Land Positives in Thodey Review

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Prosper Australia welcomes the release of the *Thodey Review into Federal Financial Relations*. It provides the vision the nation urgently needs for the post-pandemic era. The replacement of stamp duty with land tax is key to assisting the necessary productivity improvements.

"The funding challenge looms just beyond the crisis phase. To repay additional debt means facing up to the problem described in the discussion paper as the long run 'fiscal gap'. To avoid higher taxes, revenue sources must be as efficient as possible to remove the barriers to economic and productivity growth. The efficiency of state taxation is a critical hinge between the economic recovery and the fiscal recovery – attempting to repair fiscal capacity with economically damaging taxes will hold back progress on both goals.

A broad-based land tax is the best instrument for this task, and a transfer duty to land tax switch would establish the right settings for fiscal recovery and long-term growth." (p.43)

Less than one in 20 NSW households contribute to schools, roads and hospitals via their stamp duty payments. A much fairer and more resilient tax scheme would see all landholders contribute annually according to the locational advantages they enjoy.

As the review rightly argues:

> *"The Henry Review estimated that some 26 per cent of owner-occupiers have remained in the same property for at least 20 years. Most of these people have benefitted not only from the services provided by the state over that time but also from a once-in-a-generation land price windfall. In exchange for these gains, they have contributed very little towards essential services and critical infrastructure via property taxation. Others who have moved to find a job, to be closer to schools, or to match housing size to their family situation – including young buyers without the financial means or parental support to buy their 'once-and-forever' house early in life – have picked up the tab. This approach just doesn't seem fair." (p.39)*

"The value of land is a measure of the benefits accruing to particular locations from infrastructure, services, regulation, access to markets, amenity, culture and community. A tax on land is therefore like a generalised user charge for the benefits society at large provides the landowner, which is a principled way of funding public services." (p40)

The report also highlights the productivity enabling aspects of the transition away from stamp duty and towards land tax:

"[Stamp duty] impacts citizens' freedom to move home throughout their lifetime and inhibits labour market matching and transfer of business assets, ultimately reducing the productivity with which land is used." (p40)

"[Stamp duty] can be inequitable and create distortions, such as between land uses or between small and large firms, which reduces productivity." (p.48)

"The economic costs, such as lower productivity with more time spent commuting to places of work and higher transport costs are well known and quantified. Sydney is the 23rd most congested city in the world, with Sydneysiders losing the equivalent of nearly five days (119 hours) of their lives due to traffic in 2019." (p.89)

The Transition Detail

The review states in detail :

"An ideal reform under the criteria of maximising efficiency and simplicity would involve the replacement of both transfer duty and existing land tax with a flat tax rate based on unimproved land value. However, flattening the progressive rate scale of existing land tax and transfer duty would involve significant redistributions of tax from large businesses and investors onto small businesses and owner-occupiers. Those with less valuable land assets would also pay more tax relative to the replaced taxes than those with larger land asset values due to the change in progressivity of the rate structure."

"This reform would be the simplest and deliver the highest efficiency gains but would be politically challenging and raise significant vertical equity concerns."(p.45

"In designing the new land tax, a balance must be struck between fairness, efficiency and revenue objectives while bearing in mind the fundamental purpose of reform – to establish as low as possible tax settings, which are sustainable and do not compromise the ability of states to fund future services and infrastructure."

"Productivity-enhancing tax reform packages are often revenue-negative, but the scope for this in the present environment is limited. To reduce reliance on less efficient taxes in the context of the overall budget repair task any revenue loss must be carefully considered."

"Transition design is critical. There are genuine issues of equity at stake, particularly in relation to landowners who have recently paid transfer duty and who will now face a broad-based land tax."

"There could also be concerns from households whose properties have been held for extended periods of time and who will face a different future tax liability than previously expected under the old transfer duty regime. These property owners may have paid transfer duty many years ago (a significantly smaller amount than what is paid on average now given the rapid price growth over recent years) with the expectation of enjoying tax-free future tenure. Transitioning away from transfer duty to a broad-based land tax may be seen as a 'new tax' by these cohorts who will be asked to contribute a greater share of the cost of government services." (p.48)

Removing stamp duty would create short-term revenue shortfalls. NSW Treasurer Perrotet has raised the need for Commonwealth support to assist the transition.

Vertical Fiscal Imbalance

The nature of Commonwealth-state funding reveals significant pressures.

"Having the Commonwealth solely responsible for the personal income tax system has practical benefits. …

"However, this approach has its costs. By significantly reducing the revenue raising capacity of the states, the services and infrastructure that states deliver are instead funded in-part through a system of tied grants that has become increasingly complex, based on inputs rather than outcomes, and bureaucratic (at present, New South Wales is party to around 50 Commonwealth funding agreements)."

"Incentives for state governments to undertake productivity-enhancing reform are also limited since the revenue they receive is not linked with the revenue they generate from supporting employment and income growth." (p.55)

"We remain the only high- income federation in the OECD where state governments do not raise or share personal income taxes. Further it is the only one that distributes federal revenues – the GST – based on a model which fully equalises the fiscal capacity of state governments" (p.56)

"The dire economic circumstances facing the nation mean that it is a priority for state governments to show leadership in pursuing productivity-enhancing reform. In support of this, it is recommended that:

- Personal income tax revenues should be shared with the states based on the state in which the income is earned to ensure states are accountable for revenue raising and expenditure.
- The revenue received should be quarantined from the Commonwealth Grant Commission's calculation of GST relativities. That is, a state gets to retain more revenue when it undertakes reforms that support the economic recovery and the benefits are not redistributed to other states (see Chapter 4: A broad-based land tax is more efficient and equitable than transfer duty)." (p.59)

During Malcolm Turnbull's leadership, significant state-based reforms were incentivised by 'City Deals'. Such federally funded nudges need to be reintroduced.

Regarding the other major component of the review, an expansion of the GST, we advocate against the expansion of such a regressive tax. One common misinterpretation of this report by headline readers has been the assumption that stamp duties would be replaced by a higher GST. However, the report clearly warns:

"While the Review agrees reform of the GST base and rate is merited in its own right, it should not be used as a replacement revenue source for transfer duty – states should replace one property tax with another. Crucially, this is a reform any state can enact alone.31" (p44)

"31 Prosper Australia argued similarly in its submission to the Review: "There are numerous disadvantages to this [GST] proposal relative to states going it alone with a replacement land tax. One is distributional: it will result in windfall property price gains at the expense of any consumers not fully compensated through the income tax and transfer system. Another is that it would be significantly more difficult to implement, since it would require unanimous intergovernmental agreement, federal legislation, renegotiation of the GST-exempt boundary, and design of compensation for low-income households. Finally, it would further reduce states' autonomy over their revenue bases and accountability to their residents in relation to taxation".

Whilst our *Designing the Transition report* was referenced, no mention was made of increasing state borrowings to assist the move away from stamp duties. With interest rates at record lows, we expect ratings agencies to be as supportive of rebuilding economies as central banks currently are.

This report is another fine effort from Treasury. As an educative tool, it is essential reading for the civically minded.

https://www.treasury.nsw.gov.au/federal-financial-relations-review