

The current inequitable taxation of land at the three levels of Government in Australia: A case for reform.

By Irene Jablonka

BSc; BBus(Acc); MTax; DipFS(Fin Plan).

Summary;

The 1999 Ralph Report was limited to taxation at the Commonwealth level. The current review, which the Rudd Government has initiated, will overcome this restriction. Looking across the three levels of Government in Australia, I would like to see:

- ❑ Land Tax abolished at State level. This would abolish multiple taxation levels of the asset. It would also provide for consistent treatment with other assets such as shares.
- ❑ No taxation based on valuation. Taxes at whatever level of Government, which are connected with an asset to be assessed at the time that income is received (i.e. on disposal or when deriving a regular income stream). This would give the taxpayer more opportunity to have an available source of funds from which the tax could be paid.
- ❑ The immediate introduction of interim provisions to the current Land Tax and Council Rates regimes until such time as Land Tax is abolished and Rates Systems are modified.
- ❑ Economies of scale in cost of collection: - Once Land Tax is abolished, Commonwealth Government taxes (GST in particular), to provide for more of the fiscal needs of States so reduce the cost of collecting the taxes, which the State Revenue Offices currently collect.
- ❑ Any Local Council rates, which are levied, to be separated into supply and usage components and shared by the landowner and tenant. I would like these charges to be based on cost and not on a notional valuation of property.

The Tax Liabilities Of An Owner Of Land In Australia

There are four types of taxes for landowners in Australia whilst there are only two types for owners of other assets such as shares.

Furthermore the owners of land are taxed at three levels of Government, namely Federal, State and Local, whilst owners of assets, other than land, only are taxed at the Federal level¹.

The landowner must pay Land Tax² to the State Government and rates to Local Government for merely being a landowner. Both of these taxes are on the unrealised, notional value of the landholding and are payable regardless of the taxpayers' cash receipts in that year. If the land is used to derive rental income, the rent is assessable income, on revenue account, at Federal level.

If the land is sold from time to time and a gain is realised, then the gain is subject to Federal Capital Gains Tax (CGT). If there is rent, it is ordinary income for the purpose of Federal Tax. The two classes of assessable incomes, income on revenue account and profit/loss on capital account, are considered separately in the Income Tax Assessment Act (ITAA). There are some specific offset provisions in connection with losses. If land is sold as part of a business activity then it is assessable as income in the same manner that the rent was and not subject to the concessional provisions of the CGT.

Compare this to the holding of shares or options or futures.

There are no holding taxes for the holding of shares or options or other financial products at any level of government.

There is income tax on dividends at the Federal level. This may be subject to a rebate for franking credits if the company had paid taxes on profits. There is Federal tax on any capital gains following a disposal. In some cases there may be taxation on revenue account connected with the gains from the sale of the shares if there are many transactions in the year.

There is no taxation at the Local and State Government level for the share owner who merely holds shares.

So I ask why do we subject the landowner to this four-fold taxation regime relating to this particular asset i.e. CGT, Land Tax, Council rates and income tax?

¹ I am excluding the costs of asset transfer such as State stamp duty and registration fees, which may be applicable to all assets discussed in this paper.

² Land Tax is payable for land which is not in one of the exempt categories.

The Howard Government's Review and Reform of the Commonwealth Taxation System

The Tax Reform of Commonwealth Income and Business Taxes that took place about ten years ago, under the Howard Government promised us Simplicity, Incentive, Security, and Consistency³. It took years to implement the agreed changes. Numerous insurmountable hurdles and restrictions were encountered along the road to the set goals. There have been many amendments since that time.

The 1999 Ralph Report was limited to taxation at the Commonwealth level. The current review: Australia's Future Tax System (AFTS), which the Rudd Government has initiated, overcomes this restriction.

Tax reform is a time consuming and complex process, which does not happen overnight. I leave others to judge whether we as a community got the "certainty, equity and durability" we hoped for from implementation of the Ralph Review. With that in mind I shall discuss later in this paper some simple interim changes, which may be considered as a relatively 'quick fix' to the existing Land Tax and Council Rates systems.

Valuations and the Levying of Taxes

The Ralph Report, of ten years back, also offered for our consideration one of the most impractical proposals⁴ for the calculation of Taxable Income, the so-called 'Option 2'.

That method was governed by a formula, which had taxation based on a number, that combined assessable income less allowable deductions with a change in value of the net assets of the taxpayer. The net income part of the equation would have been similar to the previous method and I happily say the current method, but the change in net assets for the period in question would have been an accountant's nightmare and a bonanza for the valuers. The cost of compliance would have been huge for both the taxpayer and the regulator. Each tax return would require valuations, as would each compliance audit. At best the calculation of the change in net assets would have been an inexact science.

Over the years, I have sat through a number of conference presentations where valuers themselves state that valuation is both an art and a science. Had this method

³ *Administration and Tax Reform ; Australian Tax Teacher's Association speech by Michael D'Ascenzo, Second Commissioner of Taxation - 23 January 2004.*

⁴ *In 1999, the Australian government received and basically adopted the Ralph Report which recommended sweeping changes to the basis of business taxation in the Federal domestic and international tax regimes. Some of the recommended changes finally made their way to the statute book, others fell by the wayside. Proposals to install the 'tax value' or the 'Option 2' method of calculating corporate tax were dropped after an extended period of consultation.*

of calculating taxable income been adopted we would have had as part of our Federal Income Tax Regime, the taxation of *unrealised changes in the net assets for the year, as based on valuations obtained.*

Taxation of anything based on valuations depends on there being a market for the asset and on sufficient knowledge of the asset to be able find and use relevant comparables. It also depends on the actual and current sales of these comparables.

Clearly taxation based on valuations presents technical and methodological problems.

Fortunately we had the wisdom to leave the very theoretical, impractical and inequitable 'Option 2' alone. It was not adopted. The current taxable income is relatively easy to calculate, once you decide what income is assessable and what deductions are allowable.

Just ten years ago the Commonwealth of Australia rejected taxation based on valuations.

The Case for 'No Valuation- Based Taxes' at State and Local Government Level.

I have just discussed taxation based on valuations at the Commonwealth level, which we rejected ten years ago. Till now, there has been no opportunity to review the valuation-based State and Local Government taxes/rates that are and have been applied for many years.

Valuations take time and cost money. Generally they are out of date even at the time they are obtained. This is amply evidenced by use of the recent, but no longer current, land valuations for calculating Council Rates and for Land Tax in this current (2009) year. Land Taxes and Rates this year have been levied on 'boom-time' valuations that are over a year out of date. Since that time the market has dropped and yet these valuations will continue to be used as the basis for assessments in the following year. Councils do valuations every two years and State Government uses the Council valuations for their Land Tax assessments.

With the current taxation of land we also have the problem of equity. Is it fair to tax Australians and expect them to pay out real dollars by a specified due date on notional, unrealised gains?

We did not fall into the trap of taxing unrealised gains with respect to income tax, as would have been the case with 'Option 2' of the Ralph Report.

Yet for years we have had State and Local Government tax and expect actual payment from cash flow on unrealised assets such as land.

State Government taxes landholders (except for those in exempt categories) on valuations they have obtained for the value of the land such taxpayers hold in their State.

Similarly Local Councils also tax these landowners by way of Council Rates on the valuations they have obtained for the land they hold in the municipality.

To me it is totally irrational. It is inequitable and more than ready for reform. Will this be the year, in which, we as a community, bite the bullet and obtain equity in this area of taxation?

Let us consider the total picture of the landowner who is not in an exempt category.

Landowners pay Rates and Land Tax on land, which has not been sold. In the taxable year they have not received any consideration on disposal of the said land. Doubtless they had expenses. Some of these costs may not have been deductible under the Federal taxation regime. They may or may not have received income. At Commonwealth Government level they pay income tax for the net rent they may have received if the land or assets are rented.

If the land or assets are sold at a profit, there is Capital Gains Tax at the Federal level.

Capital Gains Tax on disposal of assets was introduced back in 1985. In its simplest form this basically means that you do not pay tax until you have realised the asset at a gain. There are other rules, which let you offset the gain provided certain criteria are met. There are also rollover provisions to defer the payment in some cases. However, in general, it means if you have a gain on capital account, for whatever asset, be it a house or land or plant and equipment or shares, the gain you made is assessable.

Such equity does not exist in the Land Taxes and Rates levied by the States and by Local Councils.

The States do not tax assets other than land. You can own a fortune in shares and even if the value of the shares is governed by trade on a regulated Stock Exchange and published minute by minute on the Internet, the States do not tax them. We have here an asset, which is valued, by the market, the valuation is recorded instantaneously at no cost to the States and no State taxes apply.

Your shares, options, futures, warrants etc may increase in value at the published rate as valued by the Market and the States are not interested in your increased wealth as a consequence of this.

They are only interested in taxing your land, based on a valuation, which often is outdated. In a radio interview this year, I heard the present Lord Mayor of Melbourne say that it took his Council eight months to obtain all the valuations for properties in his municipality. At the earliest it would be the following rate year that they could be used.

Where is the equity of that? Where is the accuracy? Where is the money going to come from, so that those who have Land Tax Assessments can pay this tax?

Landowners, especially those who have small holdings/ small business owners and/or self-funded retirees depending on this income, often suffer great financial stress when they need to find the money, to pay these State and Local Council charges. They may incur severe penalties if they do not pay by the due date.

We rejected the use of valuations for the proposed calculation of taxable income for Commonwealth taxes, yet we continue to use them at State and Local Government level.

I am not recommending that the States should tax the holding of shares. I merely ask why is it that they tax the holding of land? Not only do they tax the holding of the asset, land, they unlike the Federal Capital Gains regime, do not allow for rollover provisions on this tax which becomes payable very shortly after an assessment notice is issued.

Local Governments when levying rates do not distinguish between those who use their services and those who merely have these services available in the vicinity of their property.

Likewise Councils assess Rates on the basis of land value as adjusted for the improved value of the property. Under residential leases the owner pays the Council rates and under commercial leases it is usually the tenant. At best it is inflationary as it pushes up rents. If some landlords are forced to sell, scarcity will push up rents even further in an inflationary spiral.

Again cash flow has to be found by the owner to pay rates based on valuations that are often more than a year out of date.

Another Model For Local Government Taxes

For the non-resident landowner the payment of Council Rates provides few benefits at present. The main benefits derived from Council Services do not relate to the holding of land. Rubbish collection, childcare, libraries, sporting events most benefit the resident or workers or even members of the general public, rather than the landowner. Often if specific Council services are needed additional charges above the rate payment apply. Planning fees, inspection fees are examples of two such fees. There are many others.

It is the resident who must vote at Council elections that elect the Councillors. The non-resident landowner may vote if he wishes. Furthermore, the landowner does not vote in relation to their landholding whilst they are taxed according to the value of the landholding. I see no equity in this current arrangement.

I favour a model for collection of Council revenue to have at least some part of the Bill chargeable to the user. I do not feel it is equitable that any part of this hypothetical Bill be based on valuation of land.

I bring to your attention, in this paper, a model for charging that is currently used by the Utilities i.e. suppliers of water, gas and electricity. In general there are supply and usage charges. I would like aspects of the model considered for part of a future Local Government revenue collection system.

Instead of the current rates we could have a billing system. Those who live in/use the property/land pay the usage charge and those who have the infrastructure connected pay the supply charge. In such a model I would prefer the supply charges to be related to supply maintenance rather than a valuation of the property/land. This type of billing is used by the Water Suppliers in Victoria.

A further variation on this is the model used by the power and gas companies. These entities charge the user for both the supply and the usage of their services. In any case they do not charge a landowner for usage if he does not use their service. If there is no supply, there is also no charge to anyone.

A future basis of charging on such a Council Bill may be as follows:

Supply: costs related to infrastructure such as parks, public buildings and

Usage: costs of using rubbish collection, the tip, sporting facilities, childcare, maternal services, and domiciliary services.

State Government Taxation of Land

I submit that there is no good reason in the States continuing to tax the holding of land of those land owners, who are not in the exempt category, as they derive little overall fiscal benefit in terms of their overall State Budgets and impose a great deal of hardship on the few landowners who must pay this regressive and I would imagine 'expensive to collect' tax.

State Government provides nothing to the landowner by virtue of their land ownership even though they tax them for the holding of land in the State.

In this paper I do not intend to discuss the issue of State transfer taxes such as stamp duty and registration fees. At least these are generally 'one off' costs and are applied across most assets, even if they are not applied to all who are involved in such transfers.

Source of Funds for the Running of State and Local Governments

Having dealt with the lack of equity, consistency and accuracy in the existing systems, which tax assets in Australia I wish to say that it is in fact GST, which is the main source of funds for State Government.

In turn, it is the States that fund the Local Councils from their GST allocation.

Tracing through the funding of both State and Local Government we can only conclude that it is Commonwealth Government based. It emanates from the 'bag of gold' which derives from the GST⁵ that the ATO collects each year. Without the allocation of this 'bag of gold' to the States and subsequently its reallocation by the States to the Local councils neither tier of government would be able to exist by relying on its own current taxation practices.

⁵ GST is a not part of this Rudd Government Tax Review and will continue to be a source of State and Local Government funding.

Simply put, neither the Council rates nor the State collected taxes are able to keep these respective governments in business.

The Current Commissioner of Taxation Mr Michael D'Ascenzo⁶ in a speech in 1999 stated this very feature of the GST System.

“Indirect Tax and State Finances

The key feature is the introduction of a Goods and Services Tax (GST) at a rate of 10%. While the GST is collected by the Australian Taxation Office, the GST revenue goes to States and Territories. States are required to make payments to Local Government out of GST revenue.”

Lurks and Perks in the Current Land Tax Systems

The above discussion dealt with Council Rates and Land Tax. It focussed on the inequity issues of taxing a selected asset class (land), of having a valuation-based tax and of the lack of rollover provisions and offsets available in the systems currently in use.

I now wish to convey my concern about land being taxed independently by each state and territory.

For example: a person who has land in each state in Australia with a total value of \$10 million dollars will pay less Land Tax than another who owns \$10 million dollars worth of land in Victoria. This is because different, often progressive tax rates are applied to assessments in each jurisdiction. There are also different valuation bandwidths for each rate and different tax-free thresholds.

I believe that if we have taxation of landowners for the holding of land, it must be a National System.

Furthermore, if I beneficially hold land in Victoria via a number of entities, then each entity will be taxed separately for the land it holds. Alternatively I may decide to have each property in the name of a different family member. Here again the disaggregation will attract both the tax-free threshold and the lower rates for each legal owner.

I submit that **if** we continue to have Land Tax, something I do not recommend, then we should abolish the progressive rates which currently apply and have a flat rate of tax and an indexed tax-free threshold which is realistic in terms of the median price of land in the country, under the economic circumstances that prevail.

I also believe that there should be a cap to the tax-free threshold for the principal residence. It is totally inequitable that someone who lives in a \$10 million principal residence pays no Land Tax whilst another who owns a modest principal residence

⁶ *Challenges of a New Federation; Australian Local Government Association
1999 National General Assembly Of Local Government
Presentation by Michael D'Ascenzo; Second Commissioner of Taxation
Canberra, 30 November 1999.*

and a couple of investment properties with a total value of \$3 million suffers the spiralling cost of a valuation-based Land Tax.

Closing Remarks

I respectfully submit that we abolish valuation-based taxes.

After all, gains connected with land ownership are already taxed in a far more realistic and equitable way by the Commonwealth by means of Capital Gains Tax (CGT), which applies upon realisation of the asset and applies to a broad range of assets. ITAA also taxes any assessable income derived from the land ownership in that year of income. A trade-off point for the States to abolish Land Tax may be some form of additional allocation from the Commonwealth's collections of Capital Gains Taxes. Alternatively it may be agreed that an increased allocation from GST shall be made if the States forego the collection of Land Tax.

Such an outcome would save the States the costs of collecting Land Tax. Land Tax is a regressive tax. It has many exempt categories. I imagine that it is expensive to administer. It certainly is a huge burden on those who still suffer this liability.

If we cannot abolish Land Tax⁷ then we must immediately modify it so that it is a National System with a realistic tax-free threshold, a cap on the value of the principal residence that is exempt and a flat rate to prevent the lurks I just mentioned briefly.

I also suggest that we review the model for assessment of Council Rates.

If Councils need to charge rates then I suggest we look at aspects of the models used by providers of gas, power and water to properties. Such rates would be based on supply and usage of services and their costs. They would not be valuation of land based.

Such charges could be allocated to the resident and/or the owner and not just the owner.

I thank the reader for reading this submission and hope for your kind consideration of the matters raised herein. If nothing else I hope that I have provided some issues for further discussion.

Irene Jablonka
April 14, 2009.

[removed for privacy reasons]

⁷ Nothing would be simpler to my mind then to say to the States, no more Land Tax and here is an additional \$700,000 in GST funds from Canberra.