Will reductions in land tax make any difference to rents?

Saul Eslake – 2nd March 2022

The Government's announcement this week of forthcoming changes to the land tax scale have prompted a raft of commentary, much of it not very well informed, on the effects of land tax and the likely impact of the changes proposed by the Government on rents.

It is true that Tasmania imposes higher land tax on most taxable properties than other states and territories (with the exception of the Northern Territory, which doesn't levy land taxes at all).

The following two tables, taken from the most recent edition of the (very useful) *Overview of State Taxes and Royalties 2021-22* published by the WA State Treasury (which took over the task from the NSW Treasury a few years ago), show that Tasmania has a lower tax-free threshold for land tax, a lower threshold for the top rate of land tax, and higher rates of tax on land valued under $1 million than any other state or territory (for land valued at between $1 million and $5 million, South Australia's land tax rates are higher than Tasmania's). It also shows that land valued at over $10 million attracts a lower rate of land tax than any other jurisdiction except the ACT.

	NSW	*Vic*	*Qld*	*SA*	*WA*	*Tas*	*ACT*
Minimum threshold ($'000)	755,001	250,000	600,000	482,001	300,001	50,000	
Maximum threshold ($'000)	4,616,000	3,000,000	10,000,000	1,350,000	11,000,000	400,000	2,000,000
Minimum rate (%)	1.60	0.20	1.00	0.50	0.25	0.55	0.54
Maximum rate (%)	2.00	2.25	2.25	2.40	2.67	1.50	1.14

			Average land tax rates payable				
	NSW	*Vic*	*Qld*	*SA*	*WA*	*Tas*	*ACT*
Land value ($)							
100,000						0.33	1.93
200,000						0.44	1.26
300,000		0.13				0.48	1.09
400,000		0.14			0.08	0.49	1.10
500,000		0.16		0.02	0.10	0.70	1.10
1,000,000	0.40	0.30	0.45	0.43	0.18	1.10	1.11
3,000,000	1.20	0.83	1.25	1.66	1.02	1.37	1.12
5,000,000	1.39	1.40	1.25	1.96	1.33	1.42	1.13
10,000,000	1.70	1.82	1.50	2.18	1.67	1.46	1.14

The Commonwealth Grants Commission estimates (as part of the calculations which it makes every year in order to arrive at its recommendations as to how the revenue from the GST should be carved up among the states and territories) that Tasmania raises about 54% more revenue from land tax than it would if its land tax scales were of the same 'severity' as the average of all states and territories. These estimates take account of both the amount of land subject to land tax in each state and territory and the average value of that land.

So it *is* fair to say that, except for the most highly valued land, those land-owners who are liable to pay land tax *do* face a higher land tax burden than their counterparts in the rest of Australia (apart from the NT).

However, it does *not* necessarily follow that this is a Bad Thing.

To begin with, land tax is the *only* major area where Tasmania imposes relatively higher taxes on those liable to pay them than other states and territories. According to the same set of Commonwealth Grants Commission estimates mentioned above, Tasmania collected in 2019-20 about 17% less in total state taxation revenue than it would have done in 2019-20 had its overall state tax regime been of similar 'severity' (that is, similar rates applied to similar bases) as the average of all states and territories – the lowest of any state or territory except the Northern Territory. Tasmania collects slightly more from stamp duty and insurance taxes than it would if those tax regimes were of the same 'severity' as the average of all states and territories: but it collects a lot less from payroll tax (the most important single state tax) than any other state, relative to what it would if its payroll tax regime were similar to that of the allstates-and-territories average, and also a lot less from motor taxes.

Most economists consider land tax to be a 'good tax' – in the sense that, by comparison with most other forms of taxation, it is relatively simple to administer and difficult to avoid or evade; the revenue from it is highly predictable; it has much less of an effect in distorting investment and other decisions; and to the extent that land ownership is correlated with wealth, it is reasonably 'equitable' (and certainly more so than, for example, the GST or stamp duty).

Indeed, Adam Smith – usually referred to as the 'father' of economics – wrote, in *The Wealth of Nations* (published in 1776)

> "the aggravation of the [land] tax … is always so very small, that it can never discourage [the landowner's] improvements, nor keep down the produce of the land below what it would otherwise rise to. As it has no tendency to diminish the quantity, it can have none to raise the price of that produce. It does not obstruct the industry of the people: it subjects the land[owner] to no other inconveniency besides the unavoidable one of paying the tax"

Much more recently, the Productivity Commission's 2017 *Shifting the Dial* report concluded that

> "Taxes based on land values avoid the imposition of penalties for moving and the inequity of the tax burden falling on those who choose to move, whether for work or lifestyle reasons. Tax revenue is more stable because it is not exposed to the volatility of the housing market" (p. 150).

And the *Review of Federal Financial Relations* conducted for the NSW Government by former Telstra CEO David Thodey in 2020 came to a similar view:

> "A tax on land enacts a more equitable approach to funding government services, based on the principle of the beneficiary pays. 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 generalized user charge for the benefits society at large provides the landowner, which is a principled way of funding public services" (p. 40).

That's why the overwhelming majority of economists, and almost every authoritative review of taxation that has ever considered the subject (including the two reports mentioned above as well as the 2009 Henry Review of the Australian Taxation System) have favoured the replacement of stamp duties on land transfers with a more broadly based land tax, which would apply to owner-occupied housing as well as to 'shacks' and holiday homes, residential property investments, and commercial property (though probably continuing to exempt land genuinely used for primary production). This reform has also been supported by the non-aligned Grattan Institute; the ALP-aligned McKell Institute; the right-leaning Centre for Independent Studies; and a wide range of business groups including the Australian Institute of Company Directors, the Business Council of Australia, the Australian Chamber of Commerce & Industry and the Housing Industry Association.

So the fact that Tasmania levies higher land taxes than other states and territories is something which should be applauded, rather than regretted – even though it is also understandable that the effect of the rapid increase in land values in Tasmania in recent years in dragging more landowners into the land tax 'net', and pushing those already in it into higher tax brackets, causes some political angst for the government of the day.

The other ill-informed commentary which has been afoot in recent days has been the suggestions that reductions in land tax will result in lower rents (or that increases in land tax 'burdens' in recent years have been a factor in the rapid increases in rents in Tasmania over the past few years).

To begin with, it's important to understand that rents are determined by the interaction of 'demand' and 'supply' in the rental housing market – not as the outcome of some 'cost plus' behaviour on the part of landlords.

The latter may be plausible if there were only a single landlord – or a very small number of landlords – owning the entire stock of private rental properties. In such a hypothetical situation, where the one (or handful of) property owner(s) faced no real competition, they could pass on any increases in any of their costs (whether from tax increases or any other source) to their tenants, and there'd be nothing that tenants could do about it. But in fact, according to the ATO's most recent *Taxation Statistics* publication, there were 34,677 landlords (individuals declaring gross rental income on their tax returns) in Tasmania in 201819. So there is very little opportunity for landlords to set rentals on a 'cost plus' basis.

It's also worth noting that land taxes, like every other cost incurred by landlords in relation to their properties, are deductible expenses for income tax purposes – meaning that a proportion of them (depending on individual landlords' marginal tax rates) are in effect paid by the Federal Government (in the form of lower income tax receipts).

In fact, the effect of increases in land tax is to *reduce* land prices. That might seem counterintuitive to many people who aren't economists – and it is obviously not understood by spokespeople for landlords (although perhaps that's evidence for the proposition first advanced by the American writer Upton Sinclair that "it's difficult to get a man to understand something when his salary depends on his not understanding it" – nowadays of course one would not confine this to males). But the logic was set out in the *Henry Review*:

> "When a land tax is introduced … potential buyers of the land will reduce how much they are willing to pay for land by the value of the expected land tax payments … Potential buyers will expect to get at least the same risk-adjusted return from land as they could from alternative investments … this means that land tax does not distort investment decisions. Someone must use the land, though; because it is immobile, it cannot be shifted out of supply. This makes land an efficient tax base. Land tax therefore differs from taxes on other productive resources: taxes on labour reduce people's work effort; and taxes on capital can cause the capital to be employed elsewhere (particularly overseas). In contrast, a broad land tax is borne by landowners and the supply of land is unchanged" (Volume 1, p. 248).

It is therefore nonsense to suggest, as some have done, that the proposed reductions in land tax announced by the Premier this week will result in lower rents.

If that really were true, then the significant reductions in interest rates over the past two years – or, indeed, the steady decline in interest rates over the past ten years – should have resulted in reductions in rents since (again, according to ATO statistics) three-quarters of Tasmanian landlords have borrowings on which they claim interest payments as tax deductions.

However, some of the other measures announced by the Premier in this week's 'State of the State' Address should have a more favourable impact on rents (from tenants' perspectives) – albeit in the long run, rather than in the near term.

In particular, the plan to fund the provision of an additional 6,500 affordable homes by 2032 (in addition to the existing target of 3.500 by 2026-27), funded by borrowings through the proposed new housing statutory authority, looks highly commendable. So are the proposed introduction of a new Apartment Code to "to simplify medium-density apartment and townhouse approvals", and the intention to "work with Councils" to "achieve more 'shop top' apartments".

Unfortunately, the same can't be said of the extension (yet again) of the $30,000 First Home Owner Grant for another year, or the 50% increase (to $600,000) in the value threshold for these grants and stamp duty concessions. The Premier says that "an eligible first home buyer … purchasing a downsized property, will save around $11,250 on property duty when buying a $600,000 home". History tells us that the result of this "saving" is likely to be that what was a $600,000 home will end up costing $611,250 – with the $11,250 ending up in the pockets of the vendor (in the case of an established property) or the profit margin of the builder (in the case of a new one) … and owners of other nearby established homes perceiving that the values of their properties have increased by a similar amount. That of course is why schemes like this are so popular, despite their abject failure, over decades, to achieve their ostensible objective (higher home ownership rates) – because there are far more voters who already own at least one property (and who are the ultimate beneficiaries of policies like this) than there are people trying to become home-owners for the first time (for whom, in general, these policies do nothing at all).

I have similar reservations about the Government's "Home Share Program", to be renamed the "Housing Market Entry Program", which is a 'shared equity' scheme loosely modelled on Western Australia's long-running 'Keystart' scheme. This program is at least income- and assets- tested (a Good Thing); and it does ultimately generate a return to taxpayers (when the properties bought through the scheme are eventually sold). But while the provision of government equity for the purchase of new homes arguably does something to increase housing supply, the government's willingness to provide up to 30% of the purchase price of established homes up to $150,000 (not that there are many of them around these days) is likely to put additional upward pressure on the prices of such homes rather than get more people into them.

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