

Stamp Duties and Property Taxes:

Brief Comments on Consultation Paper and More Detailed Review

Dr. Peter Abelson

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The following are some brief comments submitted in response to the NSW Government *Consultation Paper* which proposed replacing property transfer duties (stamp duty) with a land tax, often described in the *Paper* as a property tax.

I start with brief comments on efficiency and equity impacts of existing stamp duty, followed by some comments on the proposal, and suggest an alternative strategy.

This is supported by a paper that I prepared on this issue in 2016, which provides more analysis and support for the main points made in this brief submission.

Impacts of stamp duty

1a Estimates of the marginal excess burden of stamp duty vary from about 0.30 to 1.00, i.e. from 30 cents per \$ of tax raised up to \$1.0 for each \$ of tax raised. Citing unpublished work, the *Consultation Paper* takes the view that the burden of stamp duty is at the very high end (a \$ per \$ of tax raised) of these estimates. As analysed in my paper being submitted separately, I believe that this substantially over-states the cost of stamp duty and that the accurate answer is closer to the bottom end of the range of estimates noted above. But it is agreed that stamp duty is still a significantly less efficient tax than a property or land tax and that this efficiency argument is a sound basis for change.

1b The *Consultation Paper* appears to imply that house buyers will benefit almost wholly from abolition of stamp duty. This is a fallacy. House prices will fall only by about a quarter of the stamp duty foregone.

A basic principle of public finance is that taxes are borne by the party less able to escape them (in technical terms with the lower price elasticity of demand or supply respectively). In a perfectly competitive market, a tax on producers is passed on fully to, and borne by consumers.

When I made an investment purchase a few years ago, I calculated the capital value based on the rate of return, subtracted the stamp duty payable, and offered the net price to the vendor. The vendor immediately accepted.

Analysis in the accompanying submission shows that most of the stamp duty is borne by the seller. Assuming, broadly but realistically, that housing demand elasticity (η_d) = 1.0 and housing supply elasticity (η_s) = 0.3, house vendors bear 77% of the cost of the tax (in a lower price than they would otherwise get) and house buyers bear 23%.¹

¹ The impact on the consumer (buyer) = $\Delta P^c/S = \eta_s / (\eta_d + \eta_s) = 0.30 / (1.0 + 0.30) = 0.23 = 23\%$
The impact the seller = $\Delta P^s/S = \eta_d / (\eta_d + \eta_s) = 1.0 / 1.0 + 0.30) = 0.77 = 77\%$

In so far as the stamp duty is paid in effect mainly by existing homeowners (or by landowners with new housing), who tend to have above average net wealth, stamp duty is not as inequitable tax as it is widely perceived to be. However, it does discriminate against households who move home more often and first homeowners who bear around a quarter of the stamp duty (unless exempted or subsidized in some way).

Comments on proposed changes to stamp duty

2a The *Consultation Paper* proposes exchanging the one-off stamp duty on property values with a small flat annual tax plus an annual tax on “unimproved land values”.

This language in the *Paper* is unclear in two ways. First, it often describes this as a change to a property tax, which it is not. Second, in practice it is a tax on improved land values, not unimproved land values.

In practice land tax is usually based on improved land values, not on unimproved land values. This form of land tax is less efficient than a tax on unimproved land values.

2b A basic problem arises because land values (improved or unimproved) are not well correlated to property values. For given property values, land values are usually higher for house owners than apartment owners. House owners generally pay a higher land tax than do owners of apartments of similar value. Thus, the proposal is not property neutral. Relative to stamp duty, it appears that the proposal is likely to provide a subsidy for apartment owners relative to an increased tax for homeowners.

House owners pay the same stamp duty as owners of apartments with similar prices. Equality of revenue could only be achieved under the proposal only if differential land taxes were applied to owners of apartments and owners of houses. This would seem to be problematic unless the aim is to tax homeowners more highly.

2c Under the proposal, the land tax would vary according to the use of the property, presumably at any point in time, with rented property attracting a higher land tax than owner-occupied property. This appears to be based on the federal tax deductibility for rented property. It is not clear how this is consistent with achieving revenue neutrality between stamp duty and the proposed land tax.

2d Under the proposal, after about 10 years, half of the residents of a street would be paying high annual land taxes and the other half (non-sellers) would not be paying any land tax other than council rates. This may be looked upon as very unfair and may not be politically sustainable.

An alternative Strategy

This response supports a gradual move from stamp (transfer) duty to either annual land taxes or annual property taxes.

Land taxes (especially on unimproved land values) are more efficient: they have a lower marginal excess tax burden. But property taxes are arguably more equitable and not confused with council rates.

Whether land or property taxes are adopted, this strategy could be done by gradually increasing the applications of land tax and by gradually reducing stamp duty.

Importantly, this strategy could also *include applications to many privileged sporting, religious and other entities, sitting on billions of dollars of land, who are fully or largely exempt from both stamp duty and land taxes and are not included in the Consultation Paper proposal.*

This alternative strategy is a practical, efficient and fair reform option which would appear to create fewer anomalies than the present proposal.

Tax Reform: Replacing Property Transfer Taxes with Land Tax in NSW

Peter Abelson

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Contents

- 1 Introduction
- 2 Major Recent Estimates of the Excess Burden of Property Transfer Taxes
- 3 Possible Causes of Excess Burdens of Property Transfer Tax
- 4 The excess burden of taxation of property transfers
- 5 The excess burden of the taxation of capital
- 6 Other possible kinds of excess burden
- 7 Implications of revenue neutrality and a broad land tax
- 8 Equity issues
- 9 Transition issues and excess burdens*
- 10 Conclusions

Annex

Current Property Transfer Tax and Land Tax in NSW

1 Introduction

Property transfer taxes (PTT), also known as stamp duties, are widely viewed as one of the most inefficient taxes (see Henry (Chair), 2010; Cao et al., 2015, Freebairn, 2016). Accordingly, there is a general policy consensus that PTT should be replaced with a less inefficient tax, such as a broad land tax. This note discusses the likely welfare benefits of this substitution and related issues.

The motivation for this discussion is the need to estimate these benefits robustly and in such a way that they can be explained to the public. These are essential requirements for replacing a tax that accounts for over a quarter of NSW tax revenues. Many estimates of the benefits are expressed as an output from CGE models that are not clearly demonstrable and, in the view of this paper, tend to be over-estimated.

The main focus of this note is on the benefits of a complete transition from PPT to land tax. However, the method of transition from PTT to land tax has implications for efficiency as well as for public acceptance and needs to be considered.

In this note, I start with an outline of major recent estimates of the welfare cost, known as the excess burden, of the property transfer tax. The next sections outline the main claimed components of this excess burden and discuss each of these in turn along with making some estimates of these excess burdens. To achieve tax revenue neutrality, it is also necessary to consider any excess burden associated with a substitute tax. I also discuss equity impacts and transition issues. The final section summarises the conclusions. The Annex provides data on the current PTT in NSW.

This review supports the view that there are significant benefits from replacing PTT with a broad land tax. However, in our view, the benefits are more modest than most other estimates suggest. There are also efficiency and equity issues in the transition process to be resolved. A gradual movement towards the preferred tax structure may mitigate some of these problems.

Before moving ahead with such a major policy change, there needs to be some agreement on the scale of the benefits, the means of transition and the method of public explanation.

2 Major Recent Estimates of the Excess Burden of Transfer Taxes

Recently, a Commonwealth Treasury team (Cao et al., 2015) produced a detailed review of five major taxes and produced a central estimate of the marginal excess burden (MEB) of the PTT of 0.71. This means that, for every extra dollar of tax raised, there is a welfare cost of 71 cents in addition to the \$1.0 tax burden. As shown in Table 1 below, several other leading economic modellers have produced similar estimates of the MEB of the PTT.

Table 1 Major estimates of the marginal excess burden of property transfer taxes

Source	Date	Estimated MEB
KPMG / Econtech	2010	0.34
KPMG	2011	0.80
Independent Economics	2014	0.71
Commonwealth Treasury (Cao et.al)	April 2015	0.72
Deloitte Access Economics	December 2015	0.38 – 0.61 ^a

(a) These are net effects after allowing for increase in GST to achieve revenue neutrality.

Of course, these figures are estimates of the gross MEB of a PPT. If we require tax revenue neutrality, the real net cost of the PPT is the difference between the MEB of the PTT and the MEB of the most likely alternative tax. If this is a broad land tax, which is typically estimated to have a MEB of slightly less than 10%, the net MEB of the transfer tax falls to about 0.60.

It should also be noted that the MEB of taxation generally rises with the tax rate. Thus the MEB is generally higher than the average excess burden of funds, which is the total cost of distortions divided by the total revenue collected by a government, (see Abelson 2012, Table 22.2 based on Econtech / KPMG, 2010). However, in the case of the PTT, the difference between the average excess burden and the MEB appears small.

On the other hand, it may be noted that, if abolishing the property transfer tax generates higher output and income, there may be only a partial need for a substitute tax. For example, KPMG (2016) estimates that replacing PTT with broad land tax would increase NSW gross state product by 1.0 per cent

3 Possible Causes of Excess Burdens of Property Transfer Tax

The following is based on comments in the Henry Tax Review, (Henry 2010, pp. 251-7 and 425-6). They appear to be the basis for most subsequent commentaries and estimates of PTT.

First, PTT strongly discourages property transfers. In Sydney, the PPT on a median priced home nearly doubles the cost of selling this home. In effect this is a tax of some 90% on the cost of selling a home. This substantially reduces mutually beneficial housing exchanges. It may also have the effect of increase commuting time and discourage labour mobility.

The fall in exchanges reduces dwelling utilisation and thus effective housing supply. On the other hand, it encourages investment in renovation as a second-best action to moving.

Henry (2010) also contended that the tax on transactions is particularly costly to businesses who are likely to move more often than households. Cao et al. (2015) likewise contend that high property transfer costs are likely to cause businesses to be located inefficiently and so to reduce labour productivity and consequently lower real wages.

Second, the PTT is a tax on capital and discourages the development of new housing stock. Indeed, there is double taxation when PTT is levied when a developer purchases land and then again when he / she sells the final dwelling.

Third, there may be externalities associated with longer commutes, higher unemployment and lower productivity.

Fourth, the PTT creates inequities as well as the efficiency costs. It taxes people on the basis of their need or preference to move house rather than on their income. Also, by raising house prices it makes housing less affordable to first homeowners.

4 The Excess Burden of Taxation of Property Transfers

In 2014/15, transfer duty was paid on about 206,000 residential transactions across NSW at an average amount of \$27,800 per transaction and on about 15,000 commercial sales at an average cost of \$85,700 per transaction (source: KPMG, 2016).²

Figure 1 illustrates the excess burden of a residential property transfer tax using some rounded figures. We allow an average (mean) property transfer tax of \$30,000 (which is some 3.5% of the median sale value just below \$800,000 for Sydney) and that this doubles the average cost of a residential transaction. With 200,000 residential sales per annum, this would produce transfer tax revenues of \$6.0bn (area P_1ACP_2 in Figure 1).

The excess burden (or deadweight loss, DWL, to use an equivalent term) is a product of the transactions foregone and the average welfare loss per foregone transaction. Given a linear demand for transactions, this is given by area ABC in Figure 1. This is known as the “Harberger” triangle.

DeLoitte Access Economics (2015) reviewed a range of Australian and international studies of the effects of stamp duties on transaction volumes and found “broad evidence of significant effects” citing studies showing that a 1% drop in the absolute rate of stamp duty would increase property transactions by between 8% and 20%. Taking a mean increase of say 14% and an average transfer tax rate of 3.5%, this implies that full removal of the transfer tax would increase in transactions by 50%.

Given a linear transactions demand curve, the average welfare gain would be \$15,000 as some households would transfer with only a small fall in the transfer tax and others only with a large fall in the tax.

It follows that the excess burden for NSW households equals $0.5 (100,000 \times \$30,000) = 1.50\text{bn}$.

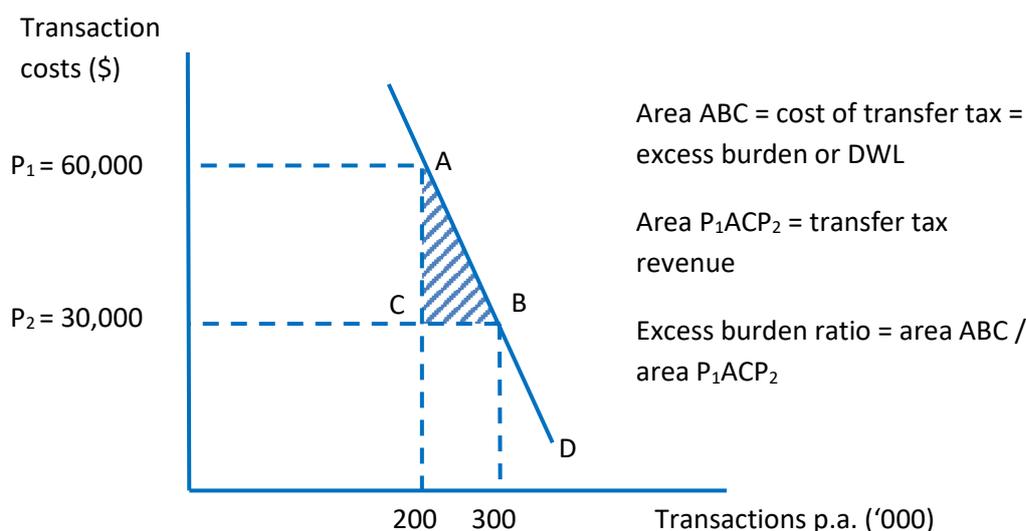


Figure 1 Excess burden of residential property transfer tax in Sydney

² Transfer duty totalled \$7.4bn in 2014-15 and rose to \$8.8bn in 2015-16.

This represents an excess burden of $\$1.5\text{bn} / \$6.0\text{bn} = 0.25$ or \$25 in every \$100 of tax revenue.

These are, of course, rounded average figures. Given the lower property values outside Sydney and the lower transfer tax rates applicable on these lower value properties, the transfer tax outside Sydney would average about \$10,000. This would be a smaller proportion of transaction costs (averaging about 30% rather than 50%) and be proportionately less distorting (with a DWL below 0.25). On the other hand, with a progressive transfer tax up to 5.09% and much higher property prices in much of Sydney, the transfer tax at around \$100,000 on a \$2.0m property could be around 70% of total transaction costs and would be more distorting (with an excess burden over 0.25) than for a median priced property in Sydney. Without more detailed work, it is not clear how these variations in property prices and transfer taxes would affect the average excess burden for residential properties across NSW but they may be assumed to broadly offset each other.

Regarding taxes on commercial property transactions, an average tax of \$86,000 combined with a transaction tax rate of 5.09% implies an average property value of about \$1.7m. If we assume that this higher transfer tax discourages say 66% of transactions (rather than 50%), we would get an excess burden = $0.5 \times (15,000 \times 0.66) \times \$85,700 = \$424\text{m}$.

This would represent an excess burden of $\$0.424\text{bn} / \$1.3\text{bn} = 0.33$ or \$33 per \$100 of tax revenue.

Adding the excess burdens for residential and commercial properties, we would get a total excess burden of around \$1.9bn for a revenue of \$7.3bn. This would represent an overall excess burden rate of \$26 per \$100 of tax revenue.

It should be stressed that this standard (Harberger) method of estimating the excess burden of property transfer tax allows for increases in commuting time and costs associated with reduced labour mobility. In essence, households who do not move value possible savings in these costs at *less than* the transfer tax costs of moving house. The Harberger triangle (area ABC) represents these benefits from moving house. It would be double counting to add these benefits to the triangle.

As noted above, the Henry Tax Review also contended that the transfer tax would be especially costly to businesses which are more likely to move than households. However, this seems to confuse business movement with property ownership. The statistics indicate that business property exchanges (sales) are relatively small. Many businesses rent properties. Again, the Harberger triangle picks up the productivity benefits to be gained by property owners from property transactions. Thus, the market statistics cited above provide a natural weighting of the benefits of residential and business property transfers.

5 The Excess Burden of the Taxation of Capital

As we have seen, the transfer tax may actually encourage investment in renovations where the cost of transfer tax exceeds the marginal benefits of moving. On the other hand, a 3.5% tax on capital improvements could have a marginal disincentive effect on other renovations. However, there is no tax on capital gains associated with home owner renovations, which makes them relatively tax attractive. Given these various factors, the PTT is unlikely to reduce the amount of expenditure on renovations (and could increase it). Thus, we focus here on the potential excess burden of a transfer tax on investment in new housing.

We adopt a similar approach to estimating the excess burden of the impact of transfer tax on new housing as above, notably by estimating the relevant Harberger triangle as shown in Figure 2. Due to the role of regulations via zoning, the supply of new dwellings per annum is relatively inelastic. For this exercise, we adopt a supply elasticity of 0.4. This is based on an elasticity of 0.33 for Sydney (Gitelman and Otto, 2012) along with a higher assumed supply elasticity in the regions. There are two demand schedules, with and without the transfer tax (D_T and D schedules respectively). The excess burden is the difference between what households are willing to pay for new housing and the real supply costs of this housing and is shown by area ABC.

$$\text{Area ABC} = 0.5 (TT) (\Delta NH) \tag{1}$$

where TT = average transaction tax

$$\Delta NH = \text{increase in new housing per annum} = NH_b \times TT/P^h \times \eta_s$$

Where NH^b = new housing in NSW in the base case with the transfer tax = 40,000

$$TT/P^h = \text{transfer tax as percentage increase for new house price} = 4.5\%$$

$$\eta_s = \text{the supply price elasticity of new housing} = 0.4$$

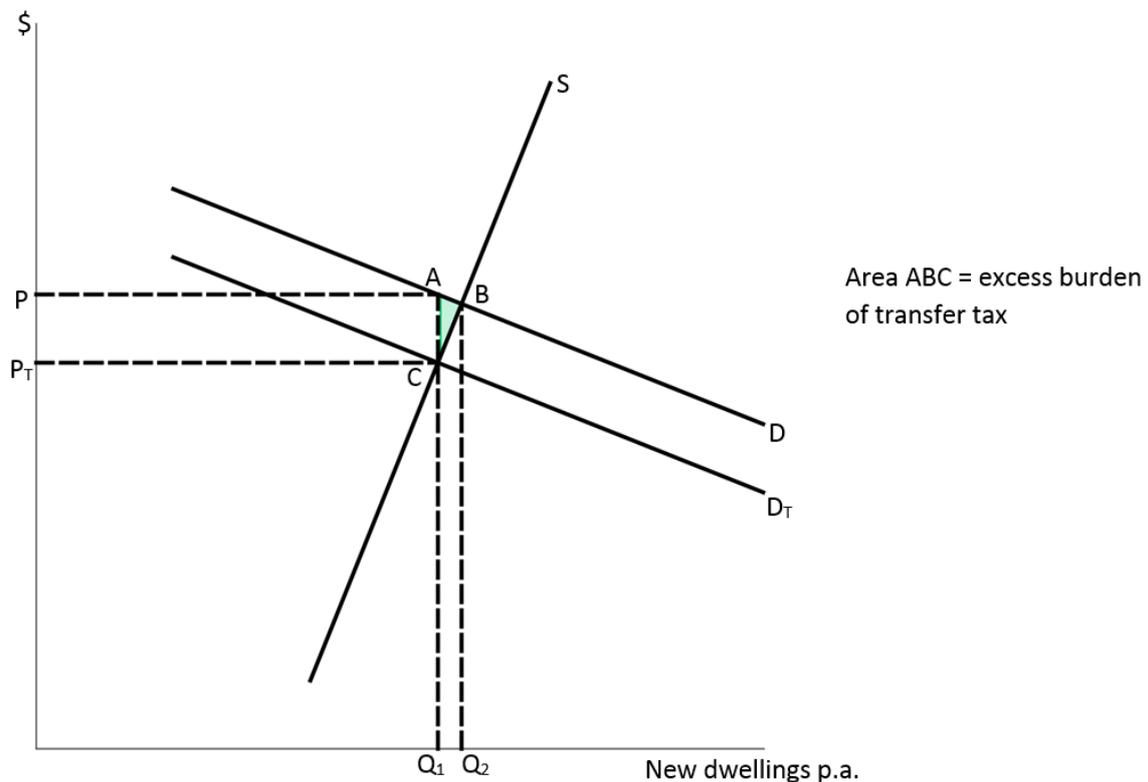


Figure 2 Excess burden of transfer tax on new housing

As noted above, the transfer tax may be levied twice, once on land and a second time on the final dwelling. Sometimes, it may be levied even more often. However, given the progressivity of the transfer tax in NSW, a tax on land of say \$300,000 would be only about \$5,000. Thus the full transfer tax with the tax on the final dwelling price of about \$800,000 would be in the order of \$35,000. Note that \$35,000 = about 4.5% of \$765,000 (the pre-tax price).

Given this formula and these assumptions, abolition of the transfer tax would increase new house completions by 600 new dwellings a year. The excess burden of this is:

$$EB_{NH} = \text{area ABC} = 0.5 \times \$35,000 \times 720 = \$12.6\text{m} \quad (2)$$

This estimated figure indicates that the transfer tax **has little impact on capital expenditures** on housing in NSW. There are two principal reasons for this. One is that, even including double taxation on land and dwelling, the transfer tax is less than 5% of the dwelling sale value. This compares with a transfer tax which doubles the cost of property transfers and hence discourages transfers. Secondly, housing supply is driven largely by zoning regulations and is relatively price inelastic.

Moreover, it should be recognised that increased utilisation of the existing dwelling stock could actually *reduce* the price of housing and the demand for new housing, which adds to the previous observations.

Of course the PTT also impacts on capital investment in commercial developments. However, in a competitive property market, the PTT (which is typically about 5% of commercial property value in NSW) is passed back in lower land values to the landowner. Thus the question is whether the small decline in land value associated with the PTT on commercial development reduces significantly the amount of commercial development.

Let us assume hypothetically that as many as 1000 commercial property developments in NSW are deterred annually by a transfer tax of \$100,000 (slightly above the average tax on existing property transfers), compared with 720 dwellings deterred. Then, applying a similar excess burden (EB) formula to commercial property (CP), the excess burden would be

$$EB_{CP} = 0.5 \times \$100,000 \times 1000 = 50.0\text{m} \quad (3)$$

This compares with an excess burden of \$1.9bn for the total excess burden of the tax on residential property transfers.

6 Other Possible Kinds of Excess Burden

The excess burdens estimated above are the costs of households or businesses who are deterred from moving or investing as a result of the PTT. It is conceivable that there may also be impacts on third parties (externalities) due to the significant reduction in property transactions as well as to the minor reduction in capital investment.

As noted above, Henry (2010) considered that there may be externalities associated with longer commutes, higher unemployment and lower productivity. Deloitte Access Economics (2015) also cites costs of lower labour supply, decreased labour mobility, increased costs of business re-structuring and impacts on removal businesses.

Critically, however, most of these factors are internal to the households or firms considering property transactions. If these costs exceed transfer tax costs, households or firms will move in any case. If not, they are minor costs and, as noted above, they are captured in the standard analytical treatment of excess burden adopted in this paper.

Given the limited impact that the PTT has on capital investment in property and consequently on aggregate demand, the PTT is not likely to have a significant impact on labour supply or productivity (other than has been estimated as part of the excess burden above) or more generally on any third party costs.

Likewise, it is hard to see how lower levels of property transactions themselves have any external impacts on levels of employment or productivity.

Advocates of any such costs need to demonstrate how they may occur and their likely magnitude.

7 Implications of revenue neutrality and a broad land tax

As noted above, unless abolition of the PTT produces a magic pudding increase in GDP, or in the case of NSW an increase in GSP, tax revenue neutrality requires that revenue be raised by a substitute tax, assumed here to be a broad land tax.

As per Cao et al (2015), Australian land taxes usually have a MEB in the order of 0.08 to 0.10. The average excess burden may be slightly lower.

The excess burdens of land tax depend on how they are set up, especially on the extent of exceptions and on whether the land tax base includes capital additions to land, as it usually does.

If we conclude from the analysis above that the excess burden of PPT is in the order of 0.28 to 0.30, then the net benefit of replacing the PPT with a fairly broad land tax would be in the order of 0.20, i.e. there would be a welfare benefit of 20 cents for each dollar of tax raised by the new broad land tax as a complete replacement for the PPT.

With a tax revenue from PPT in the order of \$8.0bn, this would be the equivalent of a net welfare gain of \$1.6bn per annum.

We discuss some transition practices below that would delay or in some cases reduce this net benefit.

8 Equity Issues

As has been noted above, there is a fundamental equity issue in raising tax on households and firms on the value of an asset when it is sold rather than on their income on profits. In any case this discriminates against households who buy or sell property as against households with similar income who do not buy or sell property. This violates the principle of horizontal equity that similar households should pay similar levels of tax.

The importance of these concerns does depend in part on whether the PTT is paid by home owners or home buyers and on whether the households bearing the main burden of the PTT are high, medium or low income households.

To assess the impact of PTT, it is useful to understand their incidence. PTT is paid by the purchaser. But this does not necessarily mean that the purchaser bears all of the cost. Part of the cost may be borne by the vendor. Indeed, if the supply of housing is relatively inelastic, most of the cost of stamp duty will be borne by house owners or suppliers.

This is illustrated in Figure 3. The S line shows housing supply. The line D_1 shows the demand curve with transfer tax. In this case, the housing price is given by $(P_1 + t)$. With no transfer tax, the demand curve shifts (by the amount of the tax) up to D_2 .³ The house price has now risen to P_2 . The house seller has gained $P_2 - P_1$. The house buyer has gained $(P_1 + t) - P_2$. *Of course, a household that is seller and buyer gains the whole benefit from abolition of the stamp duty, though they may buy a house at a different price from the one they are selling.*

To put some numbers on these concepts, suppose that housing supply has a low price elasticity of around -0.35 and that housing demand has a price elasticity of $+0.9$. Equations (4) and (5) show that housing suppliers (mostly existing home owners) bear 72% of the transfer tax and that house buyers (who pay the tax) would actually bear 29% of the tax.

$$\Delta P^C/S = \eta_s / (\eta_d + \eta_s) = 0.35 / (0.9 + 0.35) = 0.28 \quad (4)$$

$$\Delta P^S/S = \eta_d / (\eta_d + \eta_s) = 0.9 / (0.9 + 0.35) = 0.72 \quad (5)$$

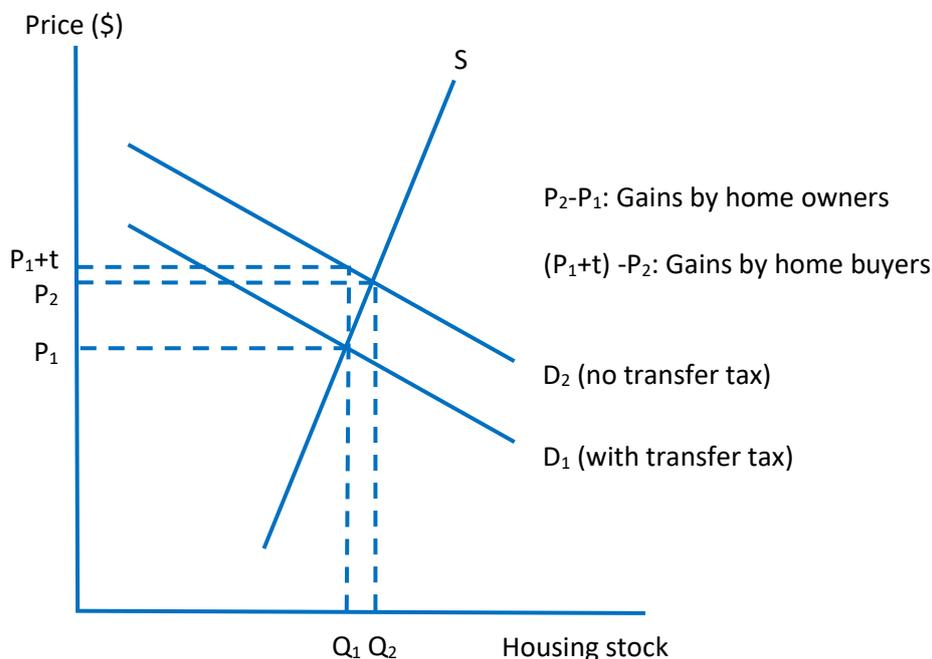


Figure 3 The effect of abolishing property transfer tax

³ This is an approximation. The demand curves are not strictly parallel.

Putting the above into \$ effects, abolishing transfer tax of say \$30,000 on a \$770,000 house price would increase the house price by about \$21,600 ($\$30,000 \times 0.72$). After paying the tax, the purchaser would save \$8,400.

We conclude from this discussion that in so far as the transfer tax is paid mainly by existing home owners (and by landowners in the case of new housing), who tend to have above average net wealth, the tax is not as inequitable tax as it is widely perceived to be. However, it does discriminate against households who move compared to those who do not and it has a small cost to first home owners.

It follows conversely from this discussion that the major beneficiaries of abolition of the transfer tax would be property owners who would now receive a higher price for their properties.

On the other hand, the model above does not allow for greater effective utilisation of the housing stock. Which increase the effective supply off the stock. This would slightly reduce housing prices. In turn, this would reduce the gains to home owners and increase the gains to first-time purchasers.

But it must also be observed that this discussion has made no allowance for the tax that may replace the transfer tax. If a land tax is introduced to replace and substitute for the transfer tax, the demand for housing will revert to something close to the D_1 schedule in Figure 3. And housing prices will fall from P_2 to P_1 .

9 Transition Issues and Excess Burdens

Transitioning from a property transfer tax to a broad land tax would be very complicated because of the very different current tax structures (see Annex). Key features are:

- In any year, only about 7% of households pay a property transfer tax. Thus 93% of households do not experience the tax in this year and many households do not experience the tax over 10 or more years. Thus any annual land tax will seem like a new tax to many households.
- The present land tax also has a huge number of exceptions, including for all home owners and for owners of land valued at less than \$432,000. For these households, an annual land tax will also seem like a new tax.
- The land tax is very highly progressive. This may be suited to commercial entities, but such progressivity would be hard to maintain for owner occupiers.
- Revenue neutrality requires a fourfold increase in revenue from land tax.

Given the extensive set of exemptions for the state land tax, the increase in land tax revenue cannot be readily recovered by simply increasing existing land tax rates, which are already high for land valued at over \$1.0 million. There would have to be a major increase in the coverage of the land tax.

There are of course many ways in which the new land tax could be configured. For this assessment, we take the broad view and assume that the reformed land tax would apply to all forms of commercial and residential properties, including owner-occupied properties, but not including primary producers.

KPMG (2016) assumed a flat rate land tax over all properties which they calculated to be a 1.3% tax rate in their broadest scenario. The results are shown in Table 2.

Table 2 Hypothetical new land taxes

Land value (\$)	KPMG tax % land value ^a	Land tax \$ p.a. ^a	Alternative % land value	Land tax \$ p.a.
100,000	1.3	1,300	1.0	1,000
200,000	1.3	2,600	1.0	2,000
350,000	1.3	4,550	1.0	3,500
500,000	1.3	6,500	1.0	5,000
750,000	1.3	9,750	1.0	7,500
1,000,000	1.3	13,000	1.0	10,000
2,000,000	1.3	26,000	1.0	20,000
5,000,000	1.3	65,000	1.0	50,000

(a) Based on KPMG forecast charge for revenue neutrality.

Given these complications, owing in large part to the exemptions from existing taxes, two main strategies have been discussed.

One is that when properties are transferred, they become automatically subject to a land tax in lieu of a transfer tax. This would have a present value at least equal to the transfer tax. In fact, to achieve revenue neutrality, the land tax would also have to cover existing revenue from the land tax.

However, this approach has two major defects. First, it leaves in place an equivalent disincentive to transfer properties at least until after the first transfer is made. Thus it has minimal efficiency benefits for 10 or more years. Secondly it will expose major disparities (inequities) between households that are paying land tax because they occupy a transferred property and those that are not paying the land tax. In our view, these are critical deficiencies of this approach.

The second approach is a gradual approach that slowly reduces the transfer tax and that slowly broadens the land tax, for example by reducing exemptions. The ACT reform to broad land tax is an example of this. A critical issue here is whether all commercial and non-commercial land will be treated equally.

This approach would produce the welfare benefits identified in this paper over time. The equity impacts would be very sensitive to policy design.

10 Conclusions

The NSW property transfer tax raises around \$8.0bn per annum and has a gross excess burden of around \$2.0bn per annum. If replaced fully by a broad land tax, albeit with some exemptions, this paper estimates that there would be a net welfare benefit in the order of \$1.5bn to the NSW community. This is a significant net benefit although less than various experts and authorities have estimated.

By far the largest part of the benefit would occur as a result of increased transfer of the housing stock. Only a small part would result from more investment in new housing.

It should be noted that the analysis in this paper is based on what is known as comparative static, partial equilibrium, analysis.

Larger estimates of the welfare gains have been made using dynamic models simulating the impacts of transfer taxes employing a CGE model and forecasting a significant impact on output and employment and hence on incomes. However, the routes to these benefits are not clearly demonstrated. Advocates of any such larger welfare gains need to demonstrate more clearly how they may occur and their likely magnitude.

The transfer tax discriminates against households who move compared to those who do not and it has a small direct cost to first home owners. It is also imperfectly related to household income and hence capacity to pay.

However, in so far as the tax is paid mainly by existing home owners (and by landowners in the case of new housing), who tend to have above average net wealth, the tax is not as inequitable tax as it is widely perceived to be.

It follows conversely from this discussion that the major beneficiaries of abolition of the transfer tax would be property owners who would now receive a higher price for their properties.

On the other hand, the model above does not allow for greater effective utilisation of the housing stock, which increase the effective supply off the stock. This would slightly reduce housing prices. In turn, this would reduce the gains to home owners and increase the gains to first-time purchasers.

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Annex: Property Transfer and Land Taxes in NSW

NSW levies a sliding scale transaction tax on sales of virtually all commercial and residential properties. Table A.1 shows the stamp duty rates as of October 2016.

Table A.1 Stamp Duty - General Rate - After 8 June 2016

Dutiable value	Duty charges
Up to \$200,000	\$20 or \$1.48 per \$100 or part thereof, whichever is greater
\$200,001 to \$300,000	\$2,960 plus \$2.50 per \$100 over \$200,000
\$300,001 to \$500,000	\$5,460 plus \$4.00 per \$100 over \$300,000
\$500,001 to \$750,000	\$13,460 plus \$5.00 per \$100 over \$500,000
\$750,001 to \$1,000,000	\$25,960 plus \$6.50 per \$100 over \$750,000
\$1,000,001 to \$1,454,999	\$42,210 plus \$7.00 per \$100 over \$1,000,000
\$1,455,001 and over	\$5.09 per \$100 applied to total transaction value

There are some minor concessions. First home buyers of new homes are exempt from stamp duty on homes Valued at up to \$550,000 and receive scaled exemptions up to \$650,000. Some other intra-family purchases are exempt from stamp duty.

Applying these rates, the following taxes apply to various property prices as from 8 June 2016.

Property price	Transfer tax	Tax as % of price
\$400,000	\$ 9,460	2.37%
\$600,000	\$ 18,460	3.08%
\$800,000	\$ 29,210	3.65%
\$1.0 million	\$ 42,210	4.22%
\$2.0 million	\$101,800	5.09%

Unlike the transactions tax, land tax in NSW is characterised by exemptions. Land tax is paid on commercial use of land (business and residential) excluding land used for primary production. It is not paid on owner occupied property.

But like the transactions tax, the land tax is progressive. Tax is levied annually at \$100 + 1.6% of land value between a base threshold value and premium value and at 2% for land values over the premium value. In 2015 the base threshold was \$432,000 and the premium value was \$2,641,000.

The following is the average annual tax rate for selected land values at 2015 rates.

Land values	Annual tax	% Land value
\$ 400,000	\$ 0	0.00%
\$ 500,000	\$1,188	0.24%
\$ 750,000	\$5,188	0.69%
\$1,000,000	\$9,188	0.91%
\$2,000,000	\$25,188	1.25%
\$5,000,000	\$82,624	1.65%