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A review of objections to residential land values used to assess State land tax: a case study of inner Sydney, New South Wales

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Abstract

New South Wales has experienced very intense affordability challenges during the 2012 to 2017 Australian housing price boom. While negative gearing has attracted the most attention in discussions of affordable housing in the media, other property tax elements also have market-distorting effects; here, we consider the effects of the land tax free threshold. We present the arguments for freezing the land tax free threshold, and examine the barriers to such a strategy, focusing on the likelihood of investor resistance to such a policy initiative by reference to objections to land values used to assess this tax.

Using ten local government areas (LGAs) in Sydney as case studies, objections to land values used to assess land tax across seven years are measured against the land tax free threshold. Census data is used to measure changes in residential property investment activity across LGAs and study periods. The article demonstrates that volatility, in particular increases in land values, is a primary factor impacting objections to land values in New South Wales. The study concludes that carefully designed changes to the land tax free threshold could smooth the transition and reduce objections to land values, while eliminating the distorting effects that the land tax free threshold has had on the competition between investors and homebuyers.

Key words: land tax free threshold, objections, land value, housing

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1. INTRODUCTION

Property values and taxation have interacted to drive property investment behaviour over the last three decades in Australia. The literature on tax reform presents strong arguments that allowances and exemptions that once played a positive role now contribute to distorting housing investment decisions; these arguments support the position that property tax mechanisms are due for review. This article investigates how the exemptions offered by Australia's State (subnational) governments affect the impost of land tax and in turn influence investment behaviour.

As of 2019 Australia's housing assets were valued at approximately AUD 6.6 trillion, representing a decline of AUD 172 billion over the previous 18 months (Australian Bureau of Statistics (ABS), 2019). While such declines may be argued to have been caused to a large extent by Australia's strong financial system, the factor that influenced the most recent decline in values related to the monetary reforms following the recommendations of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Hon Kenneth Hayne, chair) of 2019. Changes to lending policy and tightening of monetary supply have impacted house prices (Stein, 2019) which demonstrates the commitment to reforms that have contributed to driving housing prices for the past decade, particularly in Sydney and New South Wales.

Further to monetary policy, taxation is a variable that influences house prices in high-priced markets. The objective of examining taxation and how it has interacted with property markets identifies the potential impact policy changes have had on residential house prices, and provides a basis to understand their likely impacts into the future. In undertaking this review, it is acknowledged that each tier of government in Australia impacts house prices and investment through fiscal imposts or exemptions and concessions to some degree. The ability to reform a tax concession in some circumstances may be mistakenly perceived to constitute a new tax, even when the reform responds to an outdated concession that no longer serves its initial purpose.

Taking a broader view, tax policy aimed at moderating housing prices and incentivising the provision of some types of housing is consistent with the principles expressed in the International Covenant on Economic, Social and Cultural Rights,[1] a United Nations document ratified by Australia in 1975. Article 11(1) of the Covenant commits signatory states to 'recognize the right of everyone to an adequate standard of living for himself and his family, including adequate food, clothing and housing, and to the continuous improvement of living conditions'. Hohmann (2020, pp. 293-294) argues that reframing the Australian discourse on housing affordability in terms of its basis in human rights principles is essential if we are to 'shift the underlying terrain of debate' and focus on housing as a social good rather than an investment good. A close examination of the structure and distributional impacts of tax policies can contribute to this new terrain of debate.

[1] *International Covenant on Economic, Social and Cultural Rights*, opened for signature 16 December 1966, 993 UNTS 3 (entered into force 3 January 1976), https://treaties.un.org/pages/showDetails.aspx?objid=080000028002b6ed. See also Australian Human Rights Commission, 'ICESCR: Human rights at your fingertips', https://humanrights.gov.au/our-work/commission-general/international-covenant-economic-social-and-cultural-rights-human-rights (accessed 13 January 2021).

While there may be 'consensus that a coordinated well-designed reform to the treatment of housing in the tax system can make a significant contribution to improving housing outcomes' (Eccleston et al., 2018, p. 1), each tier of government plays a role in such reform. The ability to deduct a tax imposed by one tier of government (State land tax) against tax imposed by a higher tier of government (Commonwealth (national) income tax) further accentuates the attractiveness of investment in housing (Australian Treasury (2015, p. 24).

The literature review that follows commences with an overview of changes in home ownership rates in Australia over the past two decades (and the impact of investor – homebuyer competition on those changes). Next, we review the main taxes applied to housing by each level of government. The literature shows that no one tax or tax concession alone is a sole factor impacting housing. However, one allowance at the State level that may impact investment decisions and competition for housing between owner occupiers and investors is of particular interest here. A closer analysis of the relationship between the land tax free threshold and objection to land values provides an argument for the importance of the transition away from the land tax free status for residential investment property. This article provides a guide as to how such reform might be designed.

2. TRENDS IN HOMEOWNERSHIP

Nationally in Australia, homeownership rates declined slightly between 1961 (72%) and 2011 (67%) (Yates, 2015). The 2016 Census (ABS, 2017a) reported a further decline in national homeownership rates to 65.5%. Homeownership rates would likely be lower were it not for Australia's aging population, with older cohorts far more likely to own homes than younger ones. Professor Judith Yates (2015) shows that homeownership rates have contracted quite sharply for those in the 25 to 34 year age group (from 60% in 1961 to 47% in 2011) and 35 to 44 year group (from 72% to 64%). In 2016, homeownership rates among these age groups declined further, to 45% and 62% respectively (Daley, Coates & Wiltshire, 2018, p. 70). Other factors than age are at play here – changing family composition (such as later childbearing), and changing income levels and employment security are likely to be crucial contributors to these trends, along with changing migration patterns.

Burke, Stone and Ralston (2014) examine changing homeownership rates in more detail, and while they identify similar declines between 1981 and 2011 for younger households, they point out that the sharpest decline was in the 1981 to 1991 period (when interest rates were high). Home buying in fact increased for these two younger cohorts between 1991 and 2011; the significant decline is in rates of outright homeownership. They point to the increasing disparity between higher and lower income households' purchasing ability, with much higher proportions of younger purchasers in 2011 from dual-income households (80%) compared to 1981 (50%). Their research identifies a variety of adaptive strategies, concluding that 'the value of home ownership is so strong in Australia that there appears to be considerable resilience in the tenure, with households responding in various adaptive ways to achieve purchases in the face of quite difficult barriers' (Burke, Stone & Ralston, 2014, p. 2).

Can we identify a causal link between declining rates of home ownership among younger households, and the competition from investor-purchasers, responding to the tax incentive regime? Property transaction data from mid-2016 show that investors had purchased a higher proportion of low-priced properties in Sydney than owner-occupiers over the prior 12 months (Fitzsimmons, 2016). State policy has adapted by reducing or eliminating stamp duty on lower priced homes for first home buyers (Gerathey, 2017), and recent changes to lending standards have disproportionately affected highly leveraged investor-purchasers (Letts, 2018). These trends suggest that tax policy is at most only a partial driver of shifts in the balance between investors and first-time buyers; lending standards, investor regulation regimes (abroad as well as within Australia) and other direct home buyer incentives are likely to play the dominant role. Nevertheless, as political debate continues at the national level around negative gearing and other investor incentives, States clearly have a role to play in managing the fallout of the intensely competitive investor-purchaser environment of the past half-decade. The following section explains the tax environment under the influence of which housing markets have evolved in Australia.

3. THE TAXATION OF PROPERTY AND CURRENT STATUS IN AUSTRALIA

3.1 Commonwealth

Negative gearing and the capital gains tax (CGT) discount in their application to residential property are two tax concessions that have increasingly featured in tax debates over the past 30 years in Australia. These concessions have progressively continued to distort property markets and embrace outdated objectives that no longer serve Australia's modern housing needs (Wood, Ong & Stewart, 2010; Kelly, 2013).

3.1.1 Negative gearing

The Productivity Commission (2004) highlights Australia's negative gearing provisions as being among the most generous of the Organisation for Economic Co-operation and Development (OECD) member countries. The Australian government removed negative gearing in 1985; this reform was repealed two years later following a campaign for reinstatement resulting from the negative impact on the Sydney housing rental market. In defining the growth of negative gearing in the Australian residential property market, Eccleston et al. (2018) refer to estimates from the Australian Taxation Office (ATO), in highlighting that 63% of all property investors were negatively geared in 2013-14, compared to just 50% in 1993-94. This incentive boosts investors cash flow enhancing their ability to compete against first home owners.

3.1.2 Capital gains tax

Eccleston et al. (2018, p. 23) have noted that '[t]he CGT discount for individuals and trusts represented AUD 6.84 billion in revenue forgone in 2016-17. Because most capital gains are accrued and realised by taxpayers with high taxable incomes, the benefits of the discount flow disproportionately to these households'. Among the provisions that have led to a distorted and inequitable distribution of housing assets and outcomes in the housing market, Kelly (2013) defines the CGT exemption applied to the main residence as encouraging over-investment in existing housing by owner occupiers.

In highlighting the impact of the capital gains tax exemption on the home, Yates (2010) refers to the report of the Senate Select Committee on Housing Affordability in Australia (2008, [4.38]), in stating that the capital gains tax subsidy 'favours home owners, not home ownership' (Yates 2010, p. 63). Overinvestment of owner-occupied housing further extends to include the store of wealth in housing that is fuelled by demand that outstrips supply, in which Yates (2009, p. 37) states:

> As demand side subsidies that create an economic incentive to increasing consumption of housing through home ownership, they add to price pressures in the housing market and thereby contribute to the affordability constraints faced by aspiring home owners.

3.2 State and local government

Eccleston et al. (2018, p. 41 (references omitted)) have noted that:

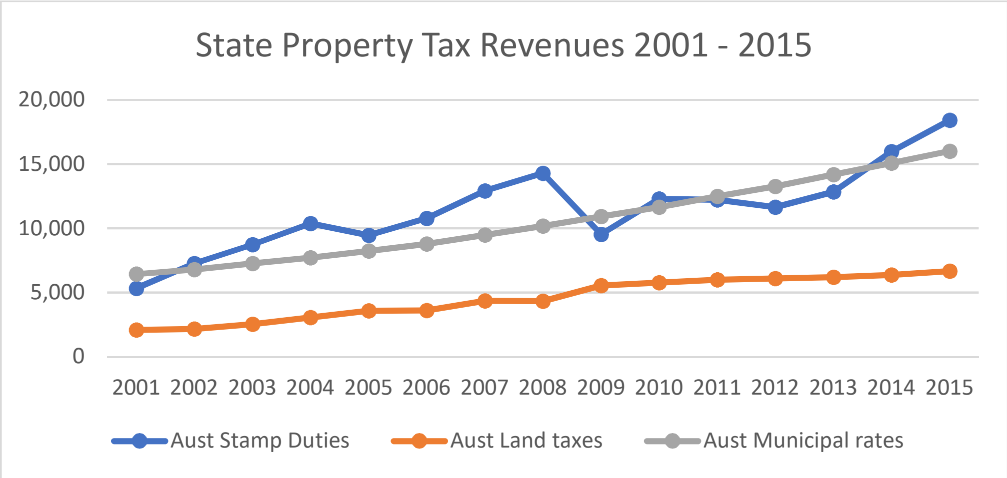
> [i]n Australia, there are currently three forms of subnational tax on land and residential property: transfer duties, state land tax and local government rates. These taxes together raised over $40 billion in 2014-15, which was 10.1 per cent of all taxes collected in Australia. They are an important source of revenue for state and local governments, with transfer duty particularly lucrative ($18.5 billion in 2014-15, or almost half of all property tax).
>
> Despite their revenue significance, however, there is agreement in the literature that state property taxes are poorly designed and require reform. … Transfer duties on property are inefficient, subject to housing market volatility, and responsible for under-utilisation of housing stock and constrained housing mobility.

Introducing a recurrent property tax on a broad base with few exemptions would provide a more stable, efficient source of revenue. Mangioni and Warren (2014) further state that that the efficiency factor often referred to is driven by the principle that property values are determined on highest and best use of land.

Transfer duties impose a 'large, up-front cost' on property, which impacts the optimal use of housing; Furthermore, '[b]ecause transfer duty revenue depends on the volume and value of transactions in the market, it is unpredictable and vulnerable to market disruptions' (Eccleston et al., p. 41, citing Henry Review, 2009 and Productivity Commission, 2018). In contrast to other State imposed taxes, Figure 1 sets out the volatility in revenue from transfer tax compared with land tax and council rates. As Eccleston et al. conclude (2018, p. 41), '[s]hifting to a recurrent property tax would generate a significant efficiency dividend through greater stability in state revenue, improved transparency within the tax system while enhancing residential mobility and housing affordability (Daley & Coates, 2015; Henry Review, 2009; Mangioni, 2016)'.

While recurrent land and property taxation is stated to be economically efficient and least distortive of the property taxes, its perception by taxpayers is not readily accepted nor always understood and the base on which this tax is set is subject to challenge. It is this factor, challenges to land values that this article now turns to in examining objections against the contestable component of this tax, namely the land value on which this tax is assessed in New South Wales. While a number of studies have examined the benefits of transitioning from transaction taxes to a broad-based land tax, what has yet to be examined is how land tax may be expanded and the potential consequences of this reform in the form of objections to land values by residential property investors.

Fig. 1: Tax Revenue from Stamp Duty, Land Tax and Council Rates (AUD million)



Source: ABS (2017b).

4. THE ASSESSMENT OF LAND TAX AND THE TAX-FREE THRESHOLD

In this section we set out an overview of this tax, its relationship to concepts of human rights to which Australia adheres, and the component parts used to assess land tax in New South Wales.

Table 1 sets out the component parts of the tax in the first column, with a summary of how these components apply to the assessment process in the second column.

Table 1: Land Tax Components

Components	Application Summary
Tax base / basis of value	The bases of value on which land tax is assessed varies marginally across the six States being either Land or Site Value. In NSW the land value is re-determined every year for the 2.5 million dollar parcels of land across the State.
Rate-in-the-dollar	This rate is applied to the land value to assess the land tax applicable. The rate-in-the-dollar is set by statute and rarely changes.
Taxpaying Entity	Depicts the various ownership types in which land is held and these comprise individual persons, companies or trusts.
Investor Tax Free Threshold	Exemption applied to State land tax and is distinguished by a number of factors including the use of the property and the taxpaying entity. This threshold is re-determined annually and is adjusted by general movement in the value of land across the state, excluding rural use land.
Land Tax Exemptions	The two main exemptions that apply are to the principal place of residence and primary production land.

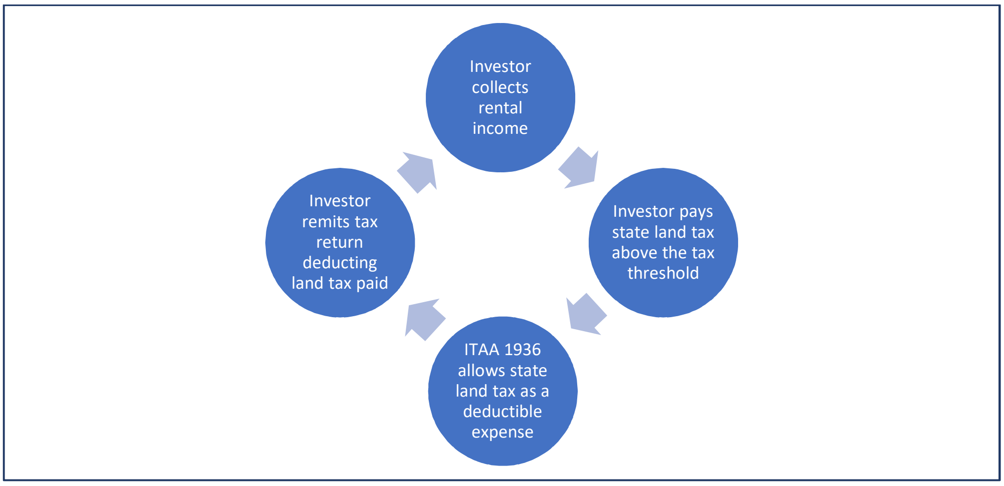
New South Wales initially introduced land tax in 1895, abolishing it in 1906 making way for the Commonwealth and local government to collect this tax. It reintroduced this tax in 1956 following the Commonwealth's abolition of the tax in 1952. New South Wales was the first State to introduce a land tax free threshold which was set at AUD 55,000 in 1972. By 1987 the tax-free threshold was $94,000 with a tax rate-in-the-dollar of 2%. The initial rationale for introducing the land tax free threshold is stated by Mangioni (2016) as being to incentivise residential property investment with a view to encouraging more rental housing stock. By the late 1980s the government came under pressure to increase the land tax threshold which progressively increased to $125,000 in 1988, $135,000 in 1989 and $160,000 in 1990, where the threshold remained without adjustment for eight years.

Following revenue pressure, in 2004 the New South Wales Government concurrently announced the introduction of a tax on the sale of residential property and an amendment to the State land tax free threshold to commence in the 2005 tax year. The Vendor Duty was imposed on all residential property excluding the principal place of residence (subject to being owned for a minimum of two years) at a rate of 2.25% of the sale price (New South Wales Parliament, 2004). The implications for investors with investment properties which were below the land tax threshold before the changes in 2005, was an incurrence of up to $1,268 increase per year. The upside to the 2005 changes to land tax was the reduction in the rate-in-the-dollar from 1.7 cents to 1.4 cents. The breakeven point of no change in land tax payable was for investors with an aggregate land value of approximately $405,000 in the 2005 land tax year.

It is apt to highlight here that the land tax free threshold does not apply to each property held by the same owner. The threshold only applies once to the aggregate land value of all property (excluding exempt property) held by a property owner. Once the tax-free threshold has been reached, a tax incentive exists for investors that allows the deductibility of land tax as an expense against the income generated from the property, or where that expense exceeds the income from that property, against other assessable income as shown in Figure 2. In essence, State land tax is a mechanism used by State government, to redistribute the tax revenue collected by the Commonwealth as a deduction against the impost of a State-imposed tax. One could argue for its basis in principles of human rights (in particular the International Covenant on Economic, Social and Cultural Rights) defining the role of housing in guaranteeing a minimum quality of life.

This tax subsidy is achieved on the basis that the rent collected from property is defined as income and land tax is an expense. What has evolved as a challenge for the States is accepting that any taxpayer would prefer not to pay tax and hence the land tax free threshold ideologically contributes to serving that purpose.

Fig. 2: Land Tax Deduction Against Rental Income



Source: Authors.

4.1 The case for land tax reform in New South Wales

Over the past two decades studies have modelled replacement of revenue from stamp duty with revenue from a broad base land tax and how this might be achieved on a revenue neutral basis (Productivity Commission, 2004; Australian Capital Territory (ACT) Government, 2012). The Australian Capital Territory's 2014 progressive transition from stamp duty to a broad based land tax as an exemplar reform for the States of Australia to follow. The Australian Capital Territory land tax applies to all residential property excluding the principal place of residence, being an exemption that applies consistently in each State. In preparing for the transition to a land tax on residential investment property in the Australian Capital Territory, residential property owners were advised ahead of its introduction, which facilitated a progressive phase-in impact to the value of investment property holdings.

The Australian Capital Territory rate-in-the-dollar applied to the unimproved value commences at 0.50 cents and progressively increases to a maximum of 1.1 cents. Across Australia this is the lowest rate-in-the-dollar applied to the highest band of property values. The broadening of the base to include all residential investment property without an investor free threshold has resulted in more property being taxed at a lower rate, thus more broadly spreading the burden while replacing revenue from stamp duty. In New South Wales, reforms are under consideration for residential property purchasers to opt for an annual land tax in lieu of stamp duty with a view to potentially improving affordability by reducing up-front transaction costs (New South Wales Treasury, 2020). This reform would further assist government by replacing stamp duty revenue which is volatile and subject to the volume of property turnover from one year to another with a more stable tax base. By removing the transaction of property as the trigger for the tax, the potential reform uses the annual land value currently used to assess land tax as the base of the tax with the trigger set at an annually defined date. Further research that goes beyond the scope of this article is needed to evaluate alternate tax policy reforms and options in targeting greater affordability.

In contrast to the introduction of the land tax in the Australian Capital Territory, in New South Wales where land tax applies to a narrow band of investment property, the proposed reform to broaden the land tax net would commence with the phase-out of the investor tax-free threshold. In contrast to the revenue replacement approach to reform, the research undertaken in this article aims to look at the potential resistance to phasing out the tax-free threshold in New South Wales. While it is beyond the scope and objective of this article to model the phase-out, the more important objective is to examine the resistance to the payment of land tax through objections to the land value component as set out in Table 1. The value is the variable component on which tax revenue increases each year and, more relevantly to this article, is the primary component of the tax that investors are able to object to in challenging this tax.

In May 2004 the New South Wales Government announced its intent to abolish the land tax free threshold in New South Wales from the 2005 land tax year, and reduce the top rate-in the-dollar from 1.7 to 1.4 cents-in-the-dollar (New South Wales Parliament, 2004). This reform resulted in the number of property owners subject to land tax increasing from 120,000 to 660,000 in New South Wales predominantly being residential property owners. This reform also resulted in objections to land values across New South Wales increasing to over 16,000; the reform was deemed to have been poorly executed and the threshold was reinstated for the 2006 land tax year. While the idea of removing the threshold was well-founded, as in any tax reform, the transition was manifestly inadequate with the threshold removed with six months notice provided and no economic scaffolding to manage the increase in objections that followed.

While small scale investors (who dominate the rental housing market in Australia) have enjoyed a range of tax incentives implicitly justified as a way to lower rents by increasing returns to landlords, it is unclear these de facto subsidies have had these effects in practice (Berry, 2000). The Reserve Bank estimates that the impact of removing negative gearing would be lower housing prices, and higher homeownership rates (reported in Ong, 2017), this in turn would constitute an overall net gain for Australians.

Offsetting arguments that investor tax incentives help lower the cost of rental housing are analyses demonstrating the longer term welfare consequences of falling rates of homeownership, particularly on retirement (Stebbing & Spies-Butcher, 2016). Intensifying inequality between owners and renters (particularly along generational lines) will also have longer term effects on social stability and the socio-economic integration that underpins both quality of life and economic growth (Daley et al., 2018).

5. RESEARCH METHOD

The two factors examined in this article are the changes in residential property investment holdings in the case study areas over the study period and whether the land tax free threshold is the primary factor impacting objections to land values used to determine land tax. In addressing these points, primary data has been provided by the New South Wales Valuer-General and Department of Land and Property Information, with secondary data sourced from the Australian Bureau of Statistics (ABS). In undertaking the review, the New South Wales Valuer-General provided objection data to land values from ten local government areas located within 15 kilometres of the centre of Sydney over seven land tax years (2011 to 2017).

As at the date of this analysis there were 41 local government areas within the Sydney metropolitan area, of which the sample of ten local government areas analysed represents approximately 25% of local government areas (LGAs). The rationale for selection of these local government areas is based their geographic proximity to the centre of Sydney; the highest values in Sydney are within these locations. A majority of the properties that attract State land tax are located within these local government areas. The New South Wales Valuer-General's Office provided the land value objection data across these local government areas, which span a seven year period, used to determine the values being made available to land tax payers.

In analysing the number of objections to land values, two factors were considered. The first consideration was the location in which objections were grouped by local government area. The second consideration was the change in the number of objections between each of the base dates of valuation. In New South Wales, each parcel of land is valued annually as at 1 July each year; this is known as the base date and is used to assess land tax in New South Wales for the following land tax year. The analysis was undertaken using objection data on land values between base dates 1 July 2010 and 1 July 2016, which apply to the respective land tax years of 2011 to 2017 inclusive. The data was analysed to address the following four questions for the ten local government areas:

1. How did the proportionate share of rental property change between the 2011 and 2016 census dates?
2. What were the key trends in the volume of objections across inner Sydney between 2011 and 2017 land tax years, for houses and units?
3. How did the volume and proportion of objections below and above the land tax free threshold change across each local government area between 2011 and 2017, for houses and units?
4. How did trends in objections to land values relative to the land tax free threshold change in the 2016 land tax year?

6. FINDINGS

Table 2 (columns C and F) shows that between the 2011 and 2016 census dates there was an increase in the percentage of rental property in eight of the ten LGAs.[2] Mosman LGA has no change between these census dates, while a decrease is noted in Woollahra. These two LGAs have the highest land values for both houses and units and have the lowest percentage of rented property as at the two census dates. It is further shown in Table 2 that there was an increase in residential unit dwellings during this period in nine of the ten LGAs with the exception of Leichhardt. Correspondingly, it is noted that there was a decrease in the number of houses in seven of the ten LGAs. Of the five LGAs with the largest increases in percentage of rental housing, three LGAs (Ashfield, Marrickville and Burwood) are located in the Inner West and two LGAs (Botany and Randwick) are located in Sydney East. In addressing the first question, we find an increase in the percentage of rented dwellings in the inner suburbs of Sydney and that as Sydney densifies, owner occupiers are indeed competing with investors for housing stock, particularly in the unit market.

To answer the second question, we commence by looking at the overall trends in objections to land values across inner Sydney in Table 3 and Figures 3 and 4 for houses

[2] See Appendix for Tables 2 to 6 and Figures 3 to 7.

and units between the 2010 and 2016 tax years. Next, we review the number of objections below and above the tax-free threshold in each LGA and draw conclusions about the relationship between median land values and the land tax threshold, for houses and units in each LGA over the study period. Table 3 and Figures 3 and 4 show 4,565 objections to land values for houses and 968 objections to land values for units. Across the study period different trends are evident. Over the 2009 to 2012 period, we find higher volatility in objections to land values for units compared to houses. The levels of volatility in objections to land values are similar for houses and units between 2013 and 2016. For both categories of dwellings, there is a sharp upward trend in objections in 2015-2016, which corresponds with the strong demand for housing and increase in values that peaked 12 months following that last period (the 2017 land tax year).

Addressing question 3, Table 4 and Figure 5 set out the percentage of objections to land values above and below the land tax free threshold for houses in each LGA. In nine of the ten LGAs, over 90% of objections are lodged against land values above the tax-free threshold on the basis that the land values are too high. The exception is Marrickville, where 20% of objections were lodged for houses valued below the threshold. We conclude that objections to land values used to assess land tax would primarily be lodged in cases of land values above the tax-free threshold as shown in objections to land values for houses. This supports the rationale that payment of land tax itself is one trigger for objections to land tax; however it does not provide the reasoning for why the objection is lodged, particularly where the land value is correct or is at the conservative end of the market value range. This factor is discussed next, in the analysis of objections to land values for units and again later in the analysis of the median land values against the land tax free threshold.

The review of objections to land values for units (in Table 5 and Figure 6) shows that in seven of the ten LGAs, more than 50% of objections to land values are below the tax-free threshold, which is in stark contrast to the percentage of objections to houses. It is important to reinforce the operation of the land tax free threshold again here in the assessment of land tax. The threshold only applies once to the aggregate land value of all property (excluding exempt property) held by a property owner, it does not apply to each property held in the same ownership. This provides insight into the likely rationale for objections to land values below the tax-free threshold: objections reflect the interests of owners holding multiple residential investment properties. The increase in objections is further emphasised by the increase noted in rented dwellings between the 2011 and 2016 census dates, which potentially renders more property liable to pay land tax once the land value trips the tax-free threshold.

In the objections to unit values, Randwick and Botany Bay stand out in Sydney East with 96% and 67% of objections to land values below the threshold. In the Inner West, Marrickville and Ashfield stand out with 59% and 100% respectively. In Sydney North, Mosman and North Sydney have objection rates of 55% and 62%. While these objection rates may appear high and in the case of units are likely to be impacted by multiple holdings pushing investors over the tax-free threshold, we now go back to Table 3 and Figures 3 and 4, to examine the spike in objections in the 2017 land tax year. Of all objections lodged across the six years examined, 37.7% were lodged against house land values and 41.5% were lodged against land values to units in the 2015 and 2016 tax years. The increase in objections to land values aligns with the increase in land values across these same two years. This provides evidence that tripping the tax-free threshold and thus incurring land tax is the primary reason for objections lodged against land values.

We now examine whether factors other than the payment of land tax itself impact objections to land values, to better define the prospect of expanding the land tax net to include all residential investment property. In further examining the increase in objections to land values in the 2016 land tax year as shown in Figures 3 and 4, we have undertaken a closer analysis on an LGA-by-LGA basis. Using the median land value for houses and units for each LGA as set out in Table 6, we graph these values against the land tax free threshold in Figure 7. In the review of land values for houses, Randwick, Botany and Waverley in Sydney East and Burwood, Ashfield and Marrickville in the Inner West show the largest increase in land values as shown in Table 6 and Figure 7. In each of these LGAs the land values are well above the land tax free threshold and highlight that the increase in land value that translates into higher land tax assessment impacts objections to values. The median land values in these LGAs have been above the tax-free threshold across the study period. The reason stated in 92% of objections lodged to land values for houses was that the land value was too high.

In the review of units, in which the total number of objections are 21% of objections lodged against house land values, Table 6 shows that the highest increases in land values are in Randwick, Burwood, Ashfield and Marrickville. The latter three of these are the LGAs that have the highest increases in rented dwellings. It is also noted that the median land value for units is below the tax-free threshold in each LGA as set out in Figure 7. It is noted that in Randwick and Marrickville the median land value for units represents 58% and 34% of the tax-free threshold. At the median land value investors can hold almost two units in Randwick and three units in Marrickville before tripping the tax-free threshold in 2016 of $482,000. While payment of land tax is one trigger for lodging objections to land values for units, the relative size of the increase in land value is also one of the primary factors driving increases in objections.

7. A FRAMEWORK FOR REFORM AND CONCLUSION

In planning for the removal of the land tax free threshold and defining the impact on objections to land values by residential investors, we now consider the justification for the threshold and how a transition for removal would be achieved. In 1972 when the tax-free threshold was introduced, home ownership rates were at 71%. The homeownership rate at 2016 was 65.5%, and investors increasingly compete for residential property at the lower end of the market. In seven of the ten LGAs examined in this article, increases in the percentage of rented property were noted in LGAs between the 2011 and 2016 census dates. It is well-established that tax incentives afforded to investors (as discussed in the literature) are a contributing factor for this competition.

It was further argued that land tax is a deductible expense against the income derived from investment property that shifts the burden of the tax from the States to the Commonwealth through tax expenditure afforded by deductibility of the tax against income from investment property. The rationale for the land tax free threshold to incentivise more rental property 50 years after its introduction is ripe for re-evaluation and policy reform, as investor-homebuyer competition for housing continues to intensify. To provide investors a tax-free threshold and a deduction for expenses is an outdated and unnecessary incentive, particularly in the Sydney housing market. While it is recognised that a proportion of land tax payers in the residential housing market use secondary residences for recreational purposes, Mangioni (2016, p. 109) discusses that this factor should not impact the argument for reform to the land tax free threshold.

The analyses in this article demonstrate two important outcomes that prompt reform. The first is that in each of the LGAs examined, the tax-free threshold incentivises small residential unit property investors over investors with houses with the tax-free threshold sitting between units and houses in all LGAs. Secondly, while objections to units are lower in volume compared with houses, objections to land values of units below the tax-free threshold are tenfold compared with those for house land values. This in part is driven by the fact that the median land value for houses is well above the tax-free threshold, but also conversely shows the trend towards multiple unit holdings, particularly in some LGAs.

What the article finds is that the payment of land tax is not overwhelmingly the only factor that triggers objection to land values. The analyses clearly show that the size of the increase in land values that impacts the amount of land tax paid as set out in the 2016 land tax year is a significant contributor to increases in objections to land values on the basis that the value is too high. This raises the question of how the reforms that might be adopted could manage the spikes in objections during periods of rapid house price inflation. In summary, if there were an increase in the rate of objections proportionate with the increase in the number of investment properties caught in the land tax net, the issue is how this reform might be managed and what mechanisms are available for a smooth transition to the removal of the tax-free threshold.

In removing the tax-free threshold, a phase-in approach has been developed comprising four measures that support a smooth transition and address those factors that hampered the 2005 attempts at removing the tax-free threshold in New South Wales. The proposed measures are set out in the summary below and address the key elements of the threshold, land value, rate-in-the-dollar and payment mechanism. In contrast to removing the threshold in one tax year, a progressive phase in approach of freezing the tax-free threshold for a minimum of five years would apply. This would result in residential investment property, in particular residential unit investment, below the tax-free threshold moving progressively into paying the tax. To address the spike in land values that impacts objections as noted in the 2016 land tax year, extending the average land value from three to five years would also factor in cyclical corrections to values in the years of high property value growth. The rate-in-the-dollar should be maintained, or where additional revenue is raised as more property becomes liable for land tax, acknowledgement provided of a downward adjustment to the rate at three or five years of introduction of the reform, returning a portion of the gain in revenue raised back to property investors. The final reform is to more evenly stagger the payment options for the tax across the year as regular quarterly payments which better acclimatise taxpayers to the tax liability.

Summary of Reform Phase-In Measures

Phase-in Measure	Tax component	Rationale
Freeze the tax-free threshold in the tax year ahead	Threshold	Mechanism used to allow a staged phase-in of a threshold removal.
Increase the average land value used to assess the tax from 3 to 5 years.	Land Value	Smooth the changes, and in particular increases in land values used to assess the tax.
Maintain the current flat rate-in-the-dollar structure for the impost of land tax.	Rate-in-the-dollar	To further add to the support of the proposed reform, provide certainty that the current flat rate (excluding the premium rate) is maintained.
Increase options for payment across three equal instalments across the year.	Payment	Introduce a 3 monthly (quarterly) payment option.

Source: Authors.

This analysis unpacks the dynamics behind one tax base measure that contributes to favouring investors over first time home buyers. Further research is needed to evaluate alternative tax policy reforms targeting greater affordability. For instance, one alternative might be to end the exemption of the primary residence (while retaining the tax-free threshold); this would, in effect, remove the tax-free threshold from all property beyond the family home, and may partially remove the threshold for more expensive homes. How would the impacts of such a measure compare with those of reforms such as ending negative gearing? While history demonstrates that reforms to investor incentives are notoriously difficult to impose, we argue that the likelihood for significant backlash can be managed through careful policy design. The recent history of reactions to the land tax free measure (in the form of objections to value estimates) provides a unique lens through which we can better understand taxpayer/investor responses to changing market conditions and taxation regimes, and apply this insight to policy design. Following Hohmann's (2020) argument for research that will 'shift the underlying terrain of debate', focusing on taxpayer responses to policy outcomes can help re-shape perceptions of the potential for reforms that contribute to greater social equity in access to homeownership.

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APPENDIX: TABLES AND GRAPHS SUPPORTING THE ANALYSES AND FINDINGS

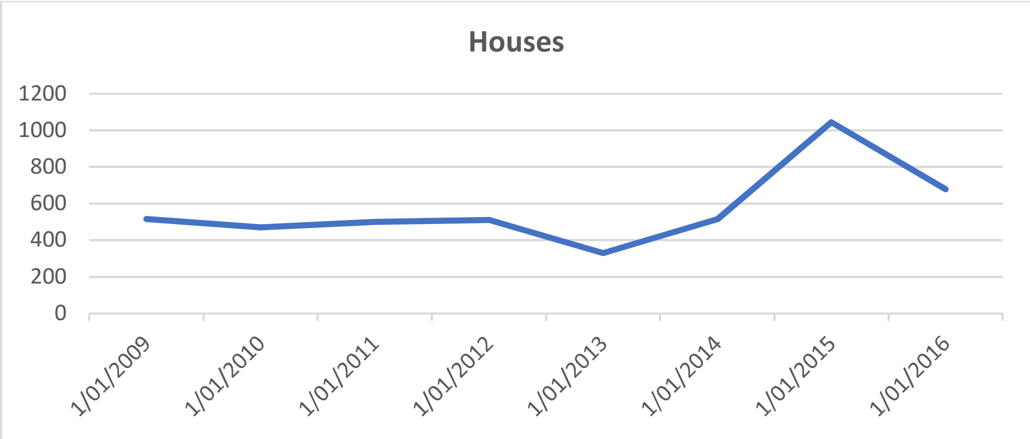
Table 2: Change in Residential Rental Property between the 2011 to 2016 Census

	2011 Census			2016 Census			% Change Unit	% change Houses / T/houses	% Change rented dwellings 2011/2016
	A	B	C	D	E	F			
LGA	Houses/ T/houses	Units	% Rented	Houses/ T/houses	Units	% Rented			
Mosman	5523	5160	34.3	5240	5701	34.3	10.5	(5.1)	0
Nth Sydney	8104	20175	50	7520	22381	50.8	10.9	(7.2)	0.8
Woollahra	9516	10841	38	9203	11632	37.3	6.8	(3.3)	(0.7)
Waverley	9617	15039	46.7	8938	15758	47.6	4.8	(7.1)	0.9
Randwick	21598	25244	44.9	21627	28109	46.9	11.3	0.13	2.0
Botany Bay	7643	6371	37.6	7653	8579	43.6	34.7	0.13	6.0
Leichhardt	4105	1292	39.8	4139	1177	40.1	(8.9)	0.8	0.3
Burwood	6830	3824	36.6	6687	5124	41.8	34	(2.1)	5.2
Ashfield	3169	5221	45.1	2657	5665	51.3	8.5	(16.2)	6.2
Marrickville	5430	3647	41.9	5094	4411	45.3	21	(6.2)	3.4

Table 3: Annual Number of Objections to House Land Values, All LGAs, 2010 – 2017

Objections	1/07/09	1/07/10	1/07/11	1/07/12	1/07/13	1/07/14	1/07/15	1/07/16	Totals
Houses	516	470	500	511	330	515	1045	678	4565
Units	101	142	111	71	64	78	209	192	968

Figs 3 & 4: Annual Objections to House and Unit Land Values, All, 2010 – 2017 Tax Years



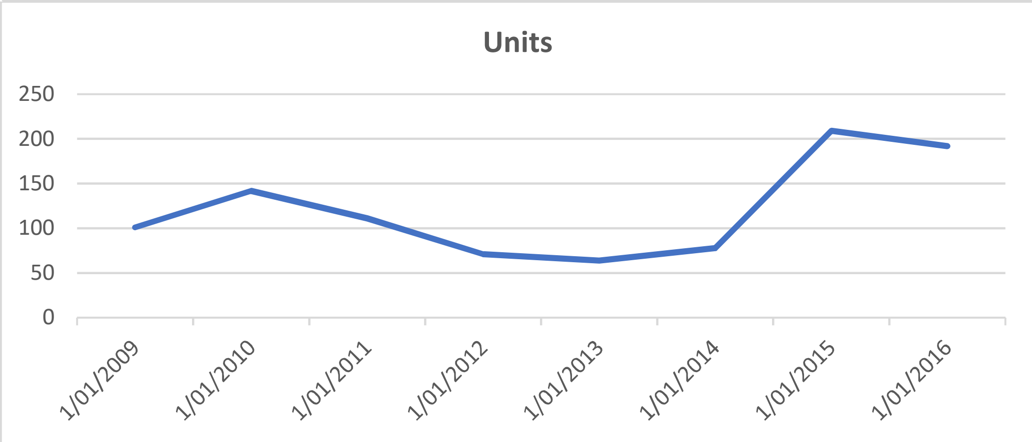


Table 4: Percentage of Objections to Houses Above versus Below the Tax-Free Thresholds 2010-2017

Units	Ashfield	Botany Bay	Burwood	Leichhardt	Marrickville	Mosman	Nth Sydney	Randwick	Waverley	Woollahra
Above	93%	95%	99%	96%	80%	98%	99%	98%	100%	98%
Below	7%	5%	1%	4%	20%	2%	1%	2%	0%	2%

Fig. 5: Percentage of Objections to Houses - Above vs Below the Thresholds

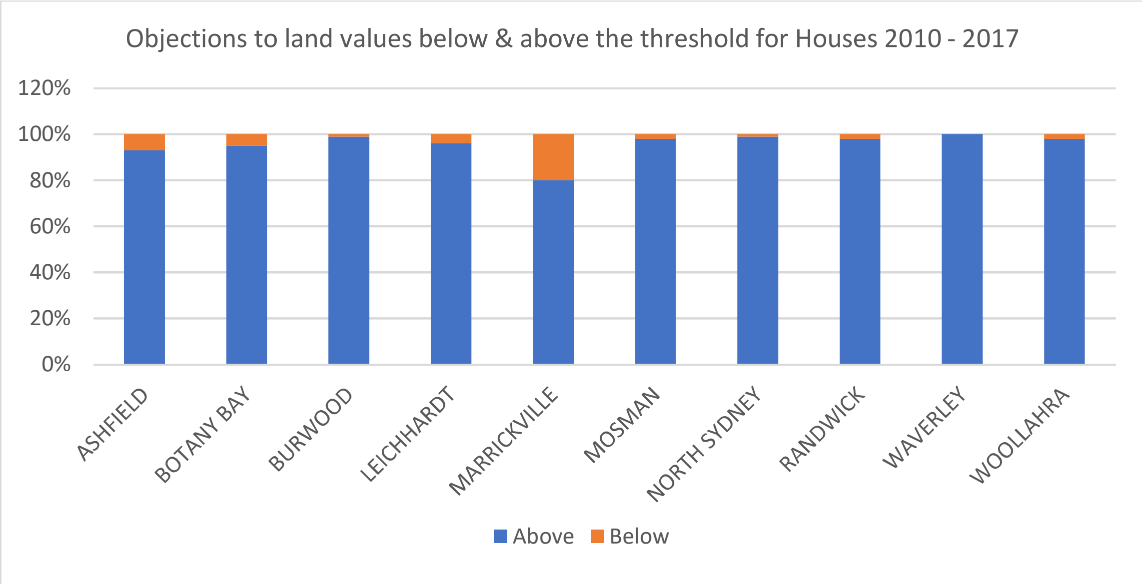


Table 5: Percentage of Objections to Units Above versus Below the Thresholds 2010 to 2017

Units	Ashfield	Botany Bay	Burwood	Leichhardt	Marrickville	Mosman	Nth Sydney	Randwick	Waverley	Woollahra
Above	0%	33%	49%	70%	41%	38%	45%	4%	65%	70%
Below	100%	67%	51%	30%	59%	62%	55%	96%	35%	30%

Fig. 6: Percentage of Objections to Unit Land Values Above versus Below the Thresholds

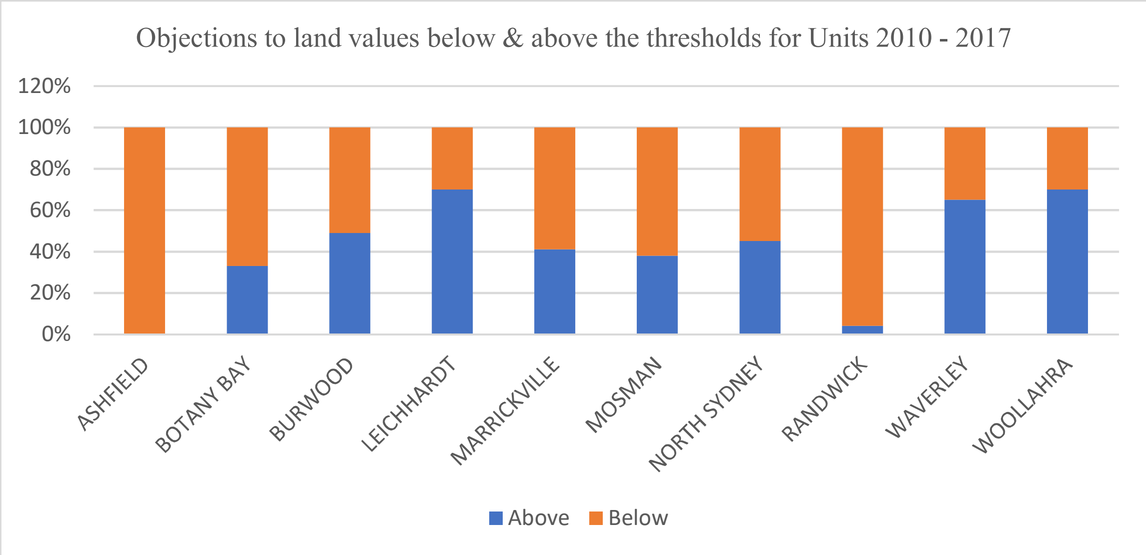
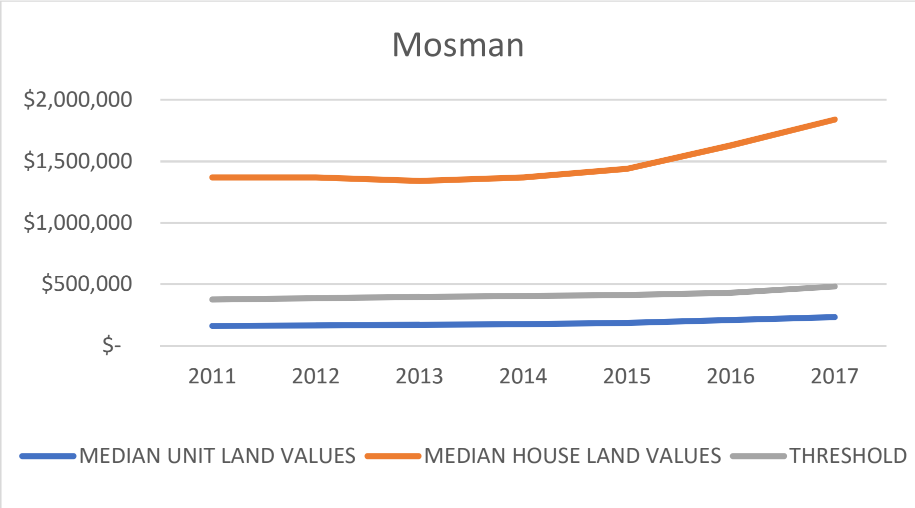


Table 6: Change in Median Land Values for House and Unit Land Values 2015 to 2016 Land Tax Year (AUD)

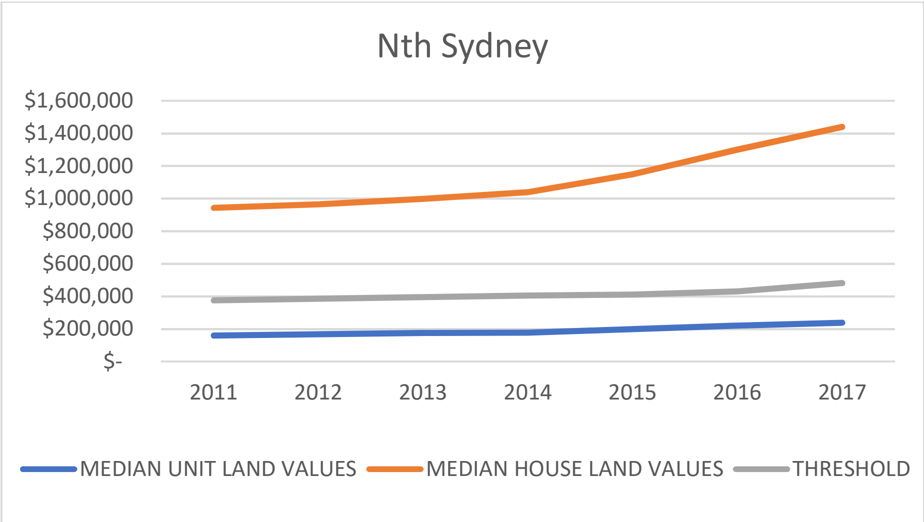
LGA	Median LV House 2015 Tax Yr	Median LV House 2016 Tax Yr	% Incr Value	Median LV Units 2015 Tax Yr	Median LV Units 2016 Tax Yr	% Incr Value	% Change in rented dwellings 2011/2016	2016 NSW Land Tax Free Threshold
Mosman	$1,440,000	$1,630,000	13%	$185,000	$210,000	14%	0	$482,000
North Sydney	$1,150,000	$1,300,000	13%	$200,000	$222,000	11%	0.8	
Woollahra	$1,550,000	$1,720,000	11%	$265,000	$294,000	11%	(0.7)	
Waverley	$1,230,000	$1,550,000	26%	$281,000	$328,000	17%	0.9	
Randwick	$888,000	$1,190,000	34%	$217,000	$278,000	28%	2.0	
Botany Bay	$745,000	$957,000	28%	$116,000	$139,000	20%	6.0	
Leichhardt	$715,000	$907,000	27%	$197,000	$237,000	20%	0.3	
Burwood	$703,000	$897,000	28%	$135,000	$170,000	26%	5.2	
Ashfield	$710,000	$913,000	29%	$152,000	$191,000	26%	6.2	
Marrickville	$584,000	$742,000	27%	$124,600	$163,000	31%	3.4	

Fig. 7: Median Land Values for Houses and Units vs Tax-Free Threshold, Each LGA (AUD)

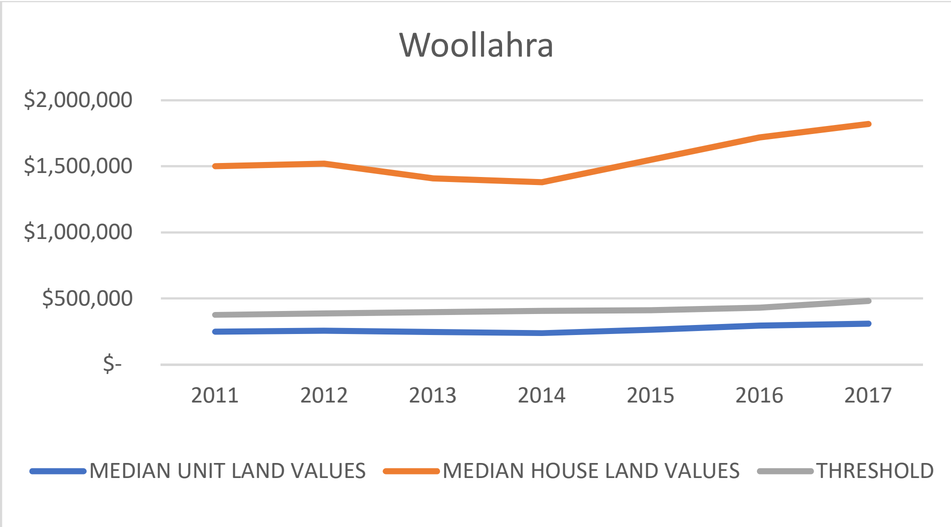
7a: Mosman



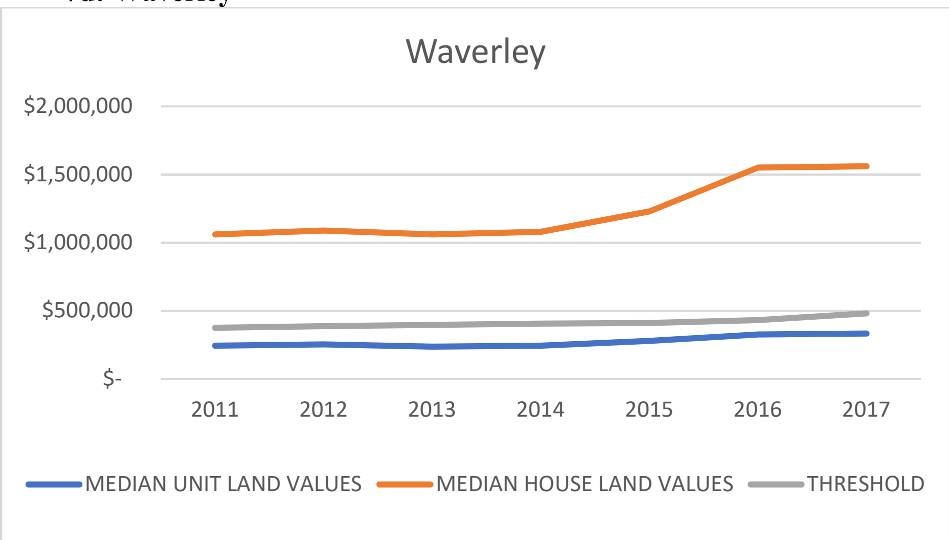
7b: North Sydney



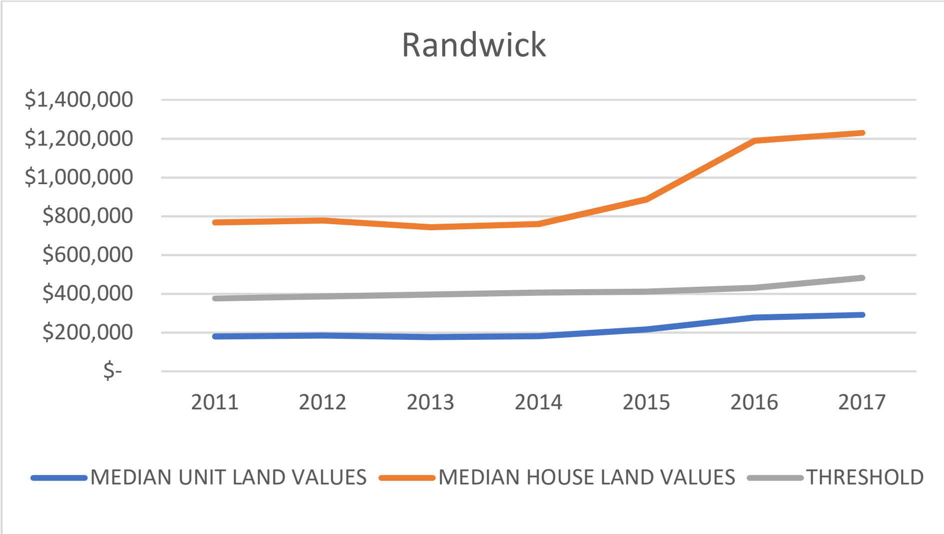
7c: Woollahra



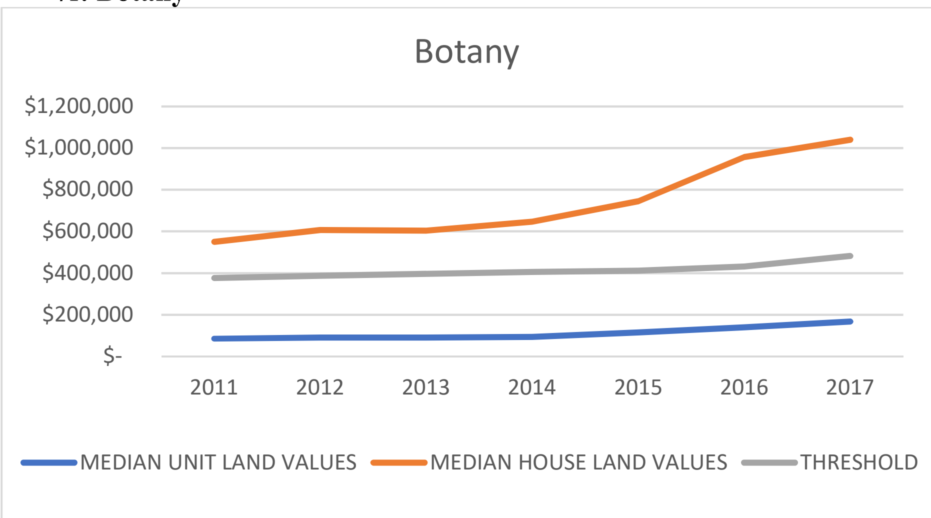
7d: Waverley



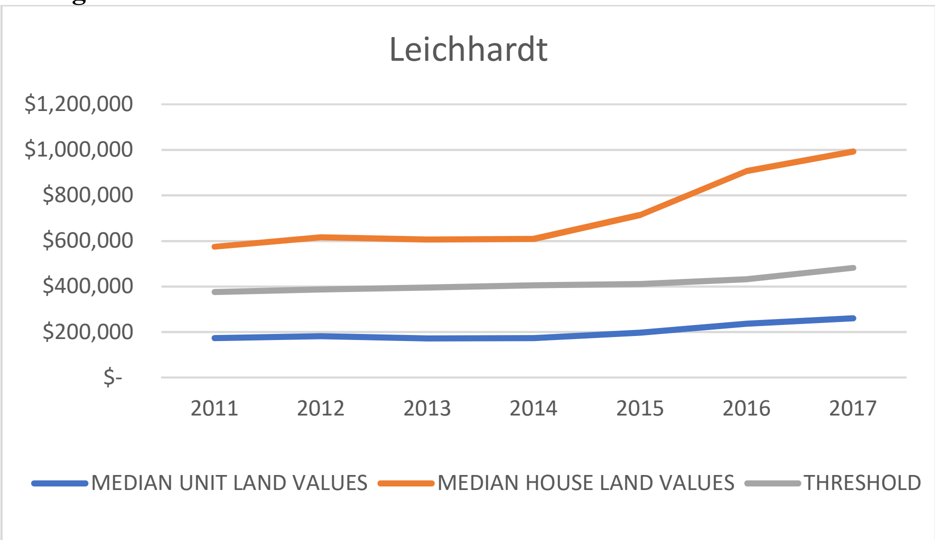
7e: Randwick



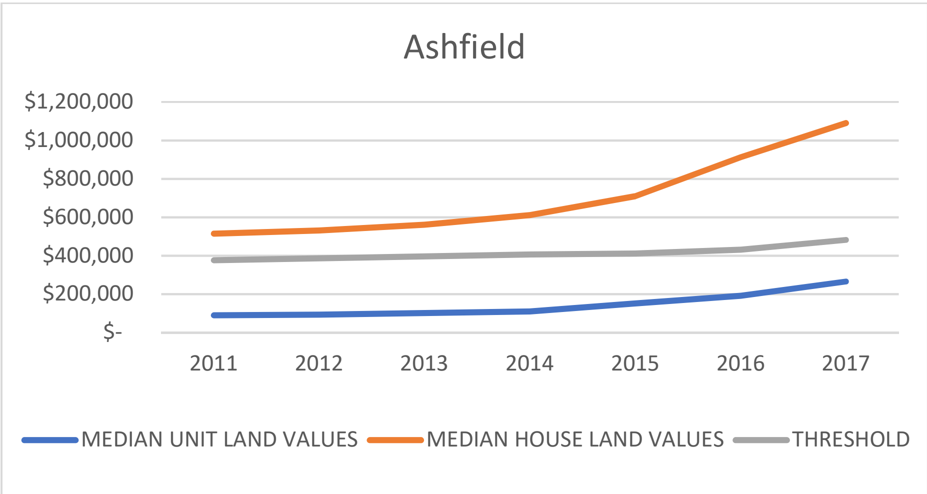
7f: Botany



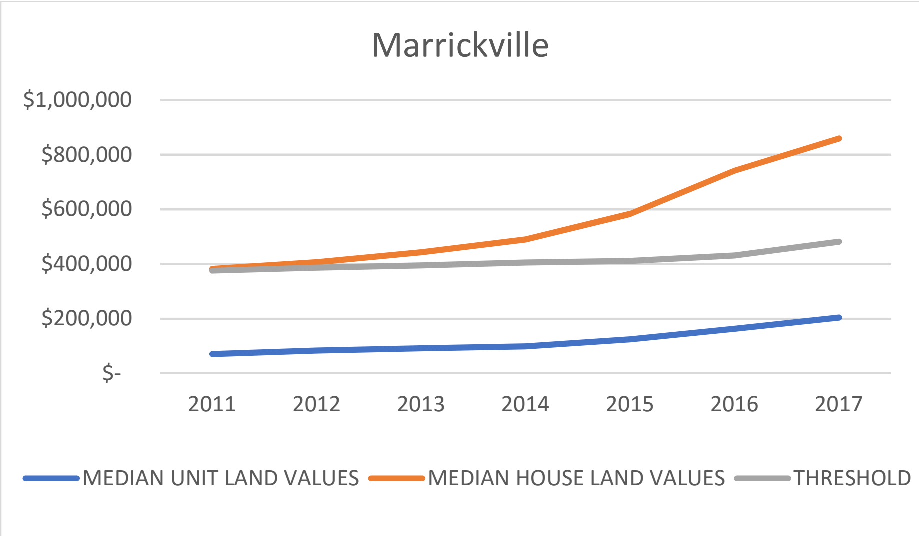
7g: Leichhardt



7h: Ashfield



7i: Marrickville



7j: Burwood