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## LAND TAX IN NEW SOUTH WALES — THE CINDERELLA TAX

By Richard Giles

(Talk given at the Land Tax Forum, November 17, 1990, at Clifton Hill, Vic.)

The basis of Land Tax is simple. Sky scrapers are not built to annoy environmentalists, but help more people to occupy the same site. A good location makes work easier. A bad location must be made up for by working harder, and no one wants to work harder. Producers compete for good locations, and this competition raises the price of access to these sites. The end result is that this price of access approximates to the price of the effort saved on the better site. This price of access to a more productive site is rent. Because there are all kinds of 'rent' we will call this higher production on a better site, and the price of access to it, *economic rent*.

The price of access is paid to the landowner, or kept by the owner if he occupies the site. This is illogical since it is the location of the site and not the land itself which gives it advantages. It is what is around the site, rather than the space which is the site, that creates its price of access.

What is around the site? The community: people; their skills, personal wealth, civilised habits; roads and public transport which give people and goods access to the site. When one pays rent for a better location, one pays for the presence of people and goods and services around the location.

Why do not we collect more economic rent as our revenue?

### WHY CINDERELLA?

I have called Land Tax in New South Wales the Cinderella Tax because it is given an obscure position among other State taxes which are quite ugly in their economic effects. I have also called it the Cinderella Tax because curiosity about it is answered by lies and half-truths, or silence.

What does our Cinderella look like in New South Wales? Land Tax, as she does in the other States, lives with two ugly sisters. These are the Payroll Tax and Stamp Duties, important taxes which absorb administrative costs and account for about 30 per cent and 20 per cent of State revenue respectively. Payroll Tax has fallen marginally in size in the ten years 1976/7 to 1986/7 but Stamp Duty has nearly doubled. At the same time Land Tax has been more than halved, falling from 13.73% of State revenue in 1976/7 to 6.61% in 1986/7.

Since Mr. Greiner's Third Budget in September, 1990, Land Tax has been levied at \$100 plus 1.5% of land value on rental properties and on commercial and industrial land over \$160,000 in value. Because valuations are made only every three years an 'equalisation factor' is introduced from estimates of land values to adjust land values for tax purposes in the intervening years. At present this equalisation factor is 17%. There are twelve large classes of exemp-

tions, most recent are retirement villages and nursing homes. The main ones are the landowner's principal place of residence and the family farm. The Collins Report in 1988 estimated the current worth of exemptions in 1988 at close to \$2b. This nearly \$2b. which the cost of these exemptions from land tax is 545% of what was collected, as compared with 27.8% as the cost of payroll exemptions and 7.4% as the cost of Stamp Duties exemptions. Had the amount of \$2b. in 1988 been collected, then Land Tax (then set at 2% of the State's land value) would have contri-

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buted nearly half of New South Wales State revenue in 1986/7; that is, nearly as much as Payroll Tax and Stamp Duties combined!

Exemptions also introduce the possibility of avoidance. One such evasion is where land that is presumably rural is, in fact, vacant and speculative awaiting rezoning or the spread of settlement.

### LESS THAN OTHER TAXES

Land Tax, which could be as large, or larger, than Payroll Tax and Stamp Duties combined, is reduced to less than the combined taxes on lotteries and poker machines (\$372m. to \$345m.). While land tax does nothing to discourage the use of land, payroll tax does a lot to discourage the employment of labour. Payroll Tax is an inducement to pay labour less and in ways other than in wages. It is an anti-labour tax. We know less about Stamp Duties but it is common knowledge that it impedes business and it is an administrative nuisance. We should also know that stamp duties have proven to be capable of avoidance and are quite volatile. They lead to transactions such as the signing of contracts and the conveyancing of property being transferred to those places which do not charge stamp duties, and about which the State has no knowledge. Complex anti-avoidance legislation has not put an end to this. As more land becomes foreign owned this problem will worsen. Stamp duties have also proven to be volatile. Mr. Greiner reports in his latest budget speech that "stamp duty on contracts and conveyances and share duty have declined \$818 million in real terms over the last two years". These losses of revenue have occurred at a time when the Commonwealth is cutting its payments to New South Wales; Mr. Greiner reports this loss over three years to be \$685m. when adjusted for inflation. By contrast, the rental value of land in New South Wales stayed more or less stable in 1990.

If Mr. Greiner was looking for a more dependable and more economically neutral revenue it seems that land tax must be seriously considered. In 1986/7, because of exemptions, it supplied \$350m. Massive exemptions downgrade land tax in relation to other revenue bases. Are incomes subject to exemption?

The fact that it applies to little more than commercial, industrial, and rented property in the city of Sydney has given the impression that only the wealthy ought to pay land tax.

"The-thin-edge-of-the-wedge" theory that it can be progressively applied has

not worked. While it is not applied at all to most people, it will only ever be applied in part to those who own the bulk of our valuable land. The exemptions to the poor have been an efficient shield protecting the rich. Far from land tax being further applied over time, it has been less applied. At the beginning of 1990 only 3% paid it in New South Wales – it is less now. With the possible advent of state income and consumption taxes the way is clear for its almost total abolition.

### PROTESTS

After well-publicised protests, land tax was reviewed in April, 1990; the main result was that the threshold was raised from \$134,000 to \$160,000 and the rate cut from 2 to 1.5%. The same sort of protests followed in Melbourne in May. In some shop windows a poster shows land tax, an ugly python, squeezing the life out of Melbourne properties.

Who or what is being squeezed by land tax? The tenant shopkeepers think it is they, since the poster goes on to say in part "Save Our Shops. Land Tax will cost jobs, cause higher prices..."

So the argument is clearly that the land tax will be passed on by city landowners to their tenants who, in turn, will either go out of business – the part about jobs being lost – or pass over the tax to consumers in higher prices.

So we must face the question; can landowners pass on a larger land tax to tenants by higher rents?

One fundamental fact is that in reality the tenant only pays rent. He does not pay some rent and some Outgoings. In the same way, the employee in reality receives only wages and not, say, some wages and some fringe benefits. In the same way as many employers turned fringe benefits into cash payments to avoid the fringe benefit tax, landlords who charge their tenants for Outgoings, get less rent than those who charge rent only – indexed to the CPI.

A fundamental fact, especially so in times of bad trade, is that very few tenants can pay more rent than they are already paying. They are rack-rented. Any increase in rent means a fall in wages to an unacceptable level. A tenant cannot continue long in this situation without relief.

As I came into Melbourne I noticed a sign on the side of a tram, "NOW is the time to buy land". In Sydney wherever one looks property is being offered for sale. Given that there are always exceptional cases, at this time of recession vacancy levels are rising. While this may threaten tenants, it does tend to make landowners, often on the advice

of their agents, cautious about raising rents. The tenant is the producer, not the landlord. You do not kill the goose that lays the golden egg.

### CONCLUSION

One could say that if land tax had not risen, then the question would not have arisen. If land tax had been reduced, tenants would have received no long term relief in rents. Under some leases tenants might lose in the short term before adjustments are made to lower their basic rents, though even here there is room for negotiation. This case would approximate to the Executive who temporarily loses his fringe benefits until he is compensated in higher wages. There are also cases where a wrong-headed landlord persists in passing on increased land tax without later adjustment. This will not drive his tenants out of business, but will inconvenience them and they will shift to another location. In times of weakening trade, it will be the landlord who suffers more, especially should he have a mortgage, and the experience will not be lost on the agent in the area. Rent does not go up because land tax is increased.

The answer that land tax cannot be passed on to tenants in any longstanding way is the standard answer given by Professor Paul Samuelson in his *Economics* (see pp.541-3, 6th Edition). As he says, "What can the landowners do but accept less return".

While welfare organisations, political parties, and the rich themselves think of land tax as a wealth tax, it is not. It is an attempt by the community to get back what it produces: that is, its economic rent. Land tax can be thought of in two ways. It is a way to force the landowner to disgorge what is not his – the price of benefits to which the site has access. It is also a way to charge the tenant for those benefits – the landowner is simply the intermediary. We do not know Cinderella's real name, but if our focus is the tenant and not the landlord, then land tax might be better named rent.

One interesting point I came across as I researched Collins' Review of the State Tax System (1988) was that, while the community does not collect much land tax, its taxes are structured by exemptions and rates so that in effect they are a "tax" on economic rent.

If what we are taxing at the moment is more or less rent, and if our tax system in New South Wales is already a clumsy kind of economic rent, why do not we change over completely to a system which will do the same thing in a more efficient way?