings valued at under \$300,000 and subsequently from houses priced under \$500,000, have had an immaterial impact on the number of transactions.

The role of increasing land tax is also likely to be a factor in this trend. Increasing tax on the unimproved value of land deters speculative behaviour in the market – as landowners become subject to the tax they are encouraged to develop vacant or underused land to cover the increased cost of holding the property (the increased tax), or sell it.

The quantum of this change is impossible to estimate as there is no means of determining 'speculative behaviour'.

ACT annual dwelling transfers per 1000 persons

Source: ABS 6416.0

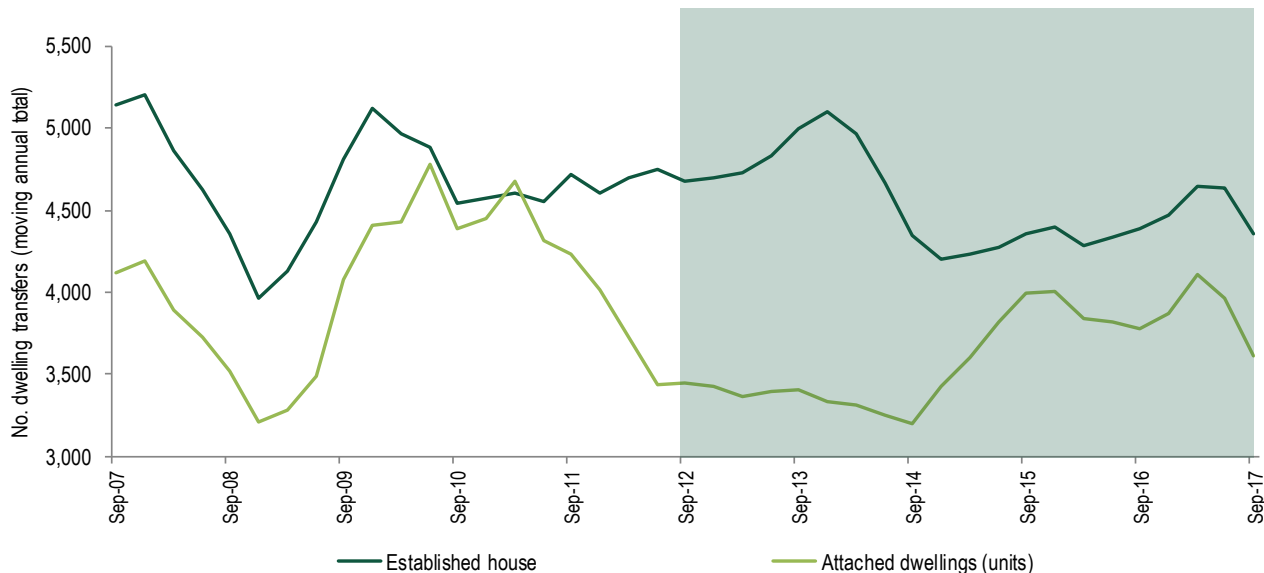




Stamp Duty

ACT dwelling transfers - moving annual total

Source: ABS 6416.0



There are two other factors worthy of note in relation to the tax reform initiative.

Firstly, the transition to a land tax does have another positive externality. The transition avoids unnecessary 'vacant land taxes' which are a poorly designed policy to address land speculation. Vacant land taxes have been introduced in a number of jurisdictions in response to very questionable data that suggested more than 10 per cent of houses in Australia were vacant.

Secondly, as the employment centres in the ACT are close to the NSW border it is possible to avoid the tax changes by relocating across state borders. If NSW does not change the application of stamp duty retains rate capping, interest rates remain low and the ACT continues to increase rates then there will be a point at which the tax burden on households could create an incentive to avoid ACT property taxes, in preference for NSW based property taxes. For example, the annual cost of borrowing \$20,000 over 25 years to incur NSW stamp duty to purchase a \$550,000 home, will be less than the annual increase in ACT rates.

This means that for households that do not need to live close to the centre of Canberra, there could eventually be a tax advantage to relocate into NSW to avoid the relative high annual rates in the ACT by incurring the cost up-front imposed by NSW stamp duty.

Residential construction – new home building and renovations activity

The ACT's tax reform initiative is likely to have supported elevated levels of residential construction – both new home building and renovations activity. Land taxes should encourage landowners to develop vacant or underused land or property to cover the increased cost of holding the property (the increased tax), or sell it.

New home building activity in the ACT (on a per new resident basis) – had been declining for a year before the tax reform initiative commenced. The decline in activity continued for a further nine months after the tax reform process commenced.

Since then overall activity has increased and has fluctuated around a relatively elevated level in the following years. Even when measured on a 'per-resident basis' and therefore taking into account the ACT's rising population, the impact on home building has been positive.

The ACT has also been adding more stock per additional new resident compared with the other eastern seaboard states. This is a quite a compelling result given the very high levels of building occurring in New South Wales and Victoria in recent years. While on a per-new resident basis, building activity in



Stamp Duty

Queensland briefly exceeded the levels in the ACT, this is largely accounted for by slowing population growth associated with a major downturn in the resources sector.

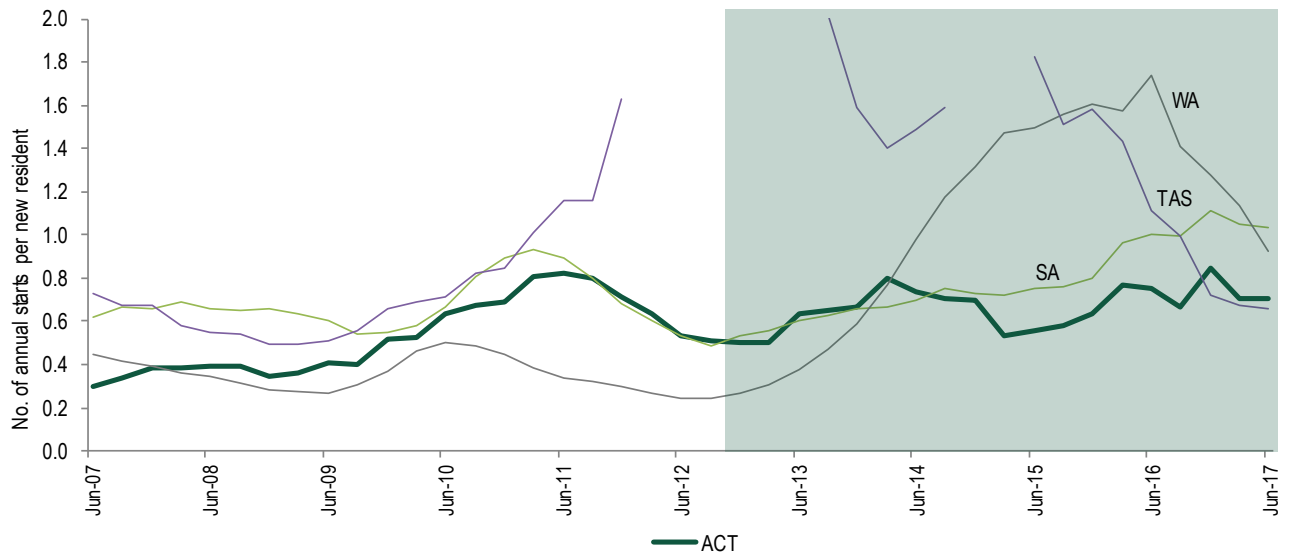
Annual starts per new resident

Source: ABS 8752.0



Annual starts per new resident

Source: ABS 8752.0



While the results in the renovations market do not appear as strong, there is still evidence that the reform has been supportive of this part of residential construction amid difficult market conditions across the country for renovations. The mechanism for this support for renovations is much the same as for new home building. That is, the imposition of the land tax encourages property owners to develop or improve underused land, or sell the land to avoid the tax liability.

Per-capita levels of renovations activity in the ACT continued their decade-long trend of decline for about two years after the introduction of the tax reform. The pace of this decline did moderate and growth materialised during the two years to September 2016. The latest level of renovations investment per capita in the ACT is just higher than where it was at in mid-2012, when the reforms commenced.

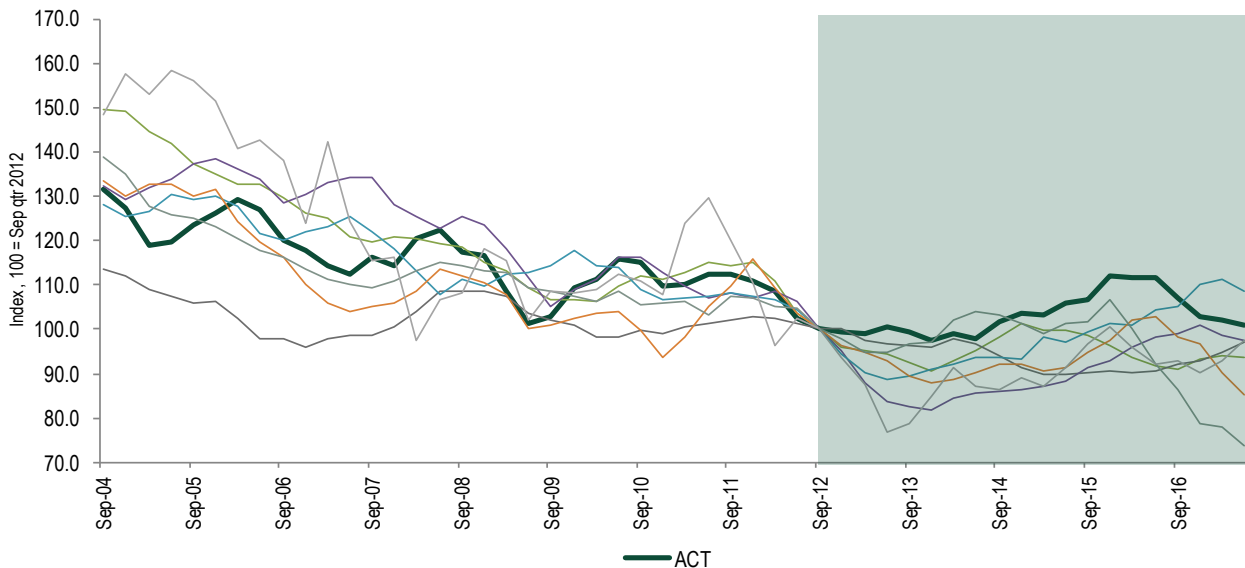


Stamp Duty

Given the difficult trading conditions facing the renovations market nationwide, most jurisdictions have seen renovations activity continue to decline to levels below where they were in mid-2012. Land tax in the ACT appears to have provided support to the renovations market through the aforementioned incentives and contributed to the ACT's out performance of most other jurisdictions.

Index of per-capita total renovations investment

Source: ABS 3101.0, National Accounts



ACT Government Revenues

An outcome of the tax reform initiative is a more reliable source of revenue for the ACT Government. Stamp duty revenues are volatile because they are determined by housing prices and market turnover that are themselves subject to significant swings. In contrast, a broad-based land tax represents a much more stable source of revenue given the inability of avoiding the tax.

The first chart below illustrates the unpredictability of stamp duty revenues during the first stage of tax reform – which demonstrate relatively large errors between budgeted and actual revenues. This contrasts with the accurately estimated rates revenues during the same time.

The ultimate goal of the reform is to switch the ACT's revenue base away from inefficient stamp duties however, this tax still accounted for a growing amount of tax revenue during the first phase. This is a result of windfall gains associated with house price increases and the consequent bracket creep in to higher stamp duty obligations.

The Budget estimated stamp duty revenue to decline by \$5.6 million over the period 2012/13 to 2016/17. Instead it has increased by \$80.4 million.

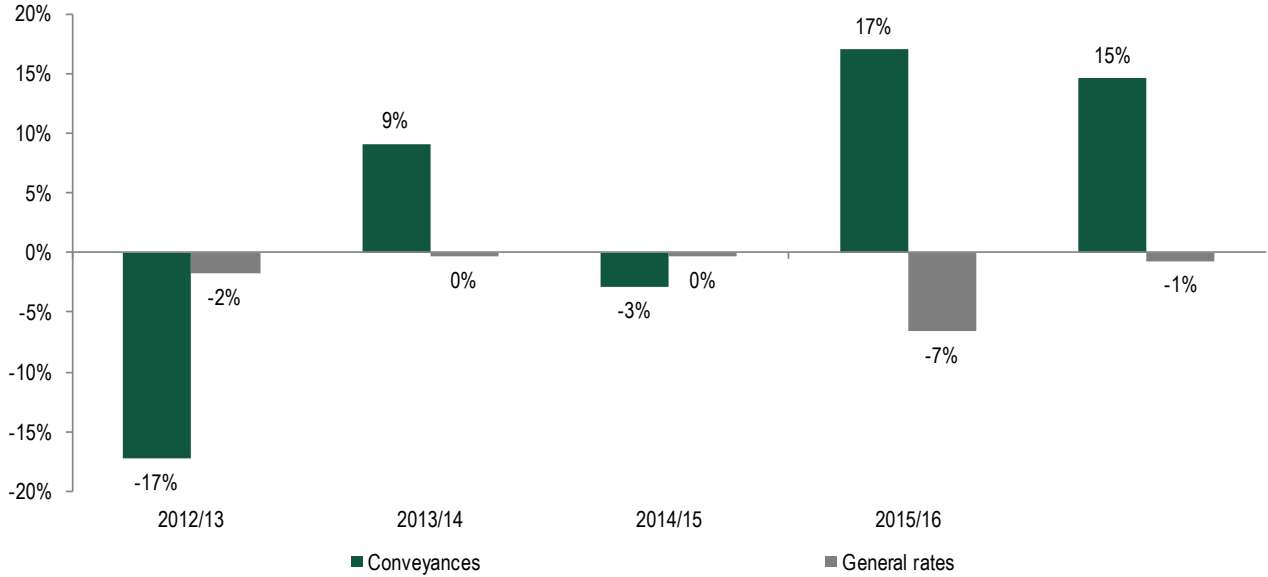
This growth in the value of stamp duty was less than the growth in other revenues and consequently the ACT Government's reliance on stamp duty has fallen. Over the decade to 2011/12, conveyance stamp duty accounted for 22.9 per cent of tax revenue in the ACT. Since then (from 2012/13 to 2015/16), the share has been 17.5 per cent. This is partly due to the rise in revenue from land taxes, but also other non-property related revenue.



Stamp Duty

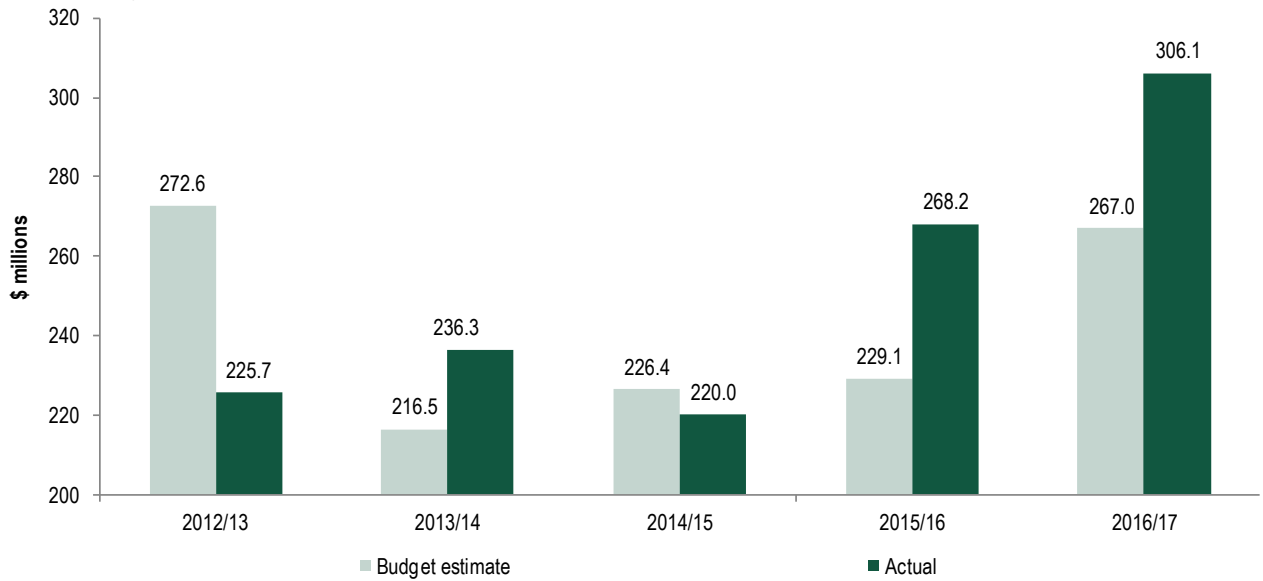
ACT general rates and stamp duty revenue - error in budget estimates

Source: ACT budget papers



ACT stamp duty revenue - budgeted vs actual

Source: ACT budget papers

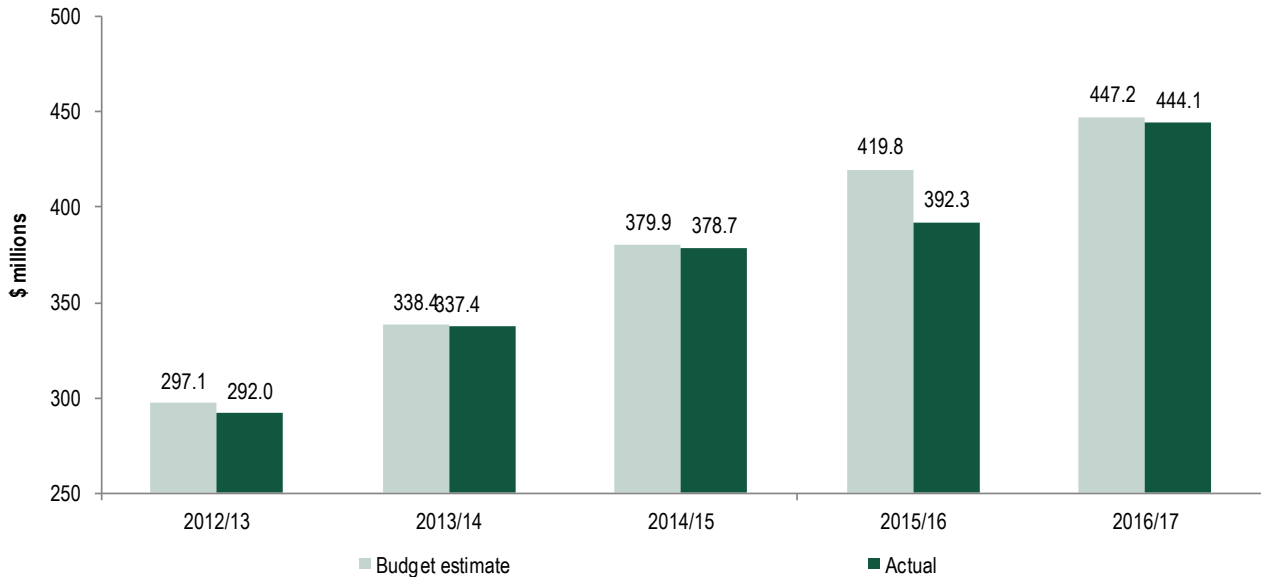




Stamp Duty

ACT general rates revenue - budgeted vs actual

Source: ACT budget papers



Progressive exemptions to stamp duty and First Home Owner Grants

First Home Owner Grants are an important component to a national housing policy as the most significant barrier to entering the market continues to be obtaining a deposit. Mortgage repayments tend to be a lower barrier to ownership than jumping that big initial deposit hurdle. This initial deposit is eroded by the imposition of punitive taxes including stamp duty on a house and on the mortgage.

A well-designed First Home Owner Grant will encourage the construction of more new homes, therefore increasing the stock of housing and lowering affordability pressures. A poorly designed scheme encourages buyers towards the existing stock, therefore restricting the growth in supply and forcing up affordability pressures.

For this reason the ACT initiative of abolishing stamp duty across all categories and price brackets is a better option than progressive exemptions to stamp duty for first home buyers.

Conclusion

Stamp duty is an inefficient tax. Land tax on the other hand provides a more reliable source of revenue. In the case study provided by the ACT Government, at this early stage, the reform is having the anticipated positive impact on the economy.

There are significant risks in pursuing these reforms. Most notable of these is that the reform agenda is abandoned, or paused, before stamp duty is abolished. As is most evident in NSW, if stamp duty rates are not adjusted every year, its burden, inefficiencies and inequities compound. Without the complete abolition of stamp duty, the tax will again grow to be a punitive tax on house transfers.

For the ACT, these risks will increase during the second phase of the tax reforms as the Government begins to experience a decline in revenue from stamp duty.