6. Land and resource taxes

Well-structured taxes on land and natural resources are a highly efficient means of raising revenue. Existing taxes on land and resources fall short of this ideal, and should be reformed so they are a more effective means of raising revenue.

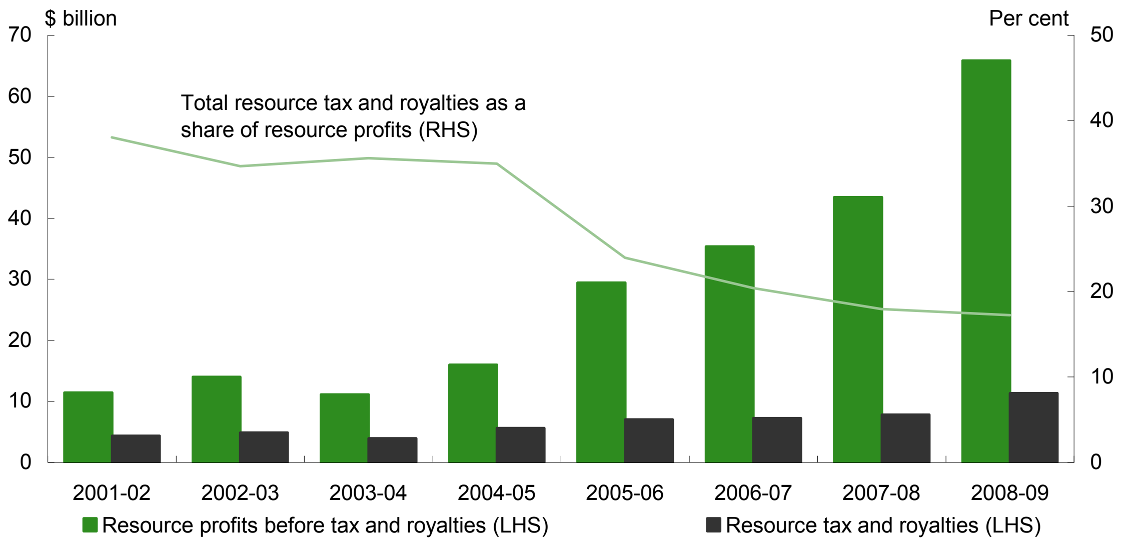
6.1 Charging for non-renewable resources

The current resource charging arrangements should be replaced with a uniform resource rent tax administered by the Australian government. Such a tax would provide a more consistent treatment of resource projects and promote more efficient investment and production outcomes. It would also ensure that the Australian community receives an appropriate return on its non-renewable resources.

Australia has abundant non-renewable resources, which are expected to continue to command high prices driven by demand, particularly from China and India. Non-renewable resources such as petroleum and minerals are a significant asset of the Australian community. Australia has the world's largest economically demonstrated resource reserves of brown coal, lead, mineral sands (rutile and zircon), nickel, silver, uranium and zinc and the second largest reserves of bauxite, copper, gold and iron ore (contained iron).

The current charging arrangements distort investment and production decisions, thereby lowering the community's return from its resources. Further, they fail to collect a sufficient return for the community because they are unresponsive to changes in profits, particularly output-based royalties. For example, existing resource taxes and royalties have collected a declining share of the return to resources over the recent period of increasing profitability in the resource sector (see Chart 6.1).

Chart 6.1: Existing taxes are inefficient and unresponsive[a]



(a) Resource profits before tax and royalties are measured using income less an allowance for corporate capital.
Source: Treasury estimates.

A uniform resource rent tax should be set at a rate of 40 per cent. It would use an allowance for corporate capital system, with taxable profit associated with a resource project equal to net income less an allowance for undeducted expenses or unused losses. The allowance rate would be set by the long-term government bond rate, as the government would share in the risks of projects by providing a loss refund if the tax value of expenditure is otherwise unable to be used.

Subject to transitional arrangements, the new rent-based tax should apply to existing projects, replacing existing charging arrangements. The allocation of revenue and risks from the new tax should be negotiated between the Australian and State governments. A cash bidding system could also be adopted to supplement the resource rent tax and promote the efficient allocation of exploration rights.

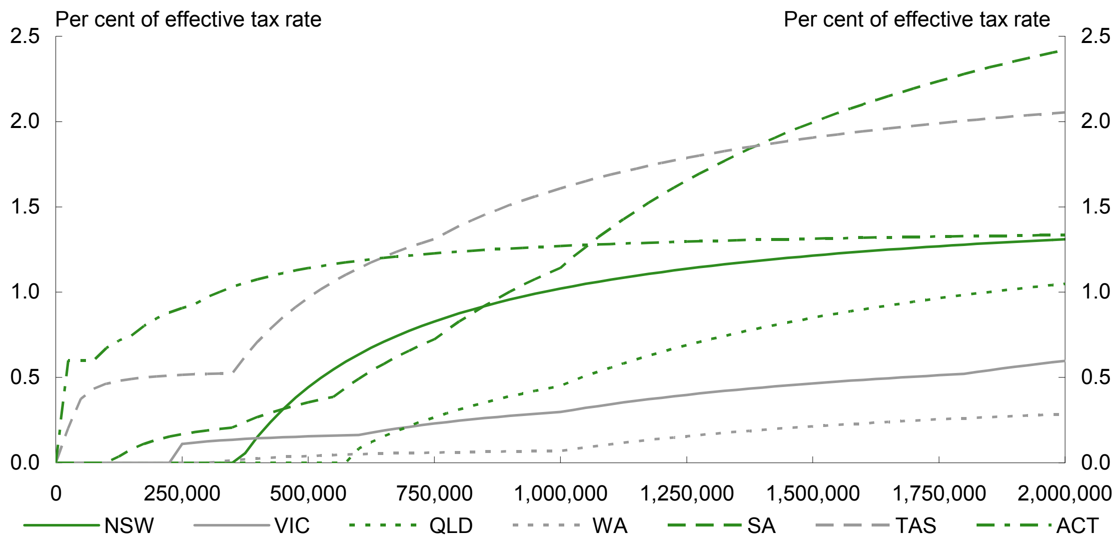
6.2 Land tax and conveyance stamp duty

Stamp duties are a highly inefficient tax on land, while land tax could provide an alternative and more stable source of revenue for the States.

When applied uniformly across a broad base, land tax is one of the most efficient means of raising revenue. This efficiency arises from the immobility of the tax base and, unlike most other taxes, levying different rates of land tax in different States has very low efficiency costs.

Existing land taxes are narrow, which make them less efficient and fair than they could be. Levying higher taxes on larger holdings discourages land-based investment by institutional investors, such as in rental housing. As owner-occupied housing is exempt, land tax on residential investment properties is probably passed through to renters as higher rent.

Chart 6.2: Thresholds and average rates of land tax



Note: Land tax in the ACT is determined on a value per property, not on aggregate holding.
Source: NSW Treasury (2009).

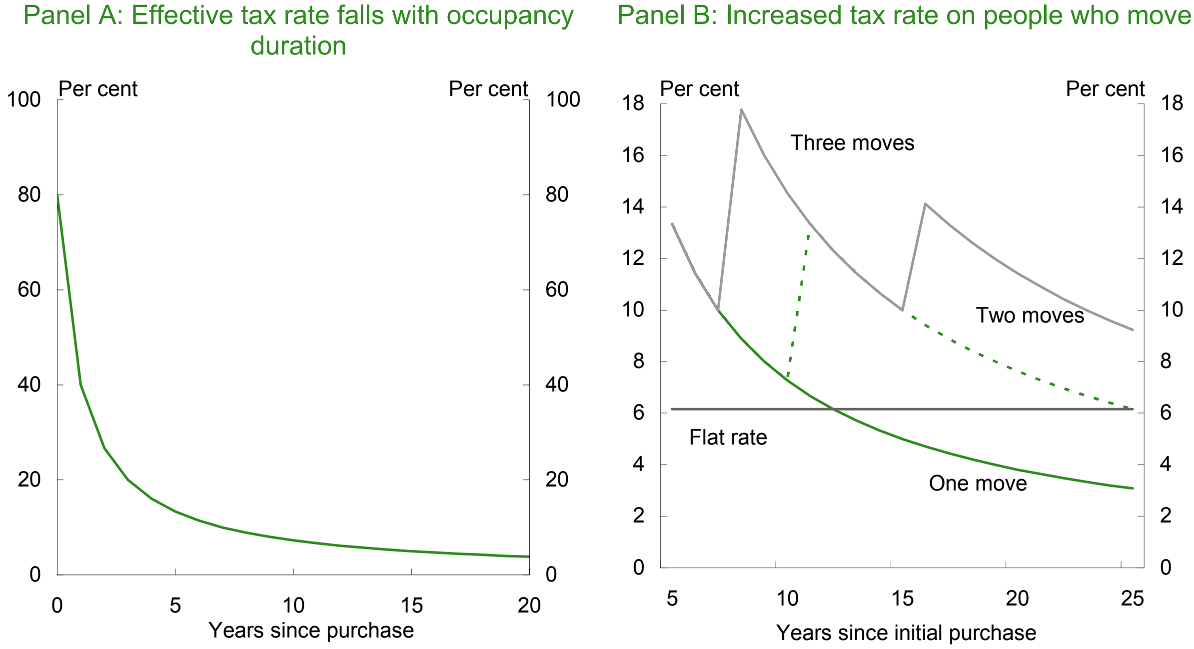
The structure of land taxes could be improved by broadening the land tax base to eventually include all land. Land tax rates should be based on the value of a given property, so that the tax does not discriminate between different owners or uses of land. A tax-free threshold based on the per-square-metre value of the land could be set such that there would be no tax liability on most agricultural and other low-value land. Higher-value land could be taxed at differentiated rates based on the per-square-metre value of the land.

Stamp duties on conveyances are inconsistent with the needs of a modern tax system. While a significant source of State tax revenue, they are volatile and highly inefficient and should be replaced with a more efficient means of raising revenue.

Conveyance stamp duty is highly inefficient and inequitable. It discourages transactions of commercial and residential property and, through this, its allocation to its most valuable use. Conveyance stamp duty can also discourage people from changing their place of residence as their personal circumstances change or discourage people from making lifestyle changes that involve a change in residence. It is also inequitable, as people who need to move more frequently bear more tax, irrespective of their income or wealth.

Reforming land tax and conveyance stamp duty arrangements, along with the proposed changes to the taxation of rental housing and Rent Assistance, will go some way toward improving housing affordability. However, to a significant extent housing affordability is a supply issue (see Box 6.1).

Chart 6.3: Stamp duty effective tax rate[(a)]



(a) The effective tax rates are calculated as the ratio of stamp duty (assumed to be $20,000) to the value of imputed rent over the period the property is owned (assumed to be $25,000 per annum). In Panel B, the 'flat rate' reflects a constant tax on imputed rent, with the rate equal to the effective rate faced by a person making two moves in 25 years (which is not average but intended to be indicative).
Source: Treasury estimates.

Box 6.1: Housing affordability

Access to affordable housing is a key policy issue for the Australian community that is likely to grow in importance. Government policies have traditionally treated owner-occupied housing as a preferred housing tenure. This approach reflects the desire of most Australians to own their home and recognises the benefits ownership can deliver to both the community and owners, such as through greater security in retirement. The approach in this Report is consistent with this policy goal. On that basis the Review has considered whether other features of the tax and transfer system are appropriately configured to meet pressures in the housing market.

Measures of housing affordability emphasise different aspects of the problem, but all reflect the price of housing and people's means to pay for it. The transfer system has a key role in ensuring that low-income earners can access an adequate standard of housing, and reforms to housing assistance will promote affordability in this regard. For purchasers, affordability is constrained by prices that are high relative to average income levels. While high prices can result from increases in housing demand, they can only be sustained when supply is not responsive. Evidence suggests that the current supply of housing is at insufficient levels, placing ongoing pressure on house prices.

The recommended reforms to stamp duties and land tax in particular should reduce current impediments to housing supply generated by the tax system. However, as taxation is not the major source of supply constraints in the Australian housing market, housing affordability would be best promoted through wider reforms that facilitate housing supply. Following these reforms and improvements to housing assistance, the taxation of investment housing should be reformed to ensure a more neutral treatment of rental property investment. While these reforms will address the significant distortions the tax system has on the housing market, a range of non-tax policies have a more significant impact on housing supply and affordability.

Housing supply can be restricted through a range of policies, such as planning and zoning regulations, as well as the approvals processes that govern them. However, such policies are designed to achieve a range of policy objectives, against which their impact on the price of housing should be assessed. The use of infrastructure charges has the potential to improve the allocation of infrastructure. However, where they are not set appropriately, infrastructure charges can reduce the supply of housing, and increase overall house prices.

While they may promote housing affordability, proposals that increase housing supply may reduce existing home values and change the shape of Australian cities in ways that many existing residents do not desire. This suggests a serious community dialogue is needed on the distribution and quality of housing across Australia. As a first step, the Council of Australian Governments should review zoning, planning and development approval policies and infrastructure charges to ensure they do not unnecessarily reduce housing supply.