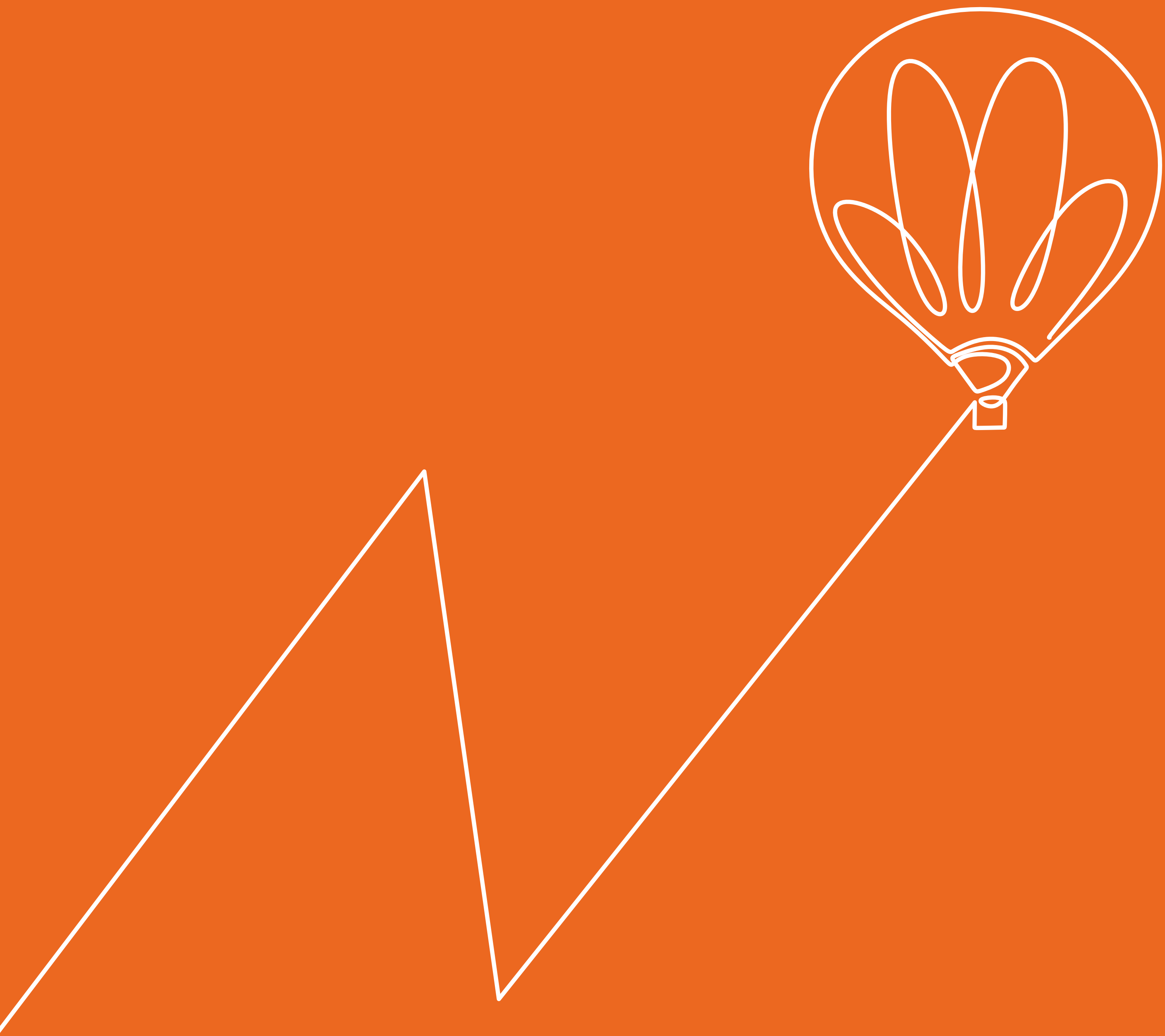
THE SECOND INTERVAL:

Evaluating the ACT's 20 Year Land Value Taxation transition after 8 years



By Warwick Smith and Jesse Hermans for Prosper Australia - October 2020

About Prosper Australia

Prosper Australia is a research institute holding up a light to the dusty corners of an economic system no longer working for the common good. In particular, we believe the missing piece in the analysis of economics and taxation is *land*.

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Introduction

Key Findings:

- **ACT land prices have not been adversely affected by the reforms.**
  Housing prices have increased, but unit prices are stable.
  Price impacts of the reforms are hard to separate from changes to the ACT's planning policies.

- **The ACT's property boom has been driven by owner-occupiers, not investors.**
  Owner-occupiers (including First Home Buyers) have increased from about 60% of the value of purchases in 2012, to 78% in 2020.

- **The average residential landowner paid $15,039 in rates during the reform period**
  (between 2012-13 and 2019-20 but saw their land value rise by $63,681 over the same period.

- **The average Treasury forecast error for revenue has fallen from 7.9%**
  before the reforms to 2.6% since the reforms began.

- **Substantial increases in general rates charges have coincided with slower growth of commercial land prices relative to residential land prices.**

Executive Summary

In 2012, the ACT Government announced it would embark on a twenty year tax reform program, abolishing stamp duties and insurance taxes and replacing the revenue by increasing general rates for all landowners. *The First Interval: Evaluating ACT's Land Value Tax Transition* (Murray, 2016), was published in 2016, four years into this transition period. This is the second of a series of five reports, to be published every four years, examining the progress and impacts of this ambitious tax reform agenda.

When the reforms were announced in 2012, the Government gave three main reasons for replacing stamp duty and insurance taxes with land tax (general rates): revenue predictability, efficiency and equity. They also promised that the reforms would be revenue neutral, reassuring residents that this was not a tax grab. This report focuses on assessing the impact of the reforms against these criteria as well as examining the impact on prices and rents.

> Overall, the reforms are proceeding as planned and are achieving their stated objectives. Political risks remain, however, with the opposition currently promising to suspend increases in general rates for four years if they win this year's Territory election.

Predictability

Given stamp duties are notoriously volatile and unpredictable and land taxes are very predictable, the reforms were always going to improve predictability of revenue and the data have borne this out. The average Treasury forecast error for revenue has fallen from 7.9% before the reforms to 2.6% since the reforms began. Revenues will almost certainly become more predictable as the reforms progress and stamp duties are eventually abolished.

Efficiency

The reforms are estimated over the first 6 years to have increased the Gross State Product of the ACT by about $302 million. Real household consumption has increased by $78m, real investment by $52m, employment by 0.11% and real wages by 0.05%. Gross State Product will now increase at about $130 million per year, and more as the transition progresses. It has also improved the appropriate use of housing stock.

Equity

The tax revenue required to provide ACT residents with government services is now shared far more evenly across all land owners, rather than concentrated on those who buy and sell property.

The tax system is also now more progressive and aligned to ability to pay, and still leaves landholders with modest unrealised capital gains. Despite the average residential landowner paying $15,039 in rates during the reform period, their land value rose by $63,681, leaving them with more than $6,000 per year in unearned income from land value increases.

Notably, the housing market share of investors by value has proportionally decreased, as investor activity has stagnated. Owner-occupiers (including First Home Buyers) have increased from about 60% of the value of purchases in 2012, to 78% in 2020. The ACT's property boom has been driven by owner-occupiers, not investors.

Prices, rents and turnover

Concerns are often expressed that increased land taxation will cause a crash in property prices. This has certainly not been the case in the ACT with prices rising since the reforms began and outpacing growth in neighbouring NSW city Queanbeyan, which is effectively part of the same housing market. Rents in the ACT are the second most expensive in the country.

If anything, the ACT is suffering from a housing affordability problem, the very opposite of a price crash. Despite higher prices, more first homebuyers have still entered the market as a result of the reforms. Owner-occupiers are also the primary increase in housing demand.

The reforms also potentially increased rental supply, and reduced rents in all but the top quintile (which increased). We speculate homeowners could be moving up the market and leasing out their previous homes as affordable rental stock, while waiting for stamp duty cuts to boost their future sale price.

Increased turnover is one of the primary theoretical efficiency benefits of the reform. However to date it has been relatively unaffected by the reforms, which warrants further investigation. It is unclear if the transition model - where stamp duty cuts are known in advance and sales can be delayed to benefit - is responsible.

Revenue neutrality

The reforms are estimated to have been "*broadly revenue neutral*" in the latest ACT revenue neutrality review.[1]
While total revenues have risen sharply, they have been driven by increases in property prices and payroll taxes.
Property price increases would also have driven revenue up from stamp duties if the reforms had not taken place.

The commercial sector has slightly increased its tax burden, but this has been offset with payroll tax reductions from increases in the tax free threshold. The residential sector has experienced a slight reduction in taxes of $128 million, although this is less if the reforms have higher price growth effects than assumed. We also note residential land taxes on investors (not related to the reforms) have increased by $10 million per year.

1 A Barr, Impacts and Outcomes of the Government's tax reform program, Sept 2020, https://apps.treasury.act.gov.au/taxreform

The 2012 'Quinlan Review' and the ACT's 20-year tax transition

In August 2010, following the release of the Federal Government's taxation review, *Australia's Future Tax System*, the ACT Government announced its own taxation review, released in early 2012.

Of the twenty seven recommendations in the *ACT Taxation Review* (Quinlan, 2012), hereafter referred to as the *Quinlan Review*, the ACT Government agreed with fifteen recommendations, agreed in principle to fourteen, noted one and did not agree with one. Almost immediately the Government embarked on an ambitious program of tax reform.

Among other reforms included in the *2012-13 ACT Budget* was a commitment to abolish stamp duties on real estate transactions, abolish insurance taxes, and replace the revenue with progressive annual general rates charged on land (Figure 1).

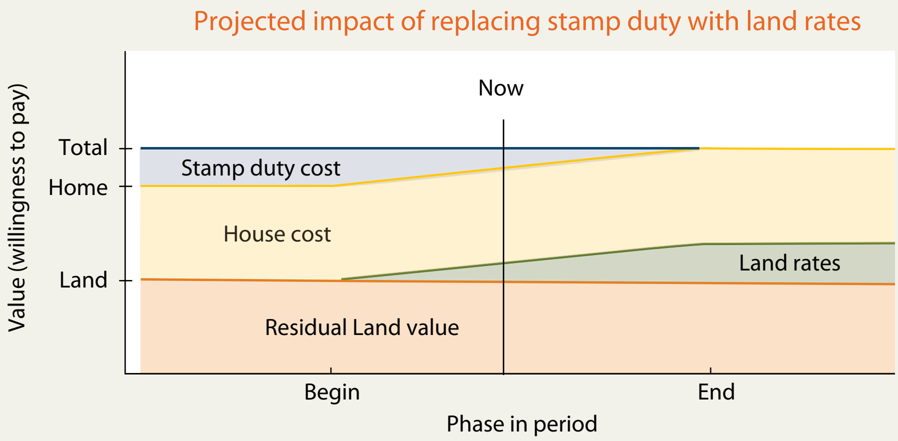

Figure 1. *The stamp duty to land tax transition. Reproduced from (Murray, 2016).*

In theory we would expect the introduction of a land tax to have a one-off impact on prices by reducing the land value in line with future land tax obligations.[2] At the same time, we would expect the abolition of stamp duty to increase prices, at least by as much as the reduction in duty, but likely more so as larger deposits can be leveraged for larger loans. Exactly how these two pricing effects will play out is difficult to forecast in advance.

In order to spread out this impact and reduce the economic disruption of these changes, the Government decided to phase in the transition incrementally over twenty years.

The ACT Government assured residents that the tax reforms would be revenue neutral; that the overall tax collected by the Government would be unaffected. They also held the transition would have minimal impact on overall housing costs whilst improving the efficiency and equity of the tax system. More efficient land use would result.

> The impact and progress, eight years into this twenty-year transition from stamp duties to land taxes, is the subject of this report. Specifically, the tax transition will be assessed against the Government's tax reform objectives of predictability, efficiency and equity.

In 2020, the ACT Treasury commissioned two independent reports to evaluate the transition. These were conducted by The *Centre of Policy Studies'* (COPS, 2020) and the *National Centre for Social and Economic Modelling* (NATSEM and TTPI, 2020). Findings from these reports have been incorporated into the following analysis where relevant.

2 For an accessible description of land value taxes and their economic impact, see Australia's Future Tax System, Part 1. P 247 (Henry, 2009).

Why abolish stamp duties and increase land taxes?

The ACT Government primarily justified these tax reforms on three grounds: predictability, efficiency and equity (ACT Treasury, 2012). In addition to these objectives, any tax reform can be evaluated against the principle: *tax bads not goods*. We should tax things we want to discourage and avoid taxing things we want to encourage. Taxes tend to discourage the activity being taxed. Taxes on transactions discourage transactions, taxes on labour discourage labour and taxes on pollution discourage pollution. Taxes on land value discourage speculation on land value.

Predictability and stability of revenue

Stamp duties are notoriously volatile taxes as they are levied on transactions. The number of real estate transactions is highly influenced by prevailing economic conditions. In addition, stamp duties increase the cost of these transactions and so act to discourage them.

Taxes that are levied on land values, by contrast, are very stable and predictable because the value of land is relatively stable.

Stability, alongside the predictability of revenue that can reliably keep pace with population and economic growth, are important for budget planning and the ongoing delivery of services.

Tax	MAPE
General Rates	1.3
Land Tax	4.6
Payroll Tax	4.8
Gambling Taxes	4.9
General Insurance	8.1
Total Taxation	**9.9**
Conveyances	31.3

Source: ACT Treasury.
Note: Numbers are rounded to the first decimal.

Table 1. *Predictability of selected taxes. General rates are the most predictable and stamp duties (conveyances) are the least. MAPE stands for Mean Absolute Percentage Error and is a measure of the historical difference between forecasts and outcomes. Reproduced from Quinlan (2012).*

Economic efficiency

Stamp duties, as a tax on transactions, discourage transactions. In practice this means that some people who may have moved to more desirable or appropriate housing, or to a more desirable or convenient location may decide not to because of the transaction costs, including stamp duty. The cost imposed on the economy by a tax is known as the marginal excess burden (or the deadweight loss).

One of the ways that excess burden manifests is through inefficient housing allocation. Many homeowners in the ACT have more bedrooms than they need. Without stamp duty, moving to a smaller house in the same suburb would save money. However, when stamp duty is combined with the other costs of moving it may tip the balance of the decision towards staying. Recent research published by AHURI found that cost was listed as the most significant barrier for older Australians moving house (Whelan, Atalay, Barrett, & Edwards, 2019). This report also finds increasing evidence that it deters upsizing.

Stamp duties are not the only public policies discouraging better use of the housing stock. The exemption of the family home from the pension assets test means that pensioners downsizing risk losing income. If anything, the pension assets test encourages upsizing in order to secure more of their assets in the primary residence.

While discouraging homeowners from buying and selling is undesirable, discouraging speculative investment in real estate is desirable. Stamp duties are a barrier to short term property investment that relies on capital gains for returns.

Dampening speculative investment is a worthwhile policy goal for improving housing affordability and home ownership.

Virtually every academic and government review of taxation in recent memory in Australia has concluded that stamp duties are among Australia's least efficient taxes (Cao et al., 2015; Henry, 2009; Lilia & Holzinger, 2016; Quinlan, 2012).

Stamp duties on transactions mean that those who move more often pay more tax. This is despite the fact that most people move from a house they own for employment, amenity or to more desirable/appropriate housing. These are not activities that we want to be discouraging or penalising.

Land taxes, by contrast, can improve economic efficiency by encouraging the efficient use of land. Idle or underutilised land is charged the same tax as equivalent land that is fully utilised.

Sufficient land tax will discourage land banking and other forms of land price speculation by reducing the returns that stem purely from land ownership.

It's worth noting, however, that land banking is minimised in the ACT due to their unique leasehold regime. More on this below.

A 2015 analysis of Australia's major taxes by the Commonwealth Treasury found stamp duties to be the least efficient and general rates and land taxes to be the most efficient (Figure 2).

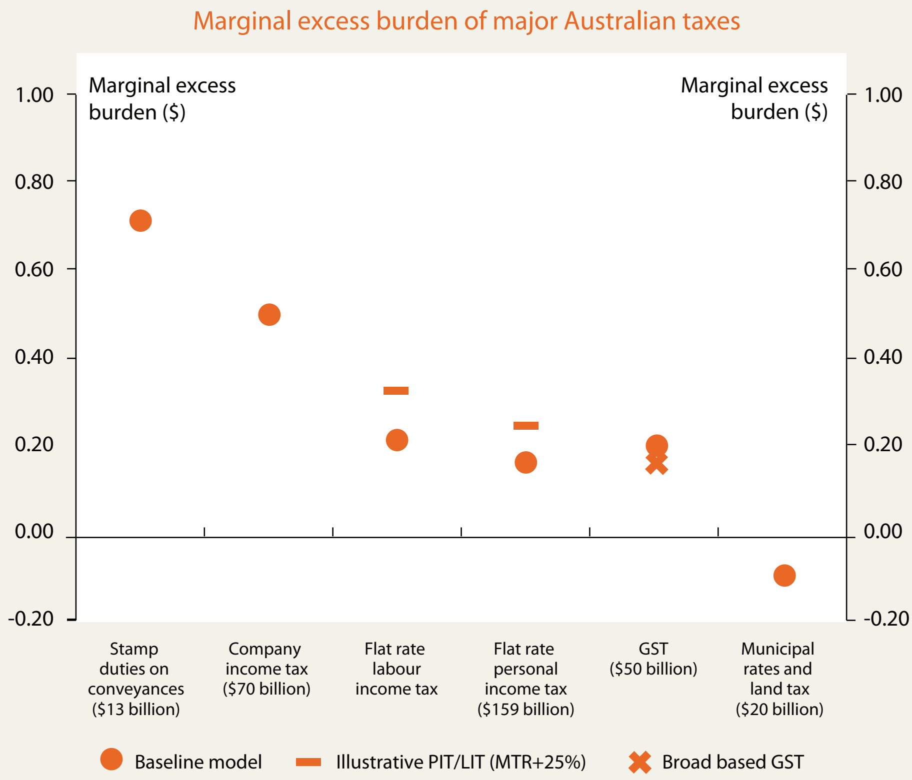

Figure 2. *Marginal excess burden of major Australian taxes. Reproduced from* (Cao et al., 2015).

Equity

One of the central principles of taxation is progressivity, meaning that higher rates of taxation should be paid by those who can best afford them. Even in the absence of progressive taxation rates, land taxes are inherently progressive because high income individuals and families tend to monopolise both more land and higher value land. In addition to this, the ACT government tax reforms introduced progressive marginal rates to their general rating system.

There are, of course, instances where low income individuals or families live on high value land – often referred to as asset rich and cash flow poor. Deferring land tax until the property is sold is a simple solution for these situations, and deferrals are available for a range of ratepayers in the ACT.

Imposing a higher tax burden on people who move more often is arbitrary and fails to meet any sensible equity principle. Such taxes also penalise people with insecure work or discourage them from home ownership.

Conversely, people who stay in the same home for life benefit from the provision of government services that are funded by stamp duties without contributing to them.

However, stamp duties also discourage investment housing turnover, meaning that they discourage speculation on land values. Stamp duties increase the capital gains threshold that makes it worthwhile for investors to buy purely, or primarily, for capital gains, as opposed to rental income.

The moral and theoretical case for taxing 'unearned income'

Not mentioned by the ACT Government in prosecuting their case for these reforms is the desirability and efficiency of taxing unearned income (known as economic rent by economists). Increases in land values are a classic example of economic rent because the owner of the land typically does nothing to bring about the increase. Land prices rise as a result of increased demand, often itself a result of government provision of infrastructure or of broader community action to improve the amenity of the area, or simply a result of population increase (Bureau of Infrastructure Transport and Regional Economics, 2015). Therefore, the income derived from buying a piece of land, doing nothing with it, and then selling it for a higher price, is unearned income. Nothing was produced or improved by the land owner to justify the income.

There is a good economic and moral argument to tax away all economic rent. If it was government and community action that lifted the land price, then the resulting income should belong to the government to provide services to the community.

Arguments against the reforms

The hissing goose

> *"The art of taxation consists in so plucking the goose as to obtain the largest possible amount of feathers with the smallest possible amount of hissing." Jean-Baptiste Colbert, finance minister to Louis XIV."*

The single greatest challenge to tax reform is political. Stamp duties are an accepted part of Australia's taxation system and, tax economists and real estate lobby groups aside, attract little attention. They are levied at a time when a very large expense with large associated costs is occurring and are therefore psychologically less abrasive than a regular bill that comes in the post every quarter to every land owner.

There is a general perception that buyers pay the cost of stamp duty because they make the payment to the revenue office. In fact, it is primarily the seller who bears the cost of stamp duty in the form of a lower purchase price. That is to say, while the *legal* incidence falls on the buyer, the *economic* incidence falls on the vendor.

Where buyers may have factored the upfront cost of stamp duty into the price they were willing to pay, it is unclear whether they will factor in the ongoing burden of rates. A substantial risk of the transition, therefore, lies in the abolition of stamp duties followed by concerted public, and then political, campaigns to reduce rates, particularly during economic booms when Territory revenues are high. This is what has happened federally with personal and company income taxes during economic booms in recent decades, leaving revenues diminished during economic downturns.

This is playing out in 2020, an election year in the ACT, with the Liberal opposition promising to freeze rate increases for four years if they win the election (Lowry, 2020). The Labor government has also frozen rate increases for a year as part of its economic response to the coronavirus crisis but promises to return to the reforms in financial year 2021/22. The Liberals are also promising to abolish payroll tax, equal with stamp duties in terms of revenue. It's unlikely they can do this and complete the abolition of stamp duties, meaning that, should the Liberal party win this years' elections, the completion of the tax transition may never occur.

The ACT's unique land supply and leasehold system

There is no private land ownership in the ACT. All land is leased from the government, usually for 99 years, and for a specific purpose. Some leases have withdrawal clauses attached to them, meaning that the ACT Government can withdraw the land when the conditions in the clause are met.

Much of the ACT's farming land traditionally had short leases and withdrawal clauses that allow the government to reclaim the land for residential and commercial development purposes. In recent years, rural leases in growth areas have been treated inconsistently, with the move from mid-term to 99 year leases incurring great cost to the taxpayer.[3 4]

When new leases for land are sold, the purchaser has two years to commence building or risk the lease being revoked. This gives the government control over residential and commercial land and dwelling supply and, therefore, substantial control over prices.

However, the ACT's *Suburban Land Agency* doesn't specifically target price. Instead, they prioritise revenue raising through land supply control and attempt to influence affordability through lease conditions. The result is that the ACT government simply replicates what developers do elsewhere, which is to keep the supply of land to a trickle in order to maintain price levels.[5] Whereas in other states this strategy boosts private profits, in the ACT this revenue flows back to the treasury, effectively enabling lower rates on existing residents.

Figure 3 reflects how land supply is altered according to population growth, restricting any pricing effect. This counters government policy, as recently stated:

> *"The Government's focus is to increase the supply of new housing in the market and our tax policy settings are aligned with our land release strategy and our housing affordability policies to achieve this policy goal."* [6]

There is no shortage of land in the ACT, at least not for the foreseeable future. Between greenfield sites and potential infill sites, the government estimated in 2012 that it has enough supply for around 100 years of population growth (Quinlan, 2012).

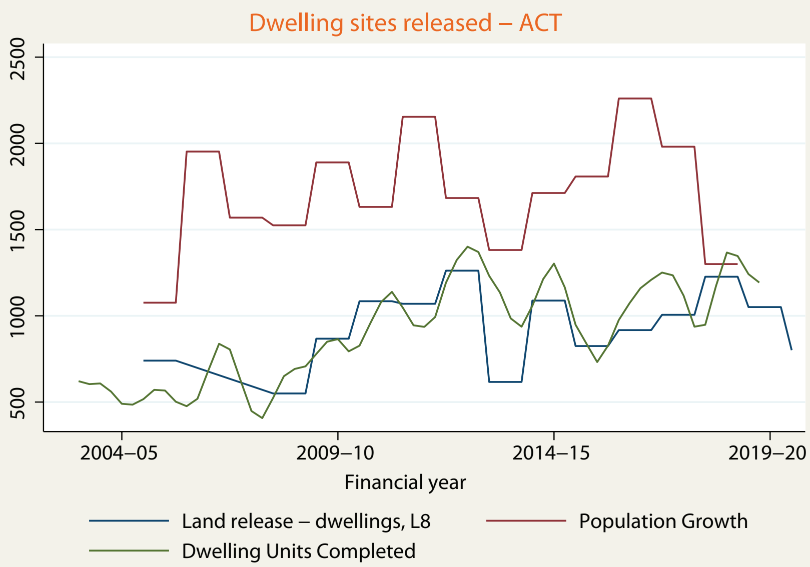

Figure 3. *Showing completed dwelling units, population growth and land releases. Land releases are lagged by 8 quarters (2 years). Population growth closely tracks land releases.*

3 B O'Reilly, Why did the ACT throw away millions of dollars in bizarre rural land sales?, https://www.smh.com.au/opinion/why-did-the-act-throw-away-tens-of-millions-of-dollars-in-bizarre-rural-land-sales-20170613-gwq9oy.html

4 Such concerns relate to long term issues the ACT government has never been willing to address regarding the simplicity of a yearly market lease. See Frank Brennan's Canberra in Crisis (1971) re the undermining of the ACT leasehold system with 20 year market valuations for all leases from 1901 - 1970. On each 20th year, the typical loud voices lobbied about large increases in leasehold payments. An annual lease based on yearly valuations would have avoided this lumpiness, delivering on the promise of one of the planet's few leasehold systems.

5 L van Onselen, Drip fed supply juices Canberra land prices, https://www.macrobusiness.com.au/2014/01/drip-fed-supply-juices-canberra-land-prices/

6 ACT media release, Stamp Duty Starts Falling From Today, https://www.cmtedd.act.gov.au/open_government/inform/act_government_media_releases/barr/2012/stamp_duty_starts_falling_from_today

The Lease Variation Charge

Another unique feature of the ACT land management system is Lease Variation Charges (LVCs). These, like land taxes, are also aimed at capturing unearned income. When a government changes the zoning (or permissible uses) of a parcel of land, the value of that land usually changes. This effect is most striking where low-value agricultural or industrial land is rezoned for residential uses. Land values can rise dramatically overnight through no effort or action of the landowner (political lobbying aside). There is no good argument for a landowner to keep *all* of the windfall gain generated by arbitrary government decisions. There is, however, some argument for landowners to receive a small portion of the rise to compensate them for the displaced land use – which often forces the cessation of the current activity, such as farming. In acknowledgement of this, the ACT government has, since 1971, taken a portion of the land value increase. The current Lease Variation Charge is 75% of the uplift in land values with the lease holder retaining the other 25%.

A recent ACT review found the LVC mechanism did not inflate the cost of land and buildings. Properties bearing the LVC had to compete with others not facing the windfall charge, ensuring the cost was not passed on.

> The review was to "help ensure the LVC continues to achieve the objective of sharing the benefit of land value uplift with the community while aligning with the Government's urban renewal and housing supply policies."[7]

LVCs collect relatively little revenue (Figure 4) but are important in maintaining equity in the tax system. They also reduce land banking and lobbying for lease variations.

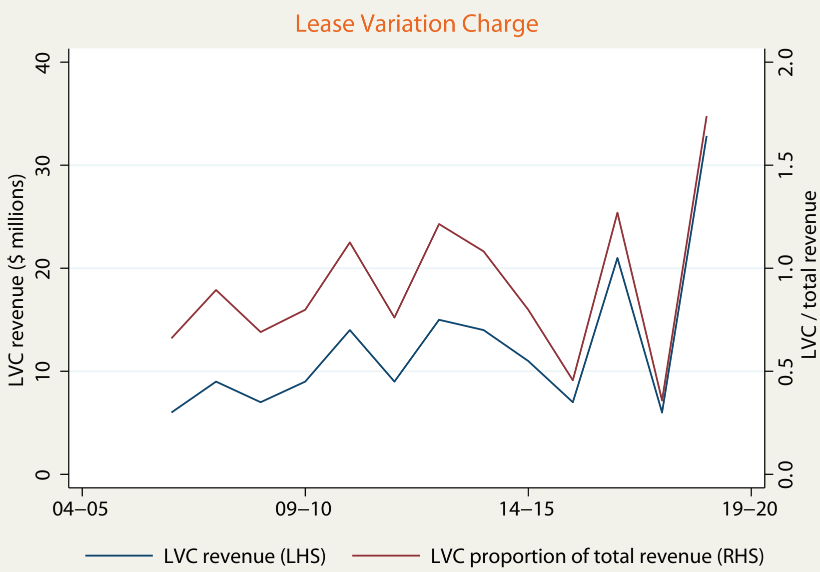

Figure 4. *Lease variation charge revenue and as a percentage of total revenue. Source: ACT Budget 2007-2019.*

7 https://yoursay.act.gov.au/lease-variation-charge

Summary of the reforms to date

General rates

Prior to the commencement of the reforms, in financial year 2011-12, residential rates were charged at $555 plus a flat rate of 0.2727 percent of the average unimproved land value (AUV), with a rate-free threshold of $16,500 applied to the AUV of each property. The ACT now uses a progressive rating schedule for individual sites that differs between houses and units,[8] and increased fixed charges.[9] This results in higher land value properties paying much higher proportions of tax relative to lower value properties. But it also ensures those enjoying locational advantages contribute to services accordingly.

All rate increases, apart from the lowest tier, were paused in 2018-19 but have resumed in 2019-20 (see Figure 5).

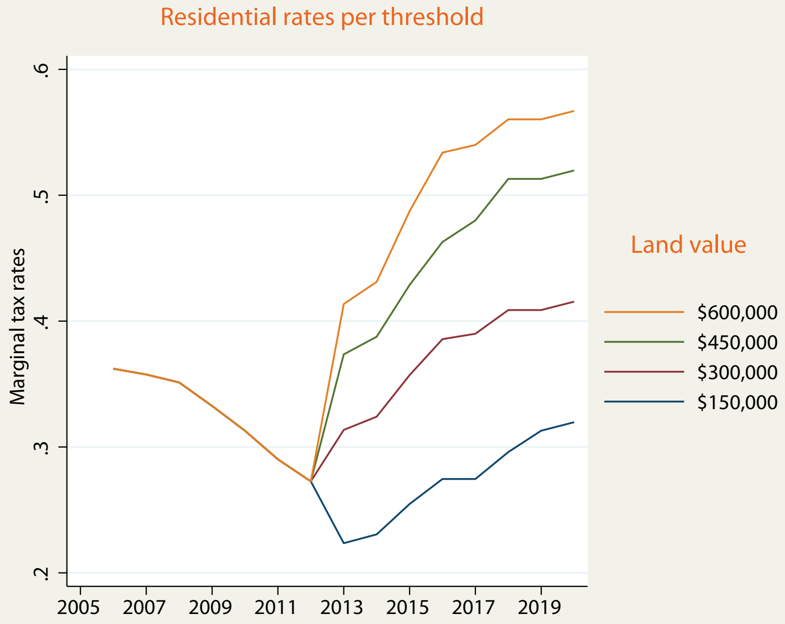

Figure 5. *Residential rates - marginal annual percent charged on unimproved land value. Source: Taxation administration (Rates) Determinations, 2007-2019.*

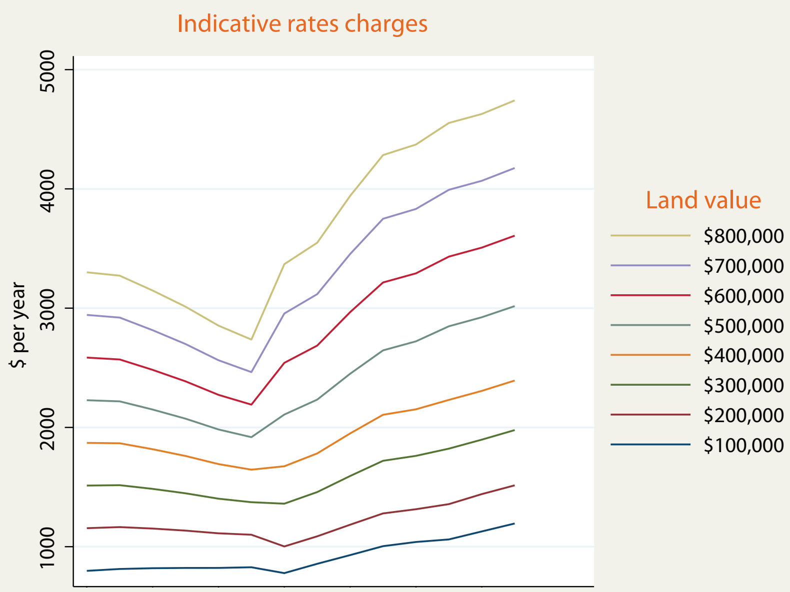

Figure 6. *Indicative general residential rates charges over time for a range of land values. Source: author calculations.*

8 For 2019-20 is shown in Appendix: Table 3 and 4. The resulting changes in charges by land value are illustrated in Figure 5.

9 $875 in 2019-20

ACT Treasury calculated that rates for a typical family had grown 27% from 2011-12 to 2016-17. They also revealed that if the tax reform had not taken place, rates plus insurance duty (abolished in 2012) would have grown 17% (ACT Treasury, 2016). According to Treasury, the typical family was paying an additional $172 per year in rates but would save over $7000 on the purchase of a new $500,000 home.

Treasury also profiled a medium sized business that employs 60 people and found them to be $18,500 per year better off under the tax reforms in 2016 than they were in 2012 (ACT Treasury, 2016).

Stamp duties

Stamp duties have been falling every year since the reforms began. In addition, first home buyers with household income less than $160,000 and commercial property transactions valued at less than $1.5 million are now exempt from stamp duties.

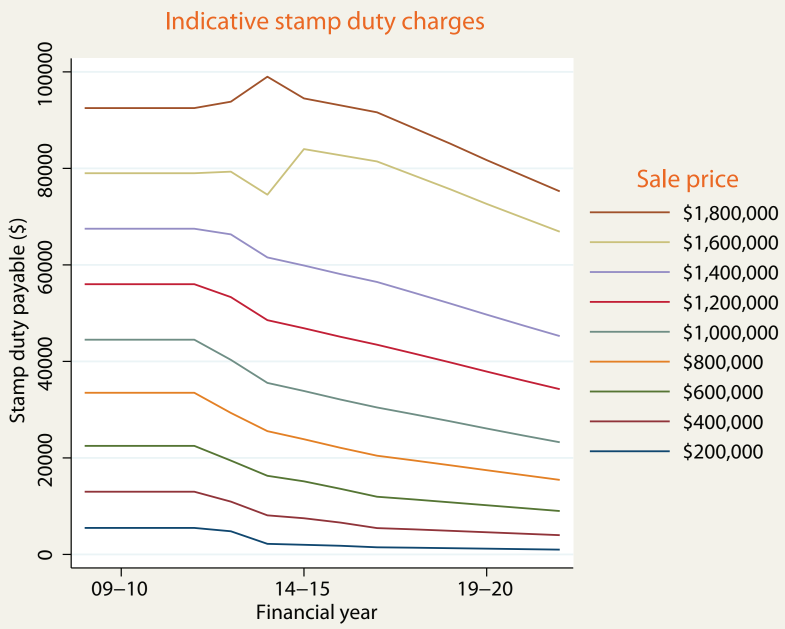

Figure 7. *Indicative stamp duty charges over time for a range of residential sale prices. Author calculations.*

Policy changes since the transition commenced

Residential rates calculations for units

In the 2016-17 Budget, the ACT Government announced changes to how it would calculate residential rates for multi-unit dwellings (units). Previously, rates for units were calculated by dividing the value of the land on which the units were built by the number of units and then calculating rates charges based on that. This resulted in many apartment dwellers paying the lowest marginal rate. The 2016-17 changes meant that rates were first calculated on the value of the block of land and then divided between the units, thus shifting the tax rate into higher brackets (see Appendix: Table 4). In addition to this, units now have their own separate progressive rating schedule (see Appendix: Table 5).

This change has been controversial, with the obvious objection that otherwise identical units will pay different rates depending on the size of the overall development they are a part of. A two-bedroom unit that's part of a 4-unit development on a small block will pay substantially less in rates than the same unit built as part of a much larger development, even when they both use the same amount of land per unit.

> One of the benefits of land taxes is that they encourage higher density living and more efficient use of land. This new rate calculation method reduces this incentive because it reduces the tax savings for those living in multi-unit developments.

The Government justified these changes by arguing that, unlike in the states, rates in the ACT funded more than just municipal services, such as rubbish collection and local roads but also fund health, education, housing and community services, public transport, and Police and emergency services (Figure 8).

Foreign ownership rates surcharge

The 2017-18 Budget Review announced the introduction of a surcharge of 0.75 percent of the unimproved value on foreign investors who own residential property in the ACT, beginning 1 July 2018 (ACT Revenue Office, 2018).

Stamp duties abolished for most first home buyers and most commercial property purchases

From July 2018 the Government abolished stamp duties for first home buyers of a new home with household incomes below $160,000. The restriction to new builds attempts to avoid government concessions pushing up the prices of existing housing, a common criticism of other first home owner schemes.

At the same time, as announced in the 2016-17 budget, the government abolished stamp duties for commercial property transactions valued at less than $1.5 million. Those that sell for above $1.5 million will attract a flat rate stamp duty of 5% of the value of the sale. At the time the Government stated that this would mean 70% of commercial transactions in the ACT would be exempt from stamp duty.

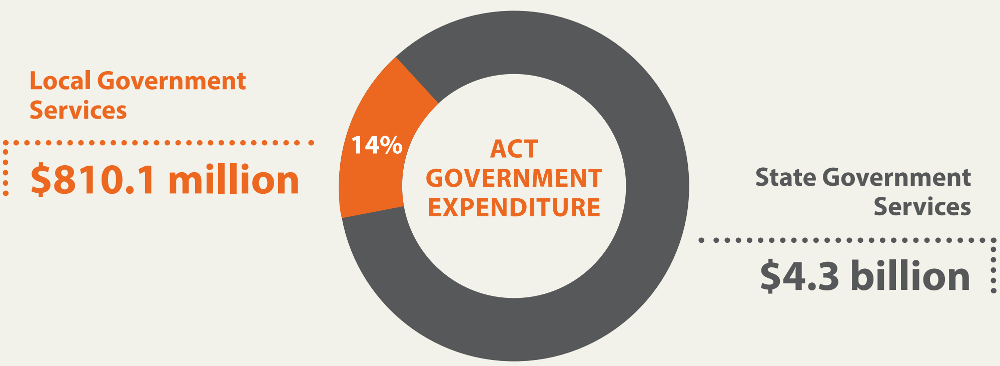

Figure 8. *Breakdown of services delivered in the ACT by type of service generally delivered by state and local governments in Australia's states. Reproduced from* (ACT Treasury, 2016).

Residential Land Tax

In addition to the Lease Variation Charge and general rates, the ACT government also levies a land tax on residential properties that are not the owner's primary place of residence.

Figure 9. *Land tax rates paid on residential properties that are not a primary place of residence.*

In the 2014-15 budget the ACT started changing the structure of residential land tax (Figure 9). The rationale for this was to flatten the residential land tax burden so it shifted more of the tax burden away from detached dwellings and towards units, which have lower AUVs. This has resulted in fixed charges being levied on investors, partially facilitating cuts in the progressive marginal rates on AUV. Such charges have added an estimated $10m p.a. (ACT Treasury, 2014).

Densification and Urban infill

Since 2011-12, the ACT has been gradually moving towards increased densification by increasing urban infill and reducing greenfield development (ACT Environment, Planning and Sustainable Development Directorate, 2018). This trend has grown since 2014-15, and by 2016-17 the six year average had become 63% infill to 37% greenfield development. When contrasted with the six years prior to May 2011, this ratio has virtually reversed. During that period, the average ratio was about 75% greenfield to 25% infill development (Commissioner for Sustainability and the Environment, 2011). This is significant, as the coinciding increased development of infill, and changing composition of housing stock, no doubt impacts analyses conducted on the reforms.

Valuation base changes

The ACT government has increased the AUV rolling average smoothing from 3 years to 5 years for commercial properties (ACT Treasury, 2019).

The purpose of this change is to insulate commercial landowners from rapid "bill shock." Increasing the rolling average maintains the integrity of annual valuations and improves the predictability of rates. However, it also reduces equity as higher value landholders receive reduced rates at the expense of lower value landholders. Moreover, it eases the pressure on commercial landholders to change or give way to higher value uses.

Analysis of reforms

Economic and political context

Fluctuations in the ACT economy are driven largely by public sector employment, which is often countercyclical i.e. employment in the ACT and thus growth in Gross State Product (GSP) often moves in the opposite direction to Australia's GDP (see ABS 5220).

Federal public sector wage freezes and limits on recruitment were likely constraining the ACT economy even before the Coronavirus induced recession (Gilfillan, 2019).

In recent years, ACT GSP per capita has been growing more slowly than GSP, indicating that some of the growth in GSP is driven purely by population growth (figure 9). However, the ACT remains the third highest GSP per capita jurisdiction in Australia, after Western Australia and the Northern Territory.

The ACT has the highest full-time average weekly earnings of any state and territory at $1829 compared to the Australian average of $1658 (Dec 2019). These factors, combined with the ACT's unique leasehold land tenure system and high reliance on federal public sector employment, make direct comparison with other states and territories complicated and problematic.

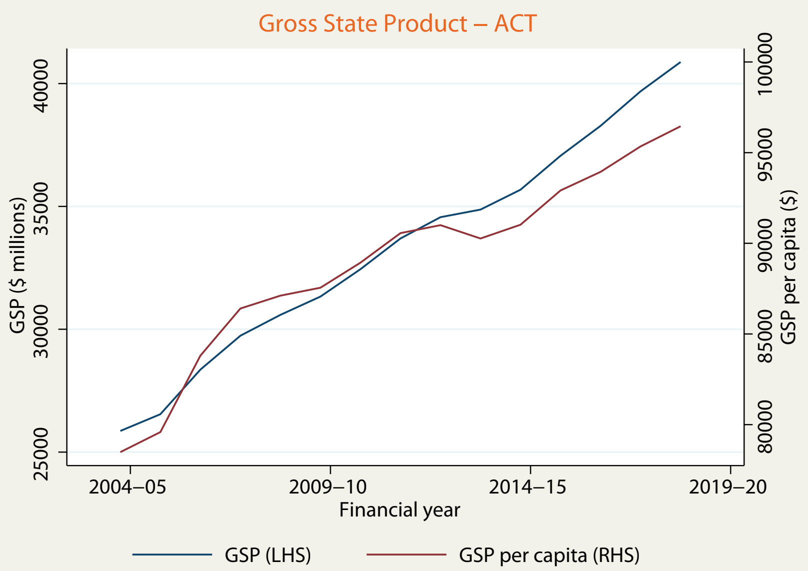

Figure 10. *GSP and GSP per capita.*
Source: ABS 5220 Australian National Accounts.

Revenue stability and predictability

In 2018-19, eighty-seven percent of ACT Government tax revenue came from five taxes: payroll tax, general rates, stamp duties, vehicle registrations and land tax (Figure 10). As intended by the 2012 tax reform package, stamp duties have been steadily declining as a percentage of ACT Government revenue while revenue from general rates has been steadily increasing (Figure 11). Insurance duties have been completely abolished since 2015-16.

The ACT has general rates, which represents a tax on unimproved land value paid by all property owners, and land tax, also a tax on unimproved land value, but paid only on residential properties that are not the owners' primary place of residence (primarily investment properties). Owners of dwellings that are not the owners primary place of residence must pay both rates and land tax. These two taxes combined, in 2018-19, made up 37.6 percent of the ACT Government's tax revenue.

Revenue stability

Comparing Treasury revenue forecasts for each tax with the budget outcomes for that year shows that the reforms have delivered substantial improvements in revenue stability and predictability. Despite a steady decline in stamp duties as a proportion of ACT total tax revenue, stamp duty revenues remain volatile and impact on the volatility and predictability of total revenues. General rates revenues, on the other hand have been smoothly increasing along with marginal rates and land values (Figure 11). The mean absolute percentage error (MAPE) in ACT Treasury forecasts for stamp duties between 2006 and 2019 was 19% compared to less than 1% for rates (table 2).

> For the years 2006-07 to 2011-12 Treasury revenue forecast error averaged 7.9%. In the years since the reforms began, forecast error has fallen to an average of 2.6% (Figure 12).

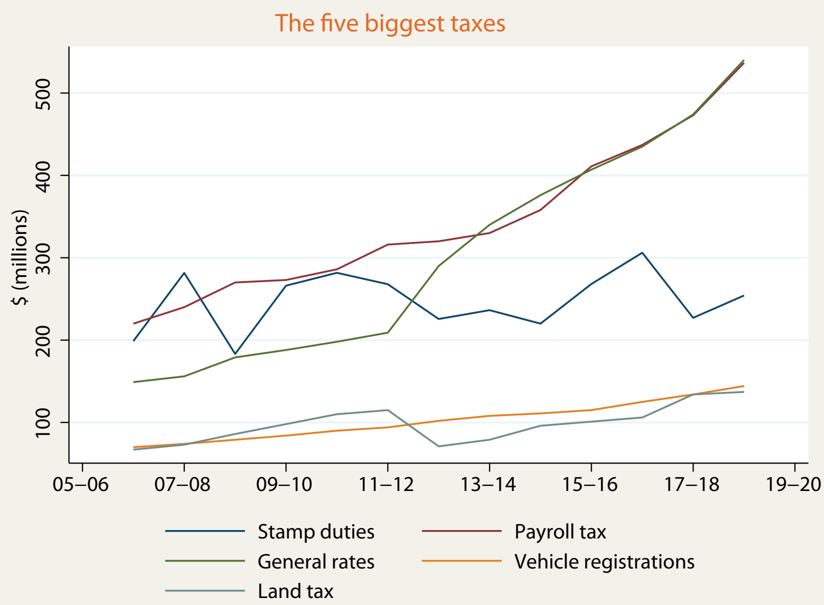

Figure 11. *The five biggest ACT taxes. Source: ACT Budget 2007-2019.*

As Figure 11 illustrates, as the reforms have progressed overall revenue predictability has improved because stamp duties are playing a steadily smaller part in overall revenue.

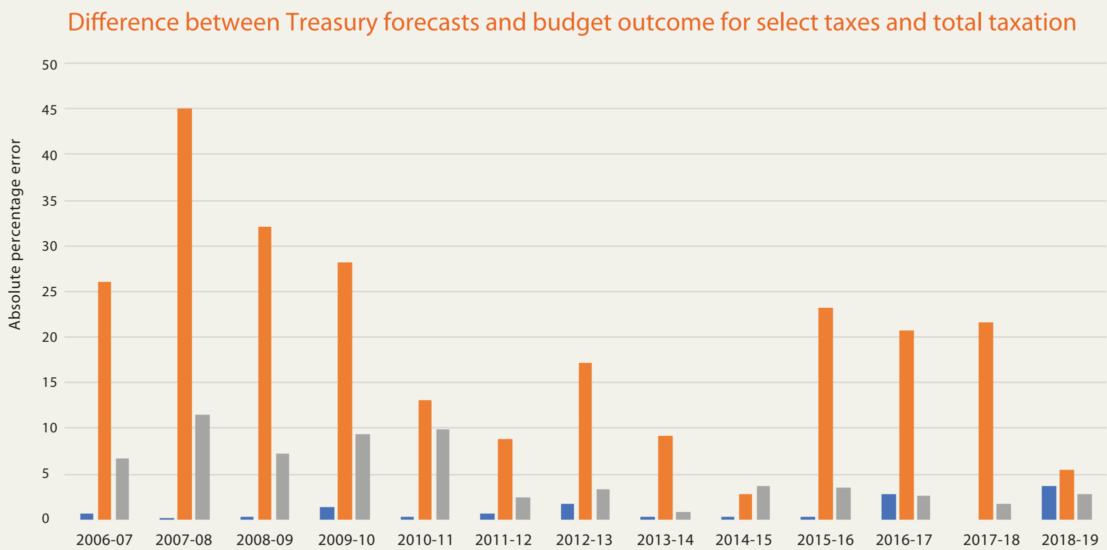

Figure 12. *The percentage error between ACT Treasury forecast revenue and actual revenue. The overall revenue predictability impact of the reforms can be seen in the contrast between the error for total taxation in the pre-reform period and the post-reform period. Source: author calculations from ACT Budgets 2007-2019.*

Tax	MAPE
Payroll Tax	2.11
General Rates	0.95
Land Tax	1.77
Conveyances	19.49
Total Taxation	**5.04**

Table 2. *Mean absolute percentage error (MAPE) in tax revenue forecasts by tax type 2006-2019. Source: author calculations from ACT Budget statements 2007-2019.*

Efficiency of the tax system

> Had stamp duties remained 23% of revenue, as they were prior to the commencement of the transition, stamp duty revenue would have totalled $436 million (2018-19). Due to the reforms they totalled just over half that, at $254 million.

The Federal Treasury estimates the marginal excess burden of stamp duty as 72c in the dollar (Cao et al., 2015). Assuming the accuracy of these estimates, the ACT economy will now be more than $130 million better off per year as a result of the transition to general rates. This represents about 0.3% of the ACT's approximately $41 billion GSP.

The *Centre of Policy Studies'* analysis (Adams, P. D., Nassios, J., & Sheard, N. 2020) of the reforms suggests similar numbers. It was estimated that *cumulative* real GSP had increased by $302 million over the first 6 years, but about $100m of this gain occurred in the last year due to lower tax rates. It also suggested that cumulative real household consumption had increased by $78m, real investment by $52m, employment by 0.11% and real wages by 0.05% over the same period.

However this study also took revenue neutrality as an inbuilt assumption. Counterfactual stamp duty revenues were assumed to further cut rates (which have a positive marginal excess burden), rather than assuming rates independently increased at the previous policy settings (like all other papers had). It also (like all CGE models) uses a representation of stamp duties that potentially overestimates their effects - in this case, framing them as a tax on "*moving services*"; something constructed as "... *labour-intensive to produce*". Whereas others (Murray, C. 2018) suggest that this is a flawed approach, and the burden is primarily on land (like rates).

When it comes to the efficient allocation of housing, we would expect reducing transaction costs to result in more appropriate use of the housing stock. While there has been little change in the reform period so far (Figure 13), we would expect this to be a slow transition taking place over decades, as only decisions at the margins will be affected and housing turnover is slow.

As noted above, the incentive for older Australians to downsize to more appropriate housing is complicated by the exclusion of the primary place of residence from the pension assets test. The result is that downsizing and banking the difference in price can reduce pensioners' income.

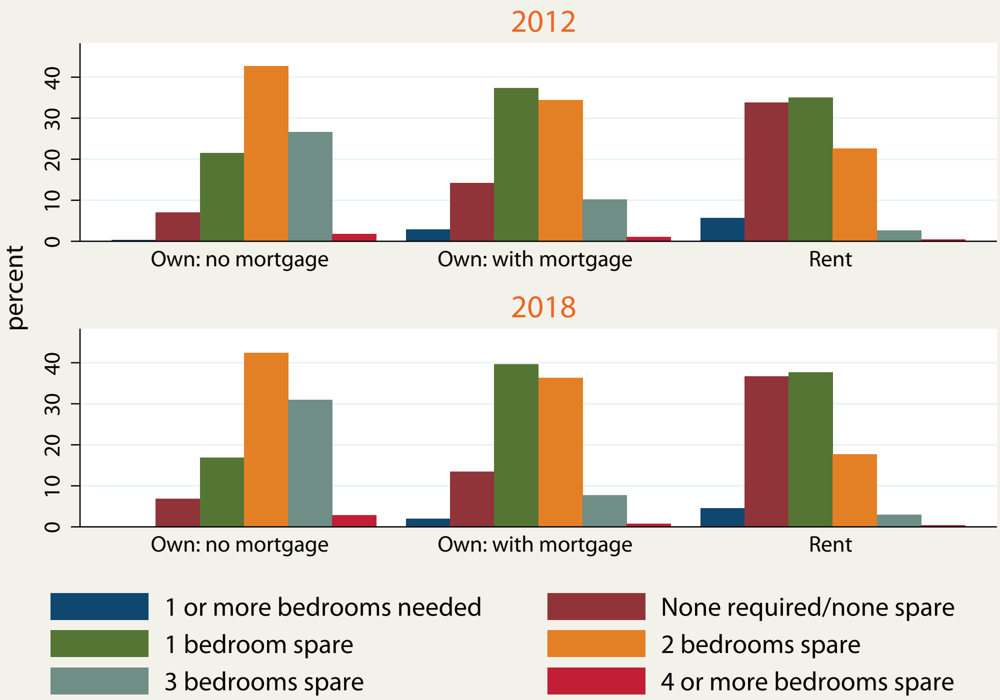

Figure 13. *Housing appropriateness in the ACT. Source: ABS survey of income and housing 2012 and 2018.*

Equity

Taxation revenue in the ACT is shifting steadily away from an arbitrary tax on property transfers towards taxes on land value. As a result all property owners, who are the beneficiaries of ACT Government services, contribute to the provision of those services. By contrast, a high reliance on stamp duties means that those who stay in the same home for decades have their services subsidised by those who move more often.

Despite falling marginal rates for stamp duties, sale prices have been climbing. This has left total revenue from stamp duties little changed during the reform period (Figure 11). As a result, stamp duties are still a very substantial tax in the ACT. The true impact of the reforms will be felt over the next 12 years as stamp duties are phased out completely.

> *"The ACT is almost mid-way through a 20-year tax reform program to replace stamp duty with general rates. While stamp duty rates have been reduced, the rise in the median price of homes in the ACT means that the stamp duty bill on a median priced home has dropped by just 1.2 percent since the last edition of Stamp Duty Watch in May 2019. The stamp duty bill of $16,368 on a median priced home in the ACT ($615,000) still ranks as the fifth highest amongst the states and territories." (Housing Industry Association, 2019)*

> Given its control over land supply and lease variation, the ACT Government has substantial control over land prices in the ACT. By dramatically increasing land supply the ACT could, theoretically, drive land prices down.

However, increased reliance on land values as a source of revenue, both from general rates and from the sale of leases, entails an incentive for the ACT Government to use its control over supply to keep land prices, and thus revenues, high and stable. As Territory expenditure requirements increase with an aging population, the Government may have little choice but to maintain high land prices.

First home buyers still benefit despite high land prices. The ACT's tax system has become more progressive as a result of the reforms, and better aligned with ability to pay. A greater proportion of rates and stamp duty are now paid by the highest wealth and income quintiles (NATSEM and TTPI, 2020). The exception being the second wealth quintile, which both substantially increased its volume and value of purchases (and thus stamp duty paid) as a result of the reforms. Price rises, potentially induced by the reforms, may have eroded some of the gains for lower income and wealth households.

In terms of equity outcomes, NATSEM found:

> *"..., the group that gained the most were renters where a woman was the head of the household (as reported in the survey) at 6.35%. These are usually single parent families, a group with lower incomes, who would benefit from the reduced stamp duty."*

Economic rent

Land as an asset can yield rental income, which may be realised by leasing it, or be invisibly "imputed" to the owner-occupier if they choose to use the land themselves and forgo that income. Notably imputed rent is not taxed as income. Land can also accrue in value (an unrealised capital gain). Both sources of income constitute an "economic rent" - income that arises from ownership of a property right, rather than by production.

> Despite substantial increases in average rates charges, the average residential landowner paid $15,039 in rates during the reform period (between 2012-13 and 2019-20) but saw their land value rise by $63,681 over the same period (Table 6, Appendix).

More than $6,000 in net economic rent per year, on average, still remains with the landowner over that period. This does not include 'invisible', untaxed imputed rental income.

This is contrasted with $5,407 in rates over the previous four years pre-transition and a land value gain of $107,733. This equates to a net economic rent gain for the average landowner of more than $25,000 per year. These two periods can only be compared with caution due to the small number of pre-reform years for which we have land value data.

Land value growth appears to have slowed during the reform period (Figure 20) but many factors influence land prices other than taxation, including the supply of residential land and increased amenity.

Impact on investors vs owner-occupiers

Since the reforms began, owner-occupier finance has dramatically outpaced investment finance (Figure 14). The trend also starts prior to APRA's macroprudential changes to investor financing, and prior to elimination of stamp duty for first home buyers.

Prices have also increased, which means we cannot know if owner-occupiers are buying more property proportionately, in absolute numbers, or are using the stamp duty savings to pay more for property (buying more property value).

Rising prices and stable investor finance would also suggest investors are buying less property, all else equal. In 2012, homebuyers made up about 60% of the purchases by value. In 2020 they now make up about 78%.

One possible explanation for this trend is that owner-occupiers are replacing investors in the market as a result of the tax reforms. Investors who are negatively gearing for capital gains returns may be leaving the ACT housing market for cash flow reasons as a result of increasing rates charges. Investors are also more likely to factor in the present value of future rates increases into their demand. If this is true, it is having little or no impact on prices as owner-occupiers step into the breach. Overall, this is a positive outcome for housing in the ACT as more residents are able to own their own home.

The ACT also reduced progressive residential land tax rates in 2014-15, and increased fixed charges on investors. It is not clear what effect (if any) this may have had. Investors may have potentially shifted their preferences away from lower AUV apartments, and towards higher AUV detached homes.

This trend also indicates that additional rental supply is *not coming from investors purchasing more properties*. Other explanations could include *homeowners converting their homes into rental stock, and purchasing an additional home to move into.* This could be attractive in a strong rental market, with future stamp duty cuts providing higher future sales prices for those who delay selling.

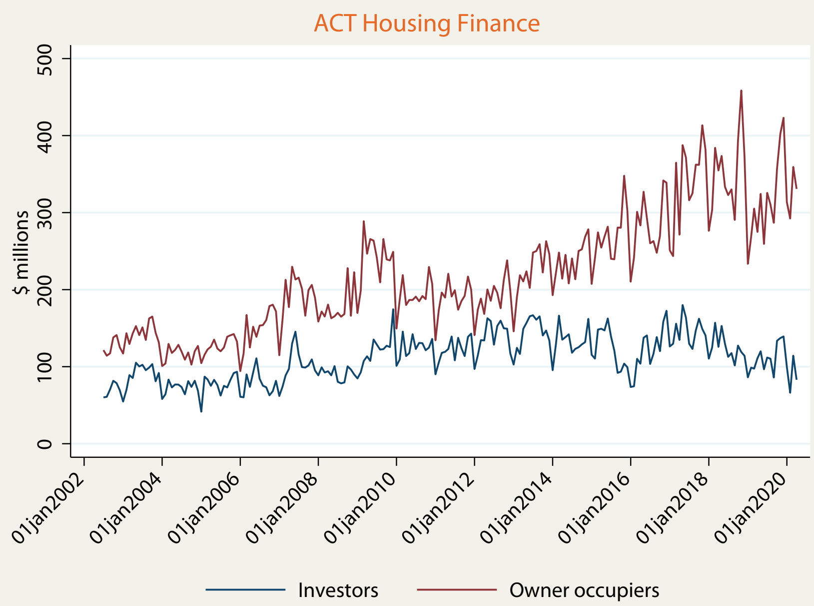

Figure 14. *Total finance for investors and owner-occupiers in the ACT. Source: ABS 5601.*

The impact on prices, rents and turnover

Prices

With the exception of Perth, all mainland capital city house prices have followed a similar trajectory since 2012. Prices in the ACT have closely tracked those in Melbourne, with Sydney outpacing both (Figure 15).

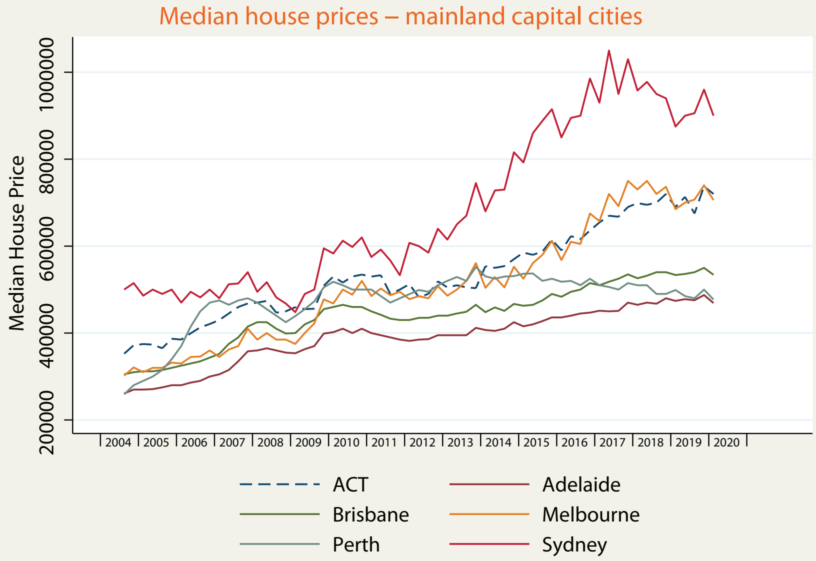

Figure 15. *Median house prices - mainland capital cities. Source: ABS 6416 Residential property price index.*

> In theory, the price impact of increased land taxation is likely to be negative because, to some extent, prospective buyers factor land tax obligations into their purchase price.

Alternatively, it constrains their ability to buy by reducing the disposable income available to borrow against. However as noted by NATSEM (2020), obtaining a deposit is a far greater obstacle to purchasing property than mortgage repayments (and by extension rates). By contrast, the price impact of reduced stamp duties is likely to be positive. Additional up-front cash, saved from being paid in stamp duty, may be leveraged as part of a larger deposit, meaning prices could rise at greater than one dollar per dollar of stamp duty reductions.

"On the demand side, conveyance duty can be a barrier to entry as it introduces an artificial time lag between the points where individuals decide to acquire a dwelling and are financially capable.

Removing conveyance duty would, in the short-term, reduce the amount of savings required to place a deposit on a property purchase for individuals who are trying to enter the housing market, or are considering moving to another property, and do not receive a concession.

However, as the demand for dwellings is brought forward, there would be a short-term increase in demand for properties which would place upward pressure on prices.

While the removal of conveyance duty would not result in permanently elevated demand for housing, there would be a sustained increase in the price of property. This would be due to lower transaction costs impacting the level of speculation, and property owners increasing the price of the property to capture the amount of conveyance duty removed. Any reform would need to be accompanied by unconstrained supply." (Quinlan, 2012)

How these two balance out in a rational market will be determined by the rate of land tax, the turnover rate of properties, and capitalisation rate (Murray, 2018).

> If buyers think the present value of future land tax obligations is less than the present value of the stamp duty reductions then prices will rise. If it's the other way around they will fall.

These notions of present value assume that buyers think rationally about future costs. While many investors do make careful calculations about the present value of future costs, we have known for many years that most owner-occupiers do not (Phipps, 1988). Instead, they tend to choose the best property (house, location) affordable to them right now. This is reflected in the lower pricing trajectory in the commercial sector compared to residential property.

It is difficult to determine how the reforms have contributed to the recent trajectory of unit and house prices because many factors influence price, including supply of new housing, population growth, the state of the labour market, interest rates, investor sentiment as well as broader national and international economic conditions. The extent to which price movements in Sydney, Melbourne and Canberra mirror each other demonstrates the dominance of broader economic conditions and federal government policy in the large scale trends of housing market outcomes (Figure 16).

The ACT Government commissioned two reports to investigate effects of the reforms on prices. Both found that the reforms had increased prices. The *Centre of Policy Studies'* modelled analysis (Adams, P. D., Nassios, J., & Sheard, N., 2020) used NSW land within a certain distance of the ACT as a counterfactual. Its findings suggested that the price changes were positive, but its results were inconclusive and likely affected by the ACT's ongoing densification. The *National Centre for Social and Economic Modelling*'s analysis (using a few different counterfactuals) suggested these price increases could be up to 2% (NATSEM and TTPI, 2020).

Attributing any particular portion of price changes to relatively small annual taxation changes is difficult without a counterfactual. Some counterfactuals are also more suitable than others. In the following section we compare changes in ACT property prices with those of neighbouring domicile Queanbeyan, NSW.

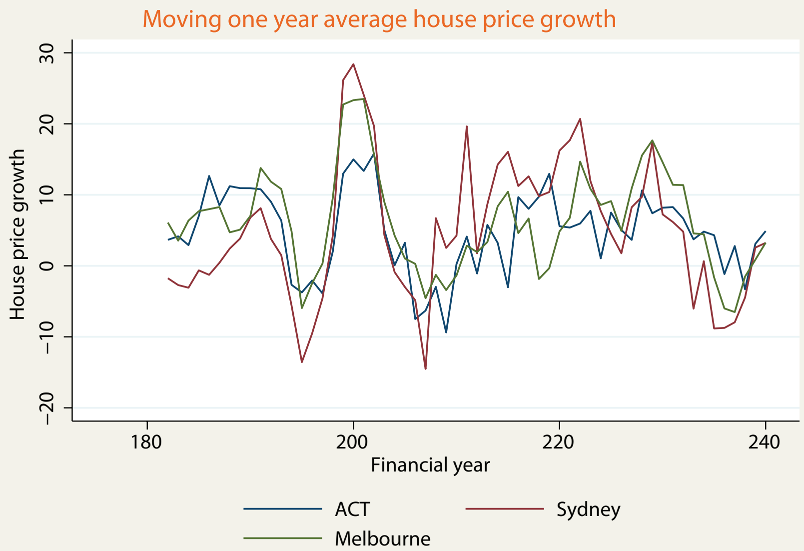

Figure 16. *House price growth in Sydney, Melbourne and Canberra. Source: ABS 6416.*

Comparing Canberra with Queanbeyan

Queanbeyan is a small NSW city that is located on the border with the ACT. The two are effectively part of the same housing market. As Quinlan (2012) notes: "Canberra is a significant employment hub for surrounding NSW. On average, more than 21,000 people commute daily from NSW to the ACT for employment. An estimated 4,300 Canberrans commute to NSW daily for employment, mostly to Queanbeyan."

This makes Queanbeyan an ideal natural experiment to examine the impact of the reforms because, despite being part of the same housing market, the taxation of Queanbeyan houses has not undergone the stamp duty to land tax shift.

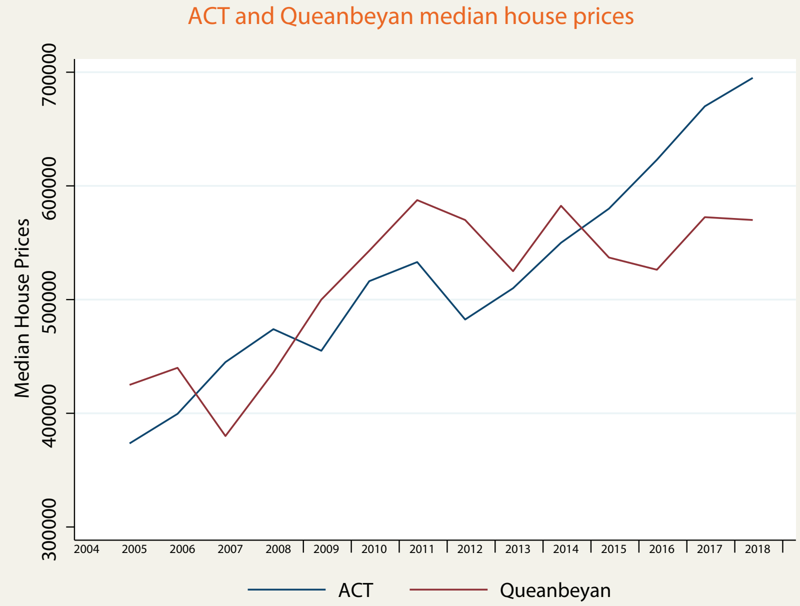

Figure 17. *ACT and Queanbeyan median house prices over time. Queanbeyan prices have remained relatively stable since the commencement of the reform period while ACT prices have risen sharply. Source: ABS 6451 and CoreLogic data.*

By dividing ACT median house prices by Queanbeyan median house price it's possible to examine relative movements in the price before and after the reforms.

This analysis shows ACT prices staying steady relative to Queanbeyan prior to the reforms and then increasing relative to Queanbeyan after the reforms (Figure 18).

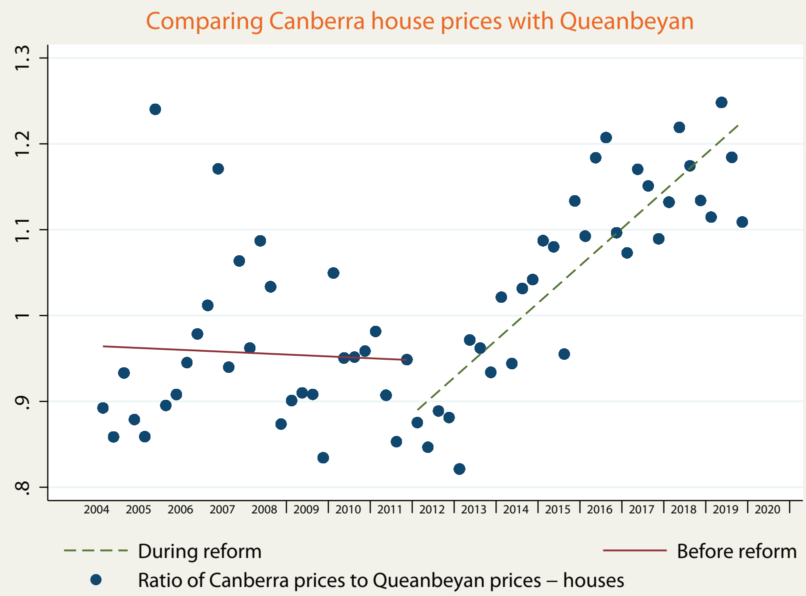

Figure 18. *The ratio of ACT median house price to Queanbeyan median house price over time. The solid and dashed lines represent linear regressions separately fitted to the two periods. Source: ABS 6451 and CoreLogic data.*

While it seems unlikely that the ACT tax transition is entirely responsible for this sharp increase in ACT house prices relative to Queanbeyan, it does indicate that, on balance, the reduction in stamp duties has lifted prices more than they have been depressed by increased rates.

Several local Canberra and Queanbeyan real estate agents, spoken to during the preparation of this report, advised that, if anything, the desirability of Queanbeyan had increased over the reform period, with substantial improvement of the town centre and attractive new developments in Queanbeyan's growth suburbs. This anecdotal evidence supports the notion that relative Canberra price rises have been a result of the tax reform process, rather than other market changes.

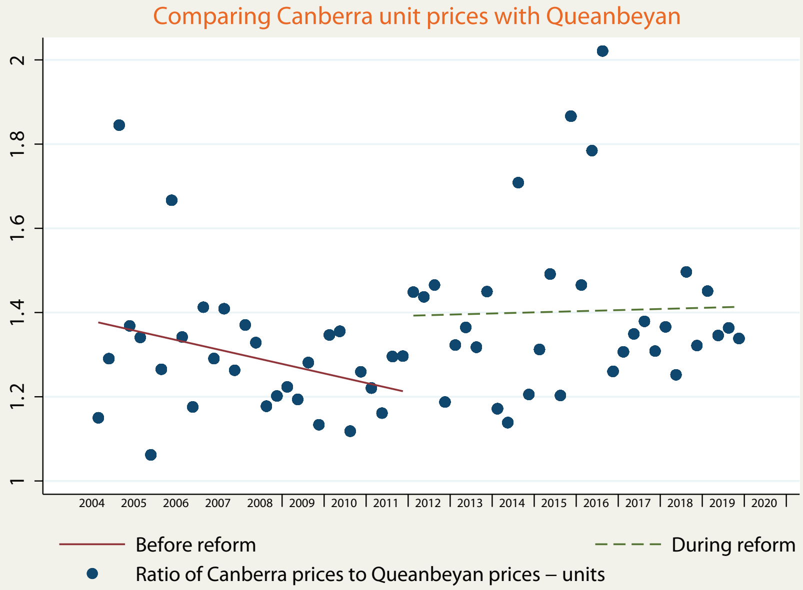

Figure 19. *The ratio of ACT median unit price to Queanbeyan median unit price over time. The solid and dashed lines represent linear regressions separately fitted to the two periods. Source: ABS 6451 and CoreLogic data.*

The ACT's urban densification strategy complicates comparisons with Quenbeyan. Queanbeyan contains mostly detached dwellings, but the majority of new housing development in the ACT is attached dwellings and units due to the strategic preference for infill and higher density development. It is notable that unit prices after the transition have remained stable relative to Queanbeyan (Figure 19), which is due to ACT unit prices remaining stable (Figure 20).

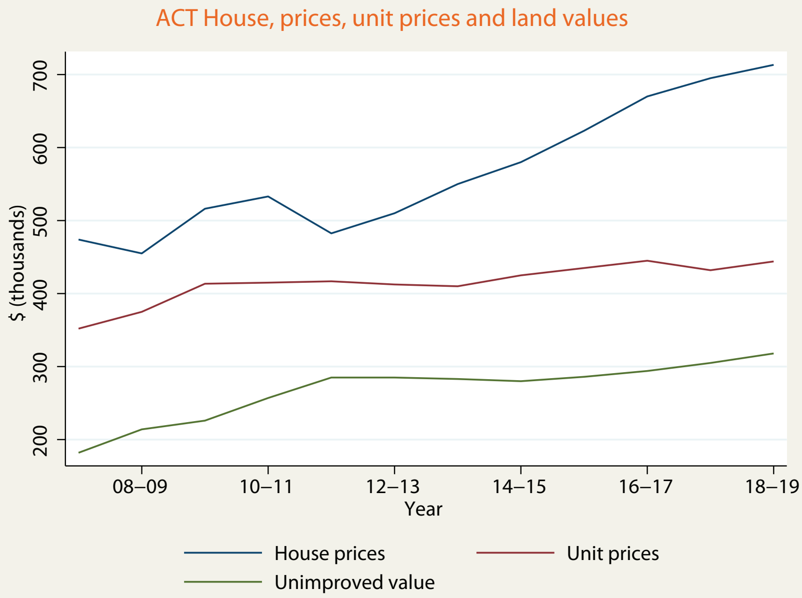

Figure 20. *Median house, unit and land values in the ACT. Slower growth in land values since the reforms began has not been reflected in slower growth in house prices. Source: ABS 6416 and author calculations from land value data supplied by the ACT Government.*

We find that increasing dwelling completions are correlated with suppressed unit price growth (Figure 21), which could explain the relatively slower growth in unit prices (Figure 20). As detached dwellings in the ACT become relatively more scarce, their price premium in the ACT will continue to increase. This factor is likely to have had some influence in the significant pricing differential between Queanbeyan and the ACT (Figure 18).

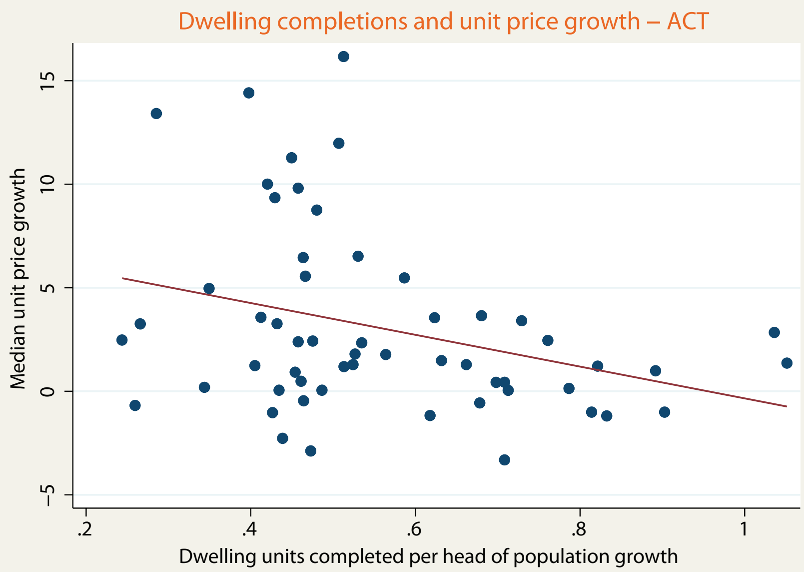

Figure 21. *The impact of dwelling construction on unit prices in the ACT.*

These results should serve to allay any fears that the tax transition is a threat to property prices in the ACT. The steep rise in rates revenue has not deterred buyers. It also appears to be shifting the balance towards more homeowners over investors (see Figure 14 *Impact on investment vs owner-occupiers*).

Impact of reforms on commercial land values and turnover vs impact on residential values

The changes to general rates charges for commercial land are perhaps the most dramatic of the reforms to date (see Figure 22). Rates for commercial land moved from 0.73% in 2011 to a progressive rate of between 3 and 5.15% in 2019 (partly offset by the abolition of land tax on commercial land).

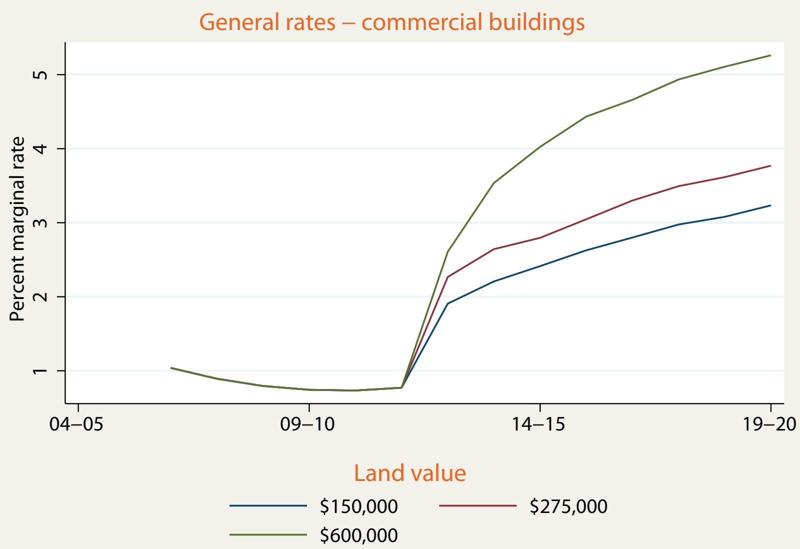

Figure 22. *Commercial rates - marginal percent of unimproved land value. Source: Taxation administration (Rates) Determinations, 2007-2019.*

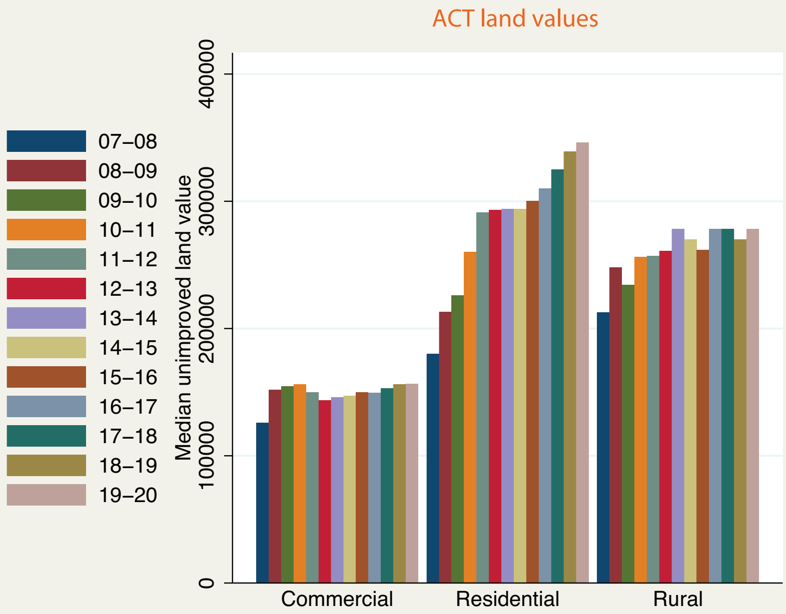

Figure 23. *Median land values by use for ACT blocks that were valued in 2007. Source: Author calculations from ACT government provided valuation data.*

It appears that this substantial increase in rates has flattened commercial land price growth when compared with residential land (Figure 23).

> Commercial real estate investment decision making is more likely to be influenced by rational calculation of future cash flows than residential purchasing, particularly by owner-occupiers.

Prices that owner occupiers are able to pay are more restricted by deposits than future cash flows, which means that the positive impact of stamp duty reductions on prices are likely to be more significant for owner occupiers than the negative impact of rates increases.

> In addition, commercial investors are more driven by rental return and less by capital gains when compared to residential investors. These factors combine to explain the different impact of the reforms on commercial land versus residential land.

Rents

At the start of the reform period rents fell sharply, implying a dampening effect of the reforms on rental prices (Murray, 2016). However, from 2016 onwards Canberra rents increased to the point whereby Canberra was the most expensive capital city in Australia in which to rent a house at the end of 2019 (Domain, 2019). Sydney has since retaken the most expensive rental city crown, but Canberra is a very close second.

Illustrating the complexity of the real estate market, there is a strongly positive relationship between rental prices and dwelling supply (Figure 25). This may be driven by higher rents in newer properties or it may be that rising returns prompt redevelopment of multi-dwelling units. Alternatively, it may be just that prices have been increasing over time and this has increased incentives for multi-unit developments.

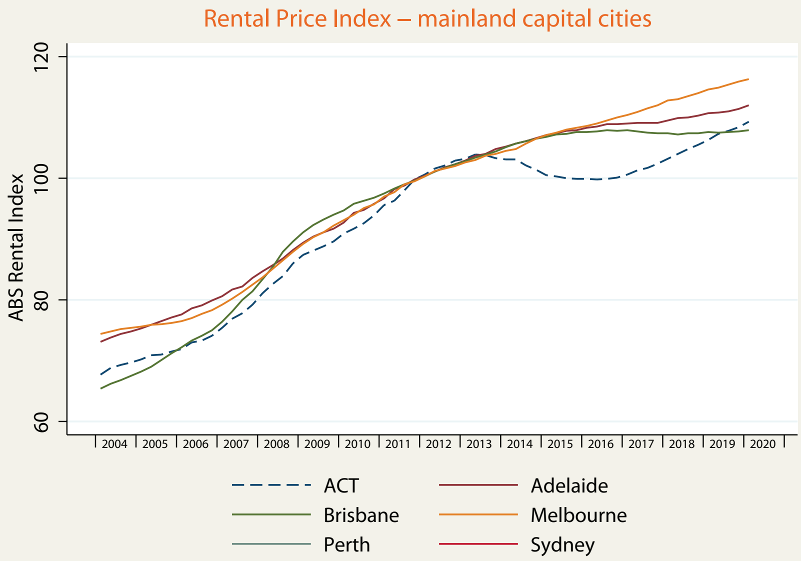

Figure 24. *Mainland capital city rental price index. Source ABS 6401.0 Consumer Price Index.*

The Tax and Transfer Policy Institute's (TTPI) analysis (NATSEM and TTPI, 2020) indicates that the reforms may have increased rental supply by 200 properties per a month. They suggested it is likely that some other factor is affecting supply differently in the ACT compared to the rest of Australia. This seems difficult to reconcile with the investor financing data (Figure 14), and supply being correlated with higher rents (Figure 25).

The TTPI also suggested that existing homeowners may have bought an additional property as their new home, and converted their previous home into rental stock while waiting for further stamp duty cuts before selling. Such a strategy would allow existing property owners to capitalise on the strong rental market while moving into more suitable housing. This explanation would also fit with differences observed in turnover and price trends between units and houses.

The TTPI also found the reforms have resulted in downward pressures on rents. Interestingly, these effects were progressively distributed. Rents in the lower four quintiles were estimated to have fallen 2-16% (depending on specification, data, and dwelling type). However rents increased in the top quintile. This gives more support to the explanation that existing homeowners are buying up in the property market, and leasing out their previous dwellings (which would be at the lower end of the market).

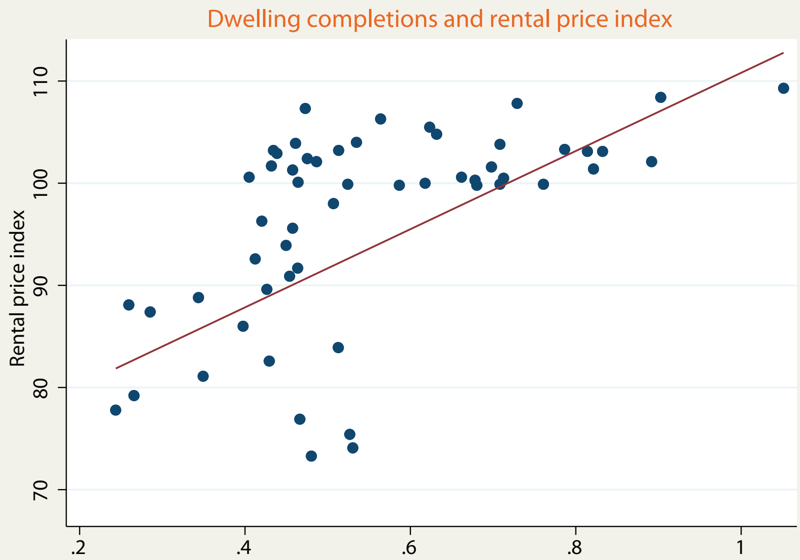

Figure 25. *Higher numbers of completed dwellings are associated with increased rents.*

This could also explain why rents have been increasing with increasing dwelling completions (Figure 25). If homebuyers are driving increasing dwelling demand, and this is concentrated at the higher end of the market, *it is possible that rents have increased due to higher end rental stock being in shorter supply despite ongoing completions.*

These results however could be also driven by other factors, such as the ACT's densification strategy. Higher rents (which create a rent-gap relative to current use) are also necessary to make intensification financially feasible and attractive. The ACT's shift to focus on infill and reducing greenfield development necessitates higher land values and rents.

Turnover

The Quinlan review predicted that a 10 percent change in conveyance duty would result in a 1.5% increase in transactions (Quinlan, 2012). Since the reforms began, we have seen fewer *detached houses* turnover (Figure 26). However, this has been a nationwide trend, and is not attributable to the reforms in the ACT.

The ACT Treasury's revenue neutrality report revealed that the trend of declining *residential property* transfers (that includes units) has reversed, returning to a long-run positive trend (pre-2018 before implementation of barrier free conveyancing distorted the numbers). This difference in trends could be explained in part by the ACT's urban densification strategy - now just over half of residential transfers in the ACT are houses. However, NSW also experienced a similar trend (NATSEM and TTPI, 2020).

The *Centre of Policy Studies'* (COPS) analysis (Adams, P. D., Nassios, J., & Sheard, N. 2020) suggests that the reforms have increased turnover. The ACT Treasury has endorsed these findings. The COPS study also noted that the transition of anticipated future cuts to stamp duties could cause some vendors to delay selling. However they suggested that rising prices meant this effect would be unlikely, as rising prices have in many cases resulted in absolute amounts of stamp duty increasing.

We note that empirical results using difference-in-difference analysis have been inconclusive. The *National Centre for Social and Economic Modelling*'s analysis (NATSEM and TTPI, 2020) found that buyer purchases had increased. It must be noted that this model assumed that everyone who met the capacity to buy property did so. This explains why the NATSEM empirical analysis suggested it was possible that turnover had even fallen:

> *"The finding that the number of sales decreases, or at least does not increase, with reduction in stamp duty does not support the theoretical argument that a reduction in transaction costs will eliminate inefficiencies in the market and lead to increased activity. It suggests that the tax might not play as big a role in the overall decision to buy/sell a house as previously thought. This finding warrants further investigation."*

Whilst both ACT Treasury funded reports came up with contradictory modelled turnover outcomes, we believe that the long run effects of the reforms on turnover won't be known until the transition approaches completion. The impacts of densification and the transition model mean it is presently difficult to draw conclusive answers to effects on turnover.

Housing turnover: selected capital cities

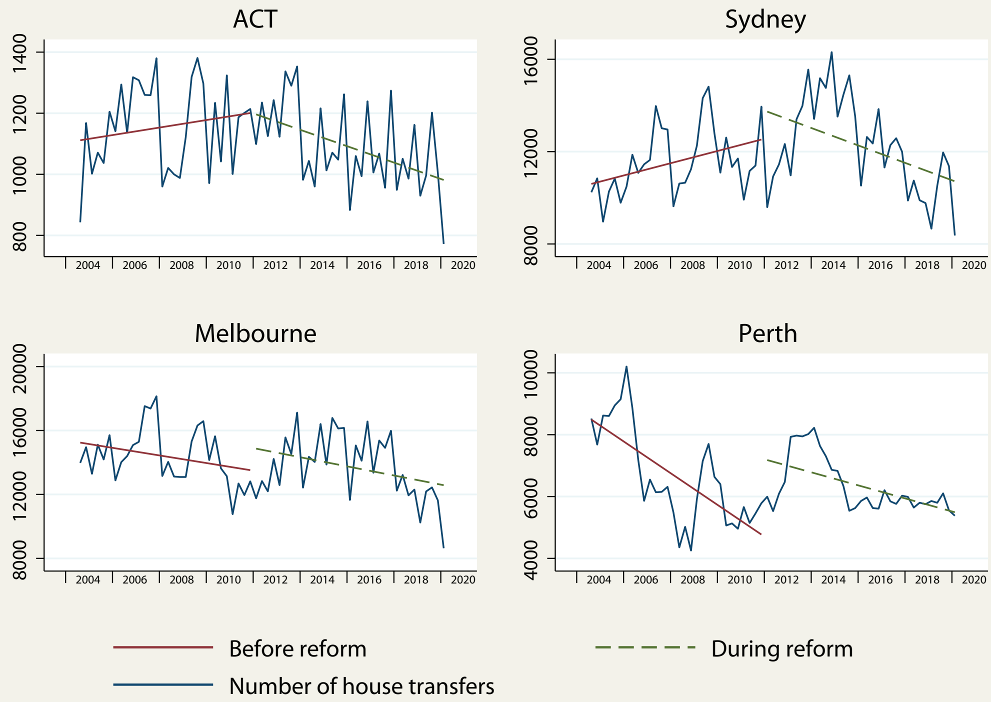

Figure 26. *Quarterly house transfers have fallen since the beginning for the reforms in the ACT and in other capital cities. Source: ABS 6416.*

Unit turnover: selected capital cities

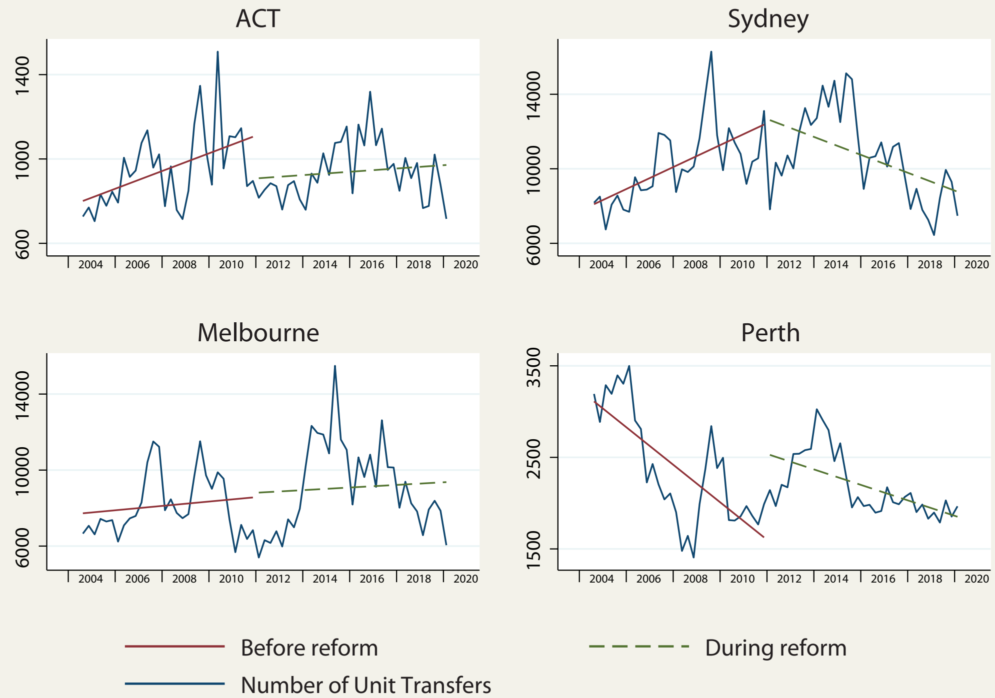

Figure 27. *Quarterly Unit Transfers. Source: ABS 6416.*

Total turnover: selected capital cities

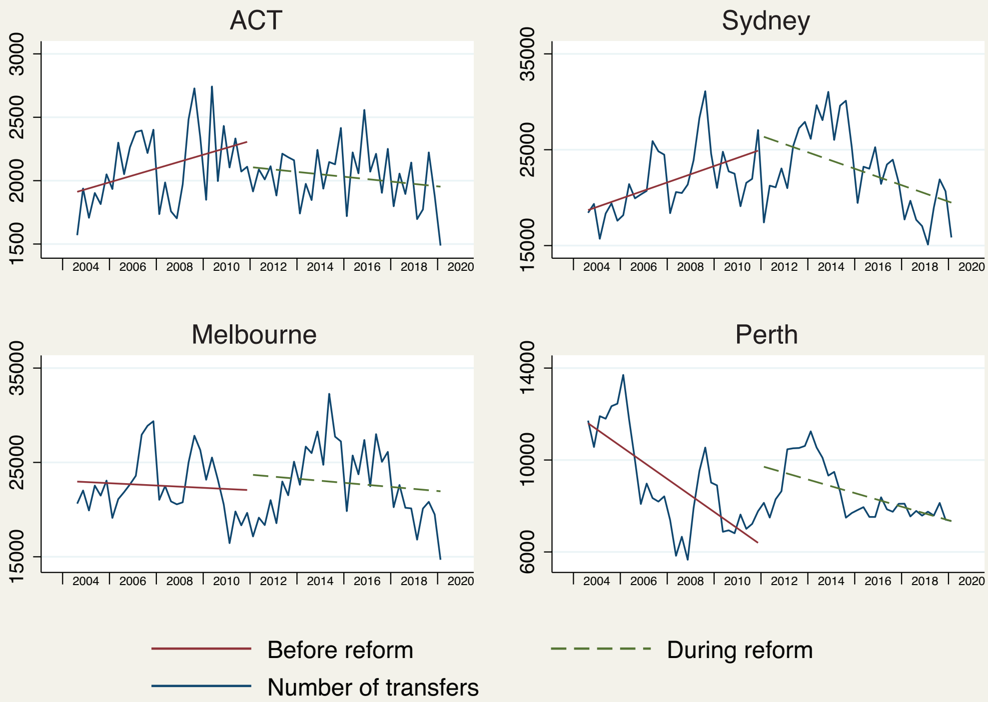

Figure 28. *Quarterly total transfers (houses plus units). Source: ABS 6416.*

Revenue neutrality

While ACT government revenues have grown substantially over the reform period, so have those of other states and territories (Figure 29). The need for revenue growth in all jurisdictions has been driven by increasing costs of service provision, particularly healthcare and aged services. In the last few years ACT revenues have been growing faster than other states and territories. This was driven by increases in real estate prices (Figure 16), and the flow onto rates, land tax and stamp duties, as well as due to increases in payroll tax receipts.

Revenue growth: all states and territories

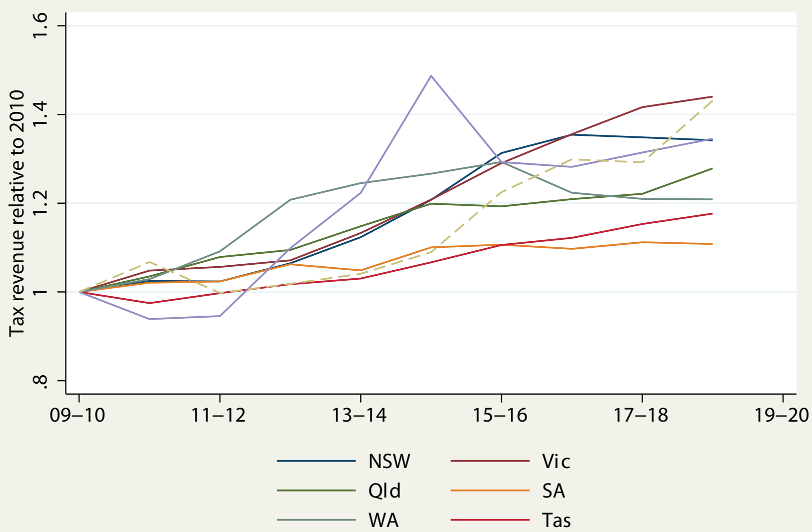

Figure 29. *Inflation adjusted revenue growth: all states and territories, including both local and state government revenues. Revenue set at 1 for 2009-10 for comparison. Source: Author calculations from ABS 5506.*

Had the tax reform not taken place, a similar trend would have occurred through revenue increases from the same taxes though the proportional contribution of stamp duties and rates would have been reversed, as the following graphs demonstrate.

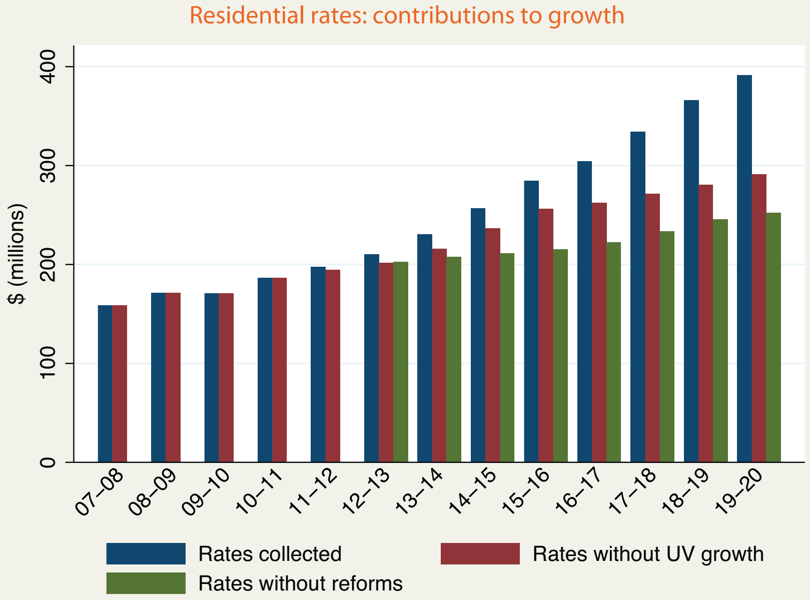

Figure 30. *Residential rates collected, rates that would have been collected if the reforms had not taken place and rates that would have been collected if unimproved land values (UV) had not grown. Rates without reforms are calculated using the same methods and marginal rates as in 2011-12 and their increase is, therefore, driven by a combination of number of properties and land value increases.*

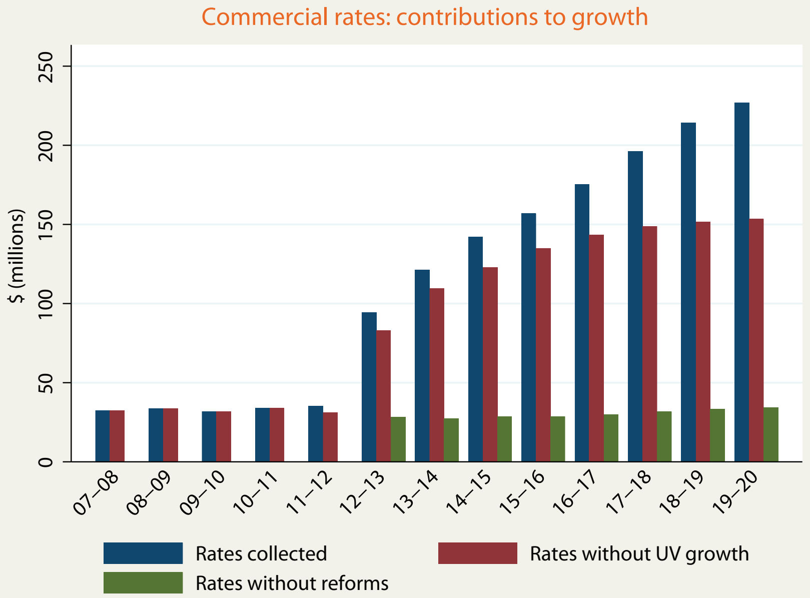

Figure 31. *Commercial rates collected, rates that would have been collected if the reforms had not taken place and rates that would have been collected if unimproved land values (UV) had not grown. Rates without reforms are calculated using the same methods and marginal rates as in 2011-12.*

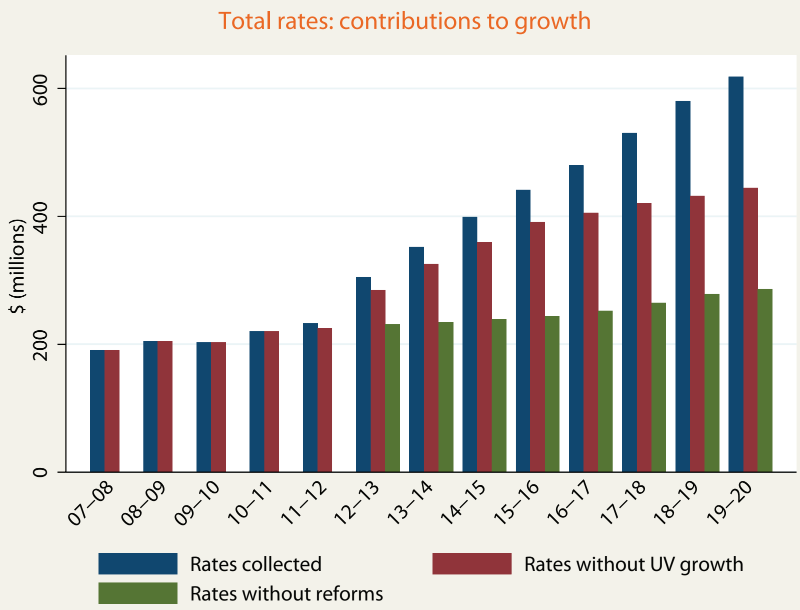

Figure 32. *Total rates collected, rates that would have been collected if the reforms had not taken place and rates that would have been collected if unimproved land values (UV) had not grown. Rates without reforms are calculated using the same methods and marginal rates as in 2011-12.*

Since the reforms began, the ACT Government has conducted two reviews into revenue neutrality. The first was for the 2015-16 ACT Budget, in preparation for the second five-year transition period (ACT Treasury, 2016).

The 2016 modelling confirmed that the transition had been revenue neutral as intended with general rates replacing the lost revenue from stamp duties and insurance taxes (Figure 11).

> With land prices and house sale prices rising substantially during the reform period, revenues have risen quite sharply, particularly from general rates. However, stamp duties would also have risen sharply, driven by the same trends, had the rate cuts not been implemented.

Since the first Treasury review of revenue neutrality, rates revenue has continued to rise sharply (figure 11), and residential property price growth has increased (figure 15). However, turnover has fallen (figure 26). Given that house prices have been rising faster than land values (figure 20), all being equal, stamp duties would have risen faster than rates.

The second Treasury review examined the revenue impacts over the first 7 years of the reforms (ACT Treasury, 2020). This recent review, supported by commissioned independent analysis, confirms once again that all being equal, stamp duties would have risen faster than rates.

The 2020 review is comprehensive, picking an appropriate counterfactual benchmark (the previous policy settings). It also considers potential tax base changes resulting from the reforms, and accounts for the increased progressiveness of the rates and stamp duty regime. Notably, it also assumes that the reforms had no impact on property turnover (see: Turnover).

The review found that if anything, the reforms had been slightly on the negative side, and were overall "broadly revenue neutral". The Government was estimated to-date to have forgone $128m from the residential sector, and raised an additional $66m from the commercial sector. However taxes on the commercial sector were largely offset by a $62-65m reduction in payroll taxes due to raising the payroll tax free threshold.

Even in the most extreme counterfactuals, it seems unlikely that the ACT has raised additional revenue since the reforms.

Conclusion

The motivation for this tax transition was to improve the predictability, efficiency and equity of the ACT's taxation system. Eight years into the twenty year transition it appears that the reforms are achieving all three objectives.

Government revenue has been far more stable and predictable during the reform period than it was before, and most of the volatility that remains is driven by the remaining stamp duties.

Efficiency in the tax system is difficult to demonstrate empirically due to the absence of a counterfactual. However, the shift away from volatile and inefficient stamp duties, the abolition of insurance taxes and the shift towards land taxes are likely to increase the ACT's Gross State Product by around $130 million per year and increasing, while the tax reforms have remained roughly revenue neutral. The reforms may also provide an incentive, at the margins, for more appropriate use of the housing stock. This will, however, take decades to flow through the housing market.

Despite the average residential landowner paying $15,039 in rates during the reform period their land value rose by $63,681, leaving them, on average, with more than $6,000 per year in unearned income from land value increases. These increases are the result of government and community activity and yet, only landowners benefit from them.

On the equity front, the number of first home buyers has risen and the incidence of taxation is shifting from people who buy and sell houses to those who monopolise high value and high quantities of land. The result is that the cost of provision of services to Territory residents is more evenly shared among all who own land.

While investors are reducing their relative share of the market, owner-occupiers are more than filling the gap, resulting in house price increases in Canberra relative to Queanbeyan, it's neighbour across the border in NSW. Any fears that rising general rates would drive down prices have been allayed. The ACT's property market is now driven overwhelmingly by owner-occupiers, who have possibly been increasing affordable rental supply by leasing (rather than selling) their former homes. The effects of the reforms have also impacted prices and turnover of units and houses differently. They are also entangled with changes in densification, and potentially the transition model itself. These factors require further investigation, as does the impact of the reforms on the prices and turnover of commercial property.

The ACT remains a very expensive place to rent and to buy and the tax transition has, so far, done little to improve affordability. Being heavily reliant on property based taxation gives the ACT Government incentives to keep property prices high and maintain growth. These incentives, combined with the Government's unique control over land and housing supply, is a recipe that is unlikely to lead to significant improvements in housing affordability. The flipside of this is reassurance to homeowners that rising rates have not eroded the value of their properties.

The economics of land and housing is complex. Investor and owner-occupier behaviour is influenced by a broad range of Territory and Commonwealth taxes and laws, including: negative gearing, capital gains tax, pension assets tests, stamp duty, land tax, immigration, land release, and land zoning, as well as prevailing economic conditions that impact wages and employment. As a result, the impacts of individual small annual changes in stamp duties and land taxes are likely to be marginal and will take time to play out.

Even without taking the current COVID-19 induced recession into account, broader economic conditions have changed substantially since *The First Interval* report, four years ago, when rents and prices in the ACT were softening. How things play out in the ACT over the next four years will depend on both the outcome of this years' ACT election and the Federal Government's response to the current recession, and the flow on impacts of that on the ACT labour market.

All told, after eight years, this bold experiment in tax reform is achieving all of the objectives that motivated the Government in 2012. It is improving revenue stability and predictability, it is making the tax system and the ACT economy more efficient, and it is sharing the funding of ACT government services more equitably and more progressively across the ACT population.

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Appendix

Table 3. ***Residential (non- unit titled) general rates - marginal rates***

Block AUV thershold	Marinal rates %
0 to $150,000	0.3197%
$150,000 to $300,00	0.4155%
$300,001 to $450,000	0.5197%
$450,001 to $600,000	0.5670%
$600,001 to $750,000	0.5767%
$750,001 and above	0.5817%

Table 4. ***Residential (unit titled) general rates - marginal rates***

Block AUV thershold [1]	Marinal rates %
0 to $600,000	0.4757%
$600,001 to $2,000,000	0.5885%
$2,000,001 to $3,650,000	0.627%
$3,650,000 to $4,850,000	0.7400%
$4,850,001 and above	0.7810%

NOTE:
1 For units, marginal rates are applied to the AUV of the block proportionate to its total residential unit entitlement. This is then multiplied by the unit entitlement, proportionate to the total residential unit entitlement of the block.

Table 5. ***Stamp duty schedule 2019-20. Source: Taxation Administration (Amounts Payable—Duty) Determination 2019 (No 2).***

Dutiable amount	Rate of duty
less than or equal to $200 000	$1.20 for every $100, or part of $100, of the dutiable amount
more than $200 000 but not more than $300 000	$2 400 plus $2.20 for every $100, or part of $100, of the dutiable amount that is more than $200 000
more than $300 000 but not more than $500 000	$4 600 plus $3.40 for every $100, or part of $100, of the dutiable amount that is more than $300 000
more than $500 000 but not more than $750 000	$11 400 plus $4.32 for every $100, or part of $100, of the dutiable amount that is more than $500 000
more than $750 000 but not more than $1 000 000	$22 200 plus $5.90 for every $100, or part of $100, of the dutiable amount that is more than $750 000
more than $1 000 000 but not more than $1 455 000	$36 950 plus $6.40 for every $100, or part of $100, of the dutiable amount that is more than $1 000 000
more than $1 455 000	a flat rate of $4.54 per $100 applied to the total dutiable amount

Table 6. ***Residential rates and land values. Author calculations from ACT Government supplied data***

Year	Average rates ($)	Rates (w/o reforms)	Average land value increase ($)
08-09	$1,317	$1,317	$33,649
09-10	$1,315	$1,315	$8,525
10-11	$1,364	$1,364	$34,335
11-12	$1,412	$1,412	$31,217
Pre-reform total	**$5,407**	**$5,407**	**$107,733**
12-13	$1,455	$1,400	$1,190
13-14	$1,549	$1,393	$3,040
14-15	$1,686	$1,385	$1,066
15-16	$1,832	$1,388	$5,946
16-17	$1,925	$1,409	$11,063
17-18	$2,070	$1,445	$16,152
18-19	$2,205	$1,479	$17,486
19-20	$2,318	$1,493	$7,737
Reform total	**$15,039**	**$11,391**	**$63,681**

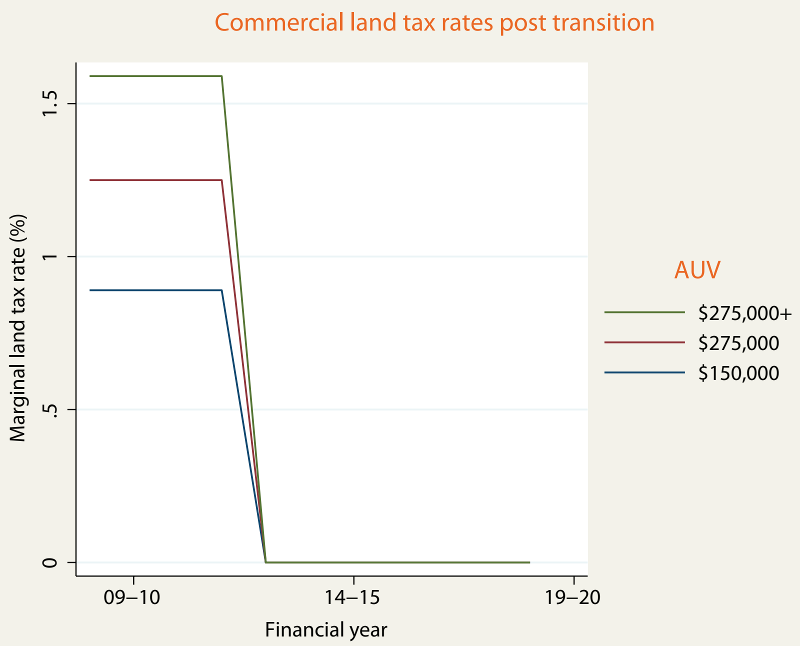

Figure 33. *Commercial land tax rates post transition.*

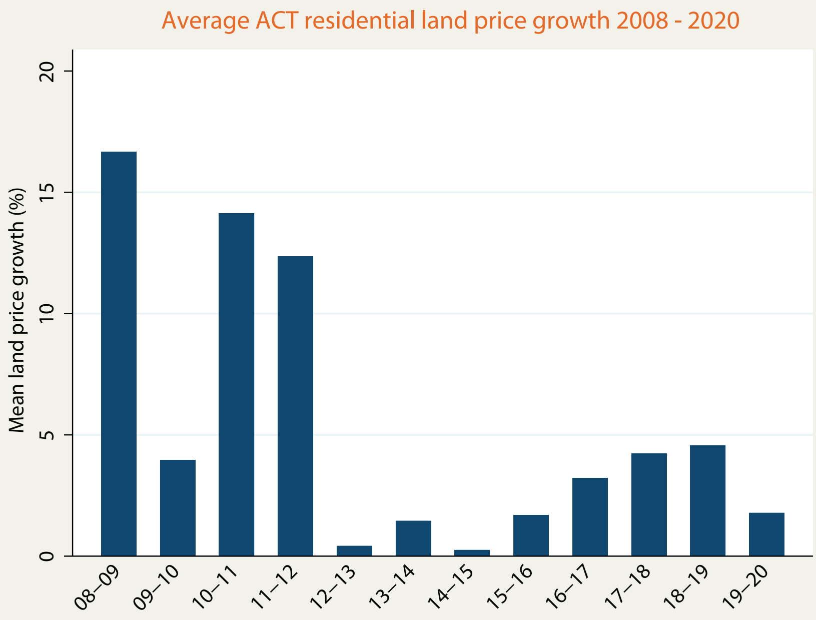

Figure 34. *Average ACT residential land price growth, only including blocks that existed in 2008-09 to exclude the impact of newly released cheaper blocks. Source: author calculations from land valuation data provided by ACT government.*