



## *Land tax and affordable housing*

### **How a reformed land tax system can help create more affordable housing**

Land tax is an important source of NSW State Government revenue. Land tax also has the potential to contribute to policies for affordable housing for purchasers and renters.

At present, this potential is not being realised. Our present system of land tax is not directed at making housing more affordable – in fact, in significant ways the present system makes affordability problems worse.

The Tenants' Union calls for reforms to land tax that broaden the base of land tax, cut the rate, reduce stamp duties and direct land tax incentives to affordable rental housing.

#### **Broaden the base**

Land tax should have a broader base that includes all residential land. Broad-based land taxes are fairer, more economically efficient, and help make housing more affordable in the long-term.

#### **Cut the rate**

A broader base means the rate of land tax could be significantly reduced, while at the same time maintaining present land tax revenues.

#### **Reduce stamp duties**

Stamp duties are less fair and less efficient than land taxes. As well cutting the rate, a broad-based land tax could help reduce the State Government's reliance on stamp duties.

#### **Incentives for affordable housing**

Land tax exemptions and concessions should be provided as incentives for investment in affordable rental housing programs.

#### **Land tax basics**

Land tax is an annual tax levied according to the value of land.

Economists regard land tax as an economically efficient tax, because it does not affect the supply of land, is difficult to avoid and tends not to distort economic decision-making (Productivity Commission, 2004:100; Warren, 2006: 14).

Land tax is regarded as a fair tax because the value of land does not derive from the work or effort of the owner, but rather from the economic development of the community generally. It is fair to return a share of this value, through tax, to community use.

Each Australian State and Territory, except the Northern Territory, levies a land tax.

#### **Land tax in NSW**

New South Wales has levied land tax since 1956. Before that the Commonwealth levied land tax.

For the year 2006-07, the NSW State Government expects to collect almost \$1.8 billion in land tax. This represents about 11 per cent of the State's tax revenues.

Land tax is levied at a rate of 1.7 per cent of the total unimproved (that is, site only) value of land above a threshold of \$352 000 (2006-07). Land values are averaged over three years. The threshold is indexed to increase with the value of NSW land generally.

### Who pays land tax?

Under the current system, not all land is subject to land tax. There are important exemptions, particularly in relation to residential land.

Land used as the owner's principal place of residence is *not* subject to land tax. (For a short period, some high-value owner-occupied housing was subject to a premium property tax, but this tax was abolished in 2004.) Currently, every owner's principal place of residence is exempt, no matter how high its value.

Land used for rental housing *is* subject to land tax (with some exceptions – see text at right). Landlords generally factor their land tax liability into the rents they charge.

So, who pays land tax on their housing? The Productivity Commission puts it simply:

*owner-occupiers are generally exempt while rental investors, and thus renters, pay.*  
(2004: 101)

### Problems with the present system of land tax

In principle, land tax is simple and efficient. In practice, however, the present system of land tax operates unfairly and inefficiently, because of poorly directed exemptions.

*Owner-occupied housing* is exempt from land tax, as well as other important taxes, such as capital gains tax, and income tax on (imputed) rents. This preferential tax treatment encourages persons with money to spare to store that money in housing, where it isn't taxed. This is a major reason why house prices experience periodic booms, and why the price of housing remains unaffordably high. Owner-occupiers' exemption from land tax, therefore, contributes to house price inflation.

- Meanwhile, the burden of land tax falls on rental property owners and tenants. There are exemptions for some types of rental housing, but these exemptions are limited and are not directed at creating more affordable housing. The exemptions are:
- *Retirement villages and residential parks for retired persons.* This is a significant exemption, valued at \$97 million in 2006-07. While many of their residents need affordable housing, parks and villages get the exemption, whether they provide affordable housing or not.
- *Boarding houses.* This exemption is available to boarding house operators who provide low cost accommodation in accordance with government guidelines. This sector of the housing system is declining, and so is the value of the exemption: about \$3 million in 2006-07.
- *Low-cost inner-Sydney rental housing.* This exemption is very tightly restricted: only properties within a 5 km radius of the Sydney GPO that are let according to government guidelines. It is worth less than \$1 million in 2006-07.

For most investors, there is no incentive in the present system of land tax to invest in affordable rental housing. A landlord who owns five \$200 000 units, rented affordably, pays the same amount in land tax as the landlord who owns a single \$1 million property, rented unaffordably.

## Principles for a reformed system of land tax

### *A broad-based land tax*

Land tax should have a broader base that encompasses all residential land, including owner-occupied land.

A broad-based land tax is fair: it would share the cost of land tax between landlords and tenants and owner-occupiers. It would return a portion of unearned increases in land values, including owner-occupied land values, to the State Government for the general benefit of the community. A broad-based land tax can be applied without causing hardship to low-income owner-occupiers, by allowing them to defer their land tax liability until the property is transferred.

A broad-based land tax helps make housing more affordable for purchasers in the long term, by tapping some of the value stored up in housing and providing a moderating influence on house price inflation.

### *Cutting the rate*

By sharing land tax across a broader base, the rate of land tax can be significantly reduced. According to the Productivity Commission, a land tax rate of 1 per cent would maintain current revenues as well as replace stamp duties on housing (2004: 100). That's 40 per cent lower than the present rate of land tax.

Cutting the rate of land tax will reduce landlords' costs and ease pressure on rents for tenants.

### *Reduced stamp duties*

A broad-based land tax, even at a significantly reduced rate, could help reduce or replace inefficient stamp duties on housing (see box at right).

### *Incentives for affordable rental housing programs*

Governments need to implement programs that direct investment to building more affordable rental housing. Land tax exemptions and concessions should be made available as incentives for investment in affordable rental housing programs, rather than given away to little or no good effect, as is presently the case.

There is growing acknowledgement of the need for a National Affordable Housing Agreement between the Commonwealth and State and Territory Governments. Under such an agreement, State and Territory Governments could provide exemptions and concessions from land tax as part of their contribution to affordable rental housing programs.

### **Land tax v stamp duties**

Land tax is different from stamp duty, which the State Government also levies. NSW levies various stamp duties, including purchaser transfer duty (PTD).

PTD is a tax on the transfer (usually the sale) of property, including land, and is paid by the purchaser. PTD is assessed on the sale price or value of the property, and is levied whenever the property is transferred (unlike land tax, which is levied annually).

Over time, the State Government has relied increasingly on stamp duties relative to other sources of revenue, such as land tax. For 2006-07, PTD is expected to raise about 19 per cent of the State's tax revenues.

Compared with land tax, stamp duties are, according to economists, more volatile and less efficient (Warren, 2006: 14). Unlike land tax, stamp duties are levied in irregular 'lumps' (Stilwell & English, 2003: 9). This discourages property-owners from selling and moving to more suitable housing, and discriminates against those who move more often (Productivity Commission, 2004: 97).

**The conventional wisdom: 'but we can't tax the family home!'**

We can, we should and, to an extent, we already do. But it needs to be done more fairly, and directed to creating more affordable housing.

*We already do tax 'family homes' - but partially and unfairly. Under the present system, tenants pay land tax on their housing - their 'family homes' - while owner-occupiers do not.*

*We should tax owner-occupied housing. It will reduce costs for landlords, relieve pressure on rents, maintain State revenues and help create more affordable housing.*

*We can tax owner-occupied housing. Land tax can be applied sensitively to low-income owner-occupiers. It can help reduce inefficient stamp duties. A broad-based, reduced-rate land tax is a fair, efficient tax.*

**Land tax and affordable housing: reform with a purpose**

In recent years, the land tax system has been subject to ad hoc changes, without an enduring purpose (for example, the land tax threshold has been abolished, then reintroduced, and indexed; premium property tax was introduced, then abolished).

Current calls to change the threshold are similarly ad hoc and lacking in real purpose. Calls to abolish land tax on residential property altogether are heedless of the importance of land tax to State revenues, and the potential for land tax to help create more affordable housing.

Broad-based, reduced-rate land tax reform represents genuine reform, with a purpose.

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*References*

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