Prosper Australia's Submission

to the

State Tax Review
Discussion Paper
Government of South Australia
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About Prosper:

Prosper Australia is a non government organisation inspired by economic justice. When wealth produced from land – the earth, minerals and natural monopolies – is the funding base for government, equality of opportunity becomes possible for all.

This concept was developed during the 18th Century era of classical economics. The theories were clarified by Henry George in “Progress and Poverty”. The success of this book and the strength of his oratory prompted a world-wide movement that continues to this day.

We reach out to business on lower taxes and greater efficiencies (through the removal of deadweight taxes) and to progressives on urban density, self funding public infrastructure and resource conservation.

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Introduction

The South Australian government has announced a tax review that looks directly at exchanging conveyancing Stamp Duty for State Land Tax.

The discussion paper states clearly the objective of the review is to promote entrepreneurship, investment and job creation in SA by making it a more attractive place to do business and an affordable place to live.

Prosper Australia has strong views on these matters and is pleased to assist the SA government in identifying the economic efficiency and social justice benefits available ahead of making any decisions. There is no Georgist organisation in SA and Melbourne-based Prosper willingly steps forward to contribute.

SA revenue sources

The Discussion Paper begins by outlining the South Australian government's key revenue measures. The government explicitly acknowledges its tax bases are of poor quality and need reform to lift competitiveness and rid the state economy of the deadweight costs it currently imposes on its citizens.

Prosper offers the following observations on certain South Australian tax bases:

Payroll Tax – business has limited capacity to bear taxation and simply passes these costs on. The economic incidence falls on labour in lower wages and on consumption in higher prices.

Emergency Services Levy on fixed property – a land tax hypothecated to fund emergency services, mainly their standby cost.

NRM levies - a land tax on a defined area hypothecated to fund natural resource management and a **water levy** on commercial users to fund water allocation plans and monitoring.

Save the Murray River levy – a land tax, surcharged on the water rates of properties drawing from the Murray River, with flat rates for residential, commercial and agricultural users.

Gambling taxes – a tax on the poor and a state government addiction. The superior base is in capturing the economic rents created by the oligarchic nature of gambling licenses, above simply appropriating a share of the money wagered.

Motor vehicle taxes – operate as a poll tax and are deeply regressive, given car ownership is nearly universal, and are a heavy burden on the poor who are almost as reliant on private transport as the wealthiest.

Emergency Services Levy on mobile property – emergency services have a key role in motor vehicle accidents and the vehicle levy seeks to reflect this. In practice, this relief from the ESL land tax can be offset or passed on, and has substantial deadweight costs.

SA government consultation

The State Tax Review discussion paper asks for guidance and feedback on a number of questions.

1. *The Government is interested in hearing views on whether conveyance duty is a barrier to business expansion and investment decisions.*

Stamp duty deters property transactions and thus hinders change and innovation. It inhibits the transfer of property to higher value uses, resulting in an inefficient allocation of state resources. This transaction tax falls on both land and buildings, whereas land tax falls solely on the underlying land. Thus, stamp duty lifts the cost of and constrains construction and construction employment.

Most studies of stamp duty focus on the residential impacts. The economic consequences for business are very similar, inhibiting moving closer to their customers, expanding and contracting efficiently, making a key capital asset less liquid and imposing avoidable costs, such as longer travel times for employees and customers with city-wide congestion impacts.

All these factors compound to reduce overall economic activity.

Land tax is a small but insistent reminder to owners of their obligation to put land to its best and highest use. Removing stamp duty on commercial property transactions and neutralising the financial impact on government by revising the state land tax schedule will sharpen this reminder, with positive economic benefits.

The discussion paper estimates SA government revenues from stamp duty this year at $886 million. KPMG Econtech[i] estimates the marginal excess burden of conveyancing stamp duties at 34 per cent, and regards this as a serious underestimate as it does not consider the cost to households displaced to renting and the welfare losses in the mismatch of housing and families. Collecting that $886 million therefore imposes a civic burden of at least $1,187 million, of which $300 million is cast on the ground in deadweight losses each and every year.

Further, recent economic modelling by federal Treasury calculates land tax actually has a negative marginal excess burden as land tax paid by foreign and domestic landowners is spent solely on domestic households[ii]. A boost to state demand of this scale would be welcomed by business and citizens alike. This reform is low-hanging fruit indeed.

2. *The Government is also interested in hearing views as to whether reducing or eliminating conveyance duty on property transactions would benefit those seeking to purchase a property, including if property owners were required to pay an annual property tax, or whether it may result in more transactions which could push up property prices and undermine the benefits of any changes to conveyance duty.*

The *statutory incidence* of Stamp Duty falls on buyers, as they must physically pay the tax. However, the *economic incidence* falls entirely on vendors. This assertion can be tested by considering what the sale price of a property would be without Stamp Duty.

However, ending stamp duty would be funded by the removal of the principal place of residence exemption from state land tax, transforming a property transaction tax into a land holding charge – one already levied on investors and second-home owners.

The complexion of the property tax base changes considerably with this reform. Prof. Gavin Wood *et al* at Australian Housing and Urban Research Institute modelled the impacts of a broad-based land tax in line with the Henry Review recommendations on Melbourne.[iii] They found landowners in Boroondara, Stonnington, Bayside, Port Philip, Melbourne and Yarra LGAs – the most valuable land per square metre in Melbourne - would pay considerably more while landowners elsewhere would enjoy overall property tax reductions.

Prosper regards this outcome as entirely appropriate and defensible on economic efficiency and social justice grounds. These parts of Melbourne are transport rich, liberally provided with quality, fully-amortised community facilities, durably superior government schools, low crime rates, high quality and rising housing stock, excellent parklands, and other permanent locational and geographic advantages.

Current tax settings confer considerable advantages upon wealthy landowners – self-defined by their demonstrated capacity to buy and occupy the most valuable sites. The exchange of stamp duty for a universal land tax levels many of these economic distortions, though there will be loud and specious arguments it does the reverse.

Stamp duty inhibits transactions. If removed, South Australia will see:

- More and better construction
- Lower rents
- Better matching of families and housing stock
- A greater propensity to buy (on ease of exit)
- Less traffic congestion
- A deeper, more active land market

Whether the exchange of stamp duty for land tax would raise or lower property prices depends entirely on the design of the future tax schedule government adopts.

Does it zero-rate low value land? To what level? How progressive is the tax scale on higher values? Does it aggregate individuals' land holdings for calculation or adopt the recommendation of the Henry Review and rate on a per square meter basis? On commercial property, does it simply perform a revenue-neutral exchange of stamp duty for a slightly higher land tax, bearing in mind the holding period for commercial property is generally much longer than for residential?

The answers to these questions are entirely up to government and the advice of Treasury. Prosper believes the SA's current exemption threshold at $316,000 inhibits the economic benefits land tax provides. A nil-exemption flat rate tax may sound a doctrinaire ideal, but landowners need to be reminded of their obligation to put land to use, no matter how modest the parcel.

3. "The Government is interested in community views on progressivity. Does the community believe that landowners with a higher value of aggregate land holdings should pay proportionately more than landowners with more modest land holdings? If so, what are the best ways to structure the land tax system to achieve this objective?

Prosper commends the Henry Review recommendation to tax on a per square meter basis, rather than aggregating holdings. The flatter the rate schedule, the less important this question becomes.

Government will be tempted to a progressive rate schedule in the mistaken belief this advantages lower income earners. Given the cost of transactions without stamp duty would be very low, over time, those owning high value land with larger land tax bills will be doing so voluntarily - choosing their own tax contribution.

4. *"A range of issues would need to be considered if the Government were to move to a broad-based property tax, including*
- would a proportional or progressive tax structure apply?
- would capital or land values be used?
- would tax revenues be linked to certain expenditures, if so what expenditures?
- what concessional arrangements would apply for pensioners and low-income residents?
- would the reform apply to all sectors (ie residential and non-residential)?

The proposed property tax should fall solely and utterly on the underlying land. Taxing structures discourages construction; land cannot be discouraged, it simply is. Larger families need larger houses. Taxing this dimension has substantial welfare costs. While introducing a 'Mansion Tax' feature may appeal, in practice extravagant construction tends to occur on the highest value land – elevating its value and all adjoining sites. Land tax addresses this directly.

Hypothecating land tax to particular expenditures is superficially tempting to calm taxpayer dissent. In recent years, fuel taxes were allegedly hypothecated to road construction – until policy changes meant these revenues and expenditures no longer matched. The political fallout this created was substantial, painful and quite unnecessary.

It is a long-standing principle that government must consider revenues and expenditures separately. Depart from this at your cost.

The discussion paper seeks comment on concessional arrangements for pensioners and low-income earners. Cash-poor asset-rich households do exist. A particular anomaly is elderly retirees trapped in large worn-out family homes unable to fund their repair or pay a land tax easily borne by others. The properties are typically almost entirely land value, which can be substantial as the city has grown around them.

We say, this problem is largely due to stamp duty, which falls upon vendors and is a particularly acute impost on retirees without other resources.

Removing stamp duty will enable these households to downsize their inappropriate dwelling for a more modern and efficient one in the same neighborhood with minimal transaction costs.

Life-long low income earners will unlikely hold very valuable land, and the same arguments on easing transactions are equally applicable.

A key equity issue in exchanging stamp duty for land tax is dealing with those who recently purchased with stamp duty paid on the transaction. This could be addressed by crediting all stamp duty paid against a hypothetical land tax from date of purchase. Recent buyers would not be liable for land tax until their credits are exhausted.

State revenue volatility

The discussion paper directly addresses in 5.4 a key government concern – the volatility of revenues and the difficulty this imposes on planning future spending.

The best revenue bases are not those that deliver a rock steady income stream to government, whatever the circumstances of its citizens. Instead, the higher objective should be to use wherever possible revenue bases with the economic virtue of being *automatic stabilisers*.

The federal income tax, in combination with unemployment benefits and the general social security system exhibits this feature, adding friction when incomes rise and joblessness falls, and supporting activity in recession without policy change.

Few state taxes have such economically useful and dynamic properties, except land tax, which rises and retreats with land price changes. This rare and valuable quality is masked by biennial land valuations.

Prosper recommends the SA government revalue all land annually, by interpolation. This is quite straightforward with computer assisted mass appraisal. The economic benefit of this automatic stabiliser function is very significant in eras of rapidly rising or falling land prices.

Finally, Prosper recommends government listen carefully to the advice of its Treasury. They appreciate the profound economic benefits this reform offers. They will confirm and amplify Prosper's opinion this will deliver a more dynamic and enterprising state economy. And they will back our bold claim there are major first-mover advantages for the state that acts first. South Australia would become a magnet for economic activity.

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[i]
http://www.taxreview.treasury.gov.au/content/html/commissioned_work/downloads/KPMG_Econtech_Efficiency%20of%20Taxes_Final_Report.pdf
[ii] http://www.prosper.org.au/2015/03/30/treasury-unearths-a-beautiful-tax/
[iii]
http://www.ahuri.edu.au/downloads/publications/EvRevReports/AHURI_Final_Report_No182_The_spatial_and_distributional_impacts_of_the_Henry_Review_recommendations_on_stamp_duty_and_land_tax.pdf