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A uniform land tax in Australia: what is the potential for this to be a reality post the "Henry Tax Review"?

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Land tax was one of the main issues examined by Dr Ken Henry in his review on "Australia's Future Tax System" and the review recommended its increased importance in raising revenue in Australia. The classical economists such as Smith, Ricardo and Mill recommended the imposition of a tax on land. Henry George also strongly advocated a tax on land instead of a tax on labour or capital. They also contended that such a tax was both efficient and equitable. This paper will examine the current position with land tax in Australia and the views of the early economists advocating the benefits of such a tax. The paper will then examine the recommendations contained in the Henry Tax Review and what would be required to reform this area of taxation law. The paper will also examine the initiative undertaken by the Australian Capital Territory (ACT) government in abolishing stamp duty on conveyances and imposing a land tax on all real property in the ACT. In conclusion the paper will contend that a reformed land tax is of critical importance for future governments and that it may not only raise considerable revenue but also result in reduced income tax rates for individuals and companies.

Keywords

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A Uniform Land Tax in Australia: What is the potential for this to be a reality post the 'Henry Tax Review'?

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Abstract

Land tax was one of the main issues examined by Dr Ken Henry in his review on 'Australia's Future Tax System' and the review recommended its increased importance in raising revenue in Australia. The classical economists such as Smith, Ricardo and Mill recommended the imposition of a tax on land. Henry George also strongly advocated a tax on land instead of a tax on labour or capital. They also contended that such a tax was both efficient and equitable. This paper will examine the current position with land tax in Australia and the views of the early economists advocating the benefits of such a tax. The paper will then examine the recommendations contained in the Henry Tax Review and what would be required to reform this area of taxation law. The paper will also examine the initiative undertaken by the Australian Capital Territory (ACT) government in abolishing stamp duty on conveyances and imposing a land tax on all real property in the ACT. In conclusion the paper will contend that a reformed land tax is of critical importance for future governments and that it may not only raise considerable revenue but also result in reduced income tax rates for individuals and companies.

I INTRODUCTION

The main focus of this paper is on the merits of a uniform land tax in Australia to not only generate revenue for the government and to broaden the tax base but also to provide relief for taxpayers in the form of a reduction in income tax rates for individuals and companies. The *Review of Australia's Future Tax System* (The Henry Tax Review)[1] renewed interest in land tax by promoting its use as a means of generating revenue. It is important to acknowledge that a land tax is imposed on some property owners in Australia by State governments and the Australian Capital Territory (ACT). The Northern Territory does not impose a land tax. It is also important to acknowledge that Local Governments also impose a land tax in the form of 'rates' and this represents about 37 percent of their total revenue that they collect.[2] The Commonwealth government also collected land tax from 1910 until 1952. Therefore, the imposition of a land tax on property owners is not new but its potential to raise revenue has been largely overlooked by

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[1] Australia's Future Tax System Review Panel, Australia's future tax system: Report to the Treasurer (December 2009)

[2] Australian Bureau of Statistics (ABS) 2012, *Government Financial Statistics, Australia*, 2010-11: Table 339 Total Local General Government Operating Statement.

the Commonwealth and State governments and if not for the Henry Tax Review, it may have continued to remain unnoticed. However, for local governments, a tax on land in the form of rates is of immense importance as a source of revenue.

It is not intended in this paper to examine the possible conflict between the Commonwealth government; the State governments and Local government if a uniform land tax was introduced and collected by the Commonwealth government. At present State governments raise approximately 5.8 percent of their revenue through taxes on land which includes stamp duty which is considerably higher than the percentage of property taxes raised by local government, namely 3.5 percent.[3] In other words, taxes on land only amount to 9.3 percent of total taxes raised by all three levels of government combined. To put this in perspective, the Commonwealth government raises 57.3 percent of revenue from taxes on income.[4]

This paper contends that taxes on land should be increased as a percentage of all revenue raised by the various levels of government and that at some point in the future, all three levels of government will need to agree on how it is to be collected; who will collect the land tax; and on what basis should it be levied, namely on the unimproved capital value of the land, the improved capital value of the land, an assessed annual value, or some other variation of the above. However, this paper will only focus on the philosophical basis for a land tax and the benefits to be derived from a tax on land and not on the political consequences associated with the introduction of such a tax. That is a matter for discussion at a later time.

In 2009 the Australian Government commenced a review of Australia's future tax system under the Chairmanship of the Secretary of the Treasury, Dr Ken Henry. The Henry Tax Review states that the future Australian tax system should increasingly rely on land values as a tax base. The Review recommended that a rent tax should be applied to land either at a flat rate or at marginal rates on all land including owner-occupied housing.[5] The Henry Tax Review pointed out the obvious fact that because land is immobile people cannot change their behaviour in order to avoid paying the land tax.[6] It is an efficient form of taxation because it does not affect the way in which land is used or how much is used but would result in a reduction in the price of land.[7] Other studies have also predicted that the imposition of a one percent land tax would result in a 16.7 percent fall in land values.[8] The reduction in value is based on calculating the net present value (NPV) of the future tax liability and deducting this amount from the current value of the land.[9] The study also discusses the impact that a fall in land values would have on housing affordability and concludes that it would improve the prospects for low income earners to enter the housing market but that it would have a minimal impact on existing home owners with a

[3] ABS, *Taxation Revenue Australia* 2010-11.
[4] Ibid.
[5] Commonwealth of Australia, *Review of Australia's Future Tax System*, (2010), 247.
[6] Ibid, 247.
[7] Ibid.
[8] Victoria University of Wellington Tax Working Group, *A Tax System for New Zealand's Future: Report of the Victoria University of Wellington Tax Working Group* (Centre for Accounting, Governance and Taxation Research, Victoria University of Wellington, 2010) 14.
[9] Ibid, 8.

mortgage.[10] However, the consequences for banks and other financial institutions that have lent money against the value of the land may be significant especially with highly geared loans by individuals or companies using land as security. This particular implication of a land tax would require separate research.

The following statement contained in the Henry Tax Review provides a very good summary of the importance of a uniform land tax.

> Land value 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 value tax is borne by landowners and the supply of land is unchanged. Land value tax falls on the owner's 'economic rent'.
>
> The relative efficiency of land value tax is supported empirically. A recent OECD report found that a 1 per cent switch to land or property tax (but not to taxes on transactions) away from income tax would improve long-run GDP per capita by 2.5 percentage points (Johansson et al. 2009). This study did not assess taxes on the economic rent from natural resources, which are also potentially efficient tax bases. [11]

The Henry Tax Review contends that there are three implications for owners of land when a land tax is introduced: first; the price of land will suffer a one-off fall in value, second; the land tax only applies to the unimproved value of the land. This means that the owner of the land still has an incentive to improve the land in the form of a new factory or improvements to a family home. Third; there should be very few exemptions from land tax. Owner occupied homes and some agricultural land that is located on the fringe of cities such as market gardens should not be exempt.[12] The Review also noted that with an ageing population there may be owner occupied homes where the owner is asset rich but income poor. In that situation it was recommended that some system of loan arrangement be introduced so that the tax was paid when the property was finally sold.[13]

A *An introduction to the ACT initiative on land tax*

In the ACT there is no local government as such. The Territory government deals with both territory and local government matters. Prior to 2012, the ACT government imposed land tax on investment properties and commercial properties. The government also imposed 'rates' on all property located in the ACT to cover services provided by local governments in the other states in Australia. The ACT government undertook a review of its taxation system in 2012 and based on recommendations of the Henry Tax Review, decided to abolish stamp duty on all conveyances and to replace the lost revenue by increasing the 'general rates' on all property in

[10] Ibid, 14.
[11] Ibid, 266.
[12] Ibid.
[13] Ibid, 267.

the ACT.[14] The government also decided to reduce the level of land tax on investment and commercial property in order to stimulate investment in the ACT. The initiative taken by the ACT government to abolish stamp duty on conveyances over the next twenty years and replace the revenue with an increase in land tax through a 'general rate' on all property does not appear to have had an adverse effect on land values. However, many home owners will be paying more in their general rates than they have before. Given that the 'general rate' is levied on the average unimproved value at progressive rates and allowing for 'bracket creep', homeowners in the ACT will be paying substantially more in a tax on land than home owners in other states in Australia. The main objective for the increase in land tax through the general rates was to be in a position to abolish stamp duty. The details of new land tax arrangements are examined in detail later in the paper.

B *The ageing population and its implications for Australia*

The need for a uniform land tax as a means of raising government revenue must be seen in the context of an ageing population in Australia. This situation is most aptly summarised in the following passage from Rob Heferen, Executive Director, Revenue Group, Department of Treasury when discussing the problem of funding the needs of an ageing population with a reduced number of income taxpayers.

> ... [W]e should not forget the looming challenge of an ageing population. The *2010 Intergenerational Report* again brought into focus that, on current trends, spending on existing programs will become unsustainable over the medium to long term. The report estimates that there will be just 2.7 people of working age to support every person over the age of 65 by 2050, compared to 5 people in 2010. Real GDP growth per person is projected to slow to an average of 1.5 per cent per year over the next 40 years. An increasingly large population of older Australians is expected to contribute to a substantial rise in Commonwealth Government spending as well. The key message taken from all three intergenerational reports is that, apart from the need for continued vigilance in the relevant outlays, attention needs to be given to increasing the size of the economy through increasing labour force participation and improving labour productivity. And it is with respect to these two policy imperatives, together with the need to provide stable, secure revenue for the Government, a number of tax initiatives have been progressed.[15]

It is contended in this paper that future Australian governments should consider the introduction of a uniform land tax imposed on virtually all real property in Australia and collected either by the Australian Taxation Office on behalf of the Commonwealth government and the State governments; or collected by State and Territory governments; or by local governments on behalf of the three tiers of government. Prior to examining the merits of a land tax it is necessary to understand what it means to tax land. In this context it is important that the concepts of a 'rent tax' or the 'economic rent' are explained as these concepts are at the foundation of a tax on land.

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[14] Quinlan, T (Chair); Smithies, M; and Duncan, A, 2012, *ACT Taxation Review*, Report to the Treasurer, ACT.
[15] Rob Heferen, 'Beyond the Tax Forum', Executive Director, Revenue Group, December 5, 2011.

II THE CLASSICAL ECONOMIST APPROACH TO LAND TAX

Prior to examining the historical approaches to land tax it is necessary to provide a brief understanding of land tax in terms of it being a tax on the 'rent' or 'economic rent' of land.

A *What is meant by the term 'economic rent'?*

Economic rent is that return over and above the return necessary for the activity to take place.[16] For example, what does it take to get a super model to work? Linda Evangelista told *Vogue* that 'we don't wake up for less than $10,000 a day.' [17] While the example is hardly scientific, for the purposes of exposition it is appropriate. If a supermodel were paid anything more than that, and they are, it is economic rent. So a Government could tax almost all of that excess without affecting a supermodel's work decisions at all. They would still go to work even if the economic rent tax reduced the return to 'just' $10,000 a day. This explanation is similar to the example provided in the Henry Tax Review when defining what is meant by the term 'economic rent'.[18] In the example provided in the Henry Tax Review, if a worker is paid $100,000 but would still be willing to work at the same job if they were paid $75,000, their economic rent would be $25,000. While these two examples do not relate to productive activities or land as such, the concept of 'rent' will become clearer when considered in light of the following explanation.

A tax on land is a form of a rent tax or a tax on the 'economic rent' of land. A very succinct explanation of the concept of 'economic rent' is contained in the following definition provided by Professors Garnaut and Clunies Ross:

> Economic rent is the excess of total revenue derived from some activity over the sum of the supply prices of all capital, labour, and other 'sacrificial' inputs necessary to undertake the activity. … In essence, it referred to the reward that a landowner could derive by virtue simply of being a landowner and without exerting any effort or making any sacrifice.[19]

Garnaut and Clunies Ross acknowledge that the definition is based on the work by Ricardo.[20] Adam Smith also examined the concept of economic rent in his treaties on '*The Inquiry into the Wealth of Nations*' and contended that rent is an unearned surplus which is appropriated by the landlords through the exercise of their monopoly power.[21] Smith and Ricardo considered rent to be the unearned income obtained from renting land to entrepreneurs who then grew crops or livestock. The entrepreneur took the risk in buying seeds, planting the crop, harvesting the crop and finally selling the product. The fact that the owner of the land had a monopoly and was able

[16] W.H. Wessel 'A note on economic rent', (1967) 57(4) *American Economic Review* 873, 885.
[17] Van Meter J, 'Pretty Women' in *Vogue* (October 1990)
[18] Commonwealth of Australia, above n 1, 737.
[19] Ross Garnaut and Anthony Clunies Ross, *Taxation of Mineral Rents* (1983)26.
[20] Ibid, 27.
[21] Joseph Keiper, Ernest Kurnow, Clifford Clark et al, *Theory and Measurement of Rent* (1961), 14.

to extract a rent without undertaking any activity or risk, caused political economists such as Smith to develop the theoretical concept of taxing the economic rent of the landowner.

Similarly, a mine owner obtained a rent after capital and labour costs were deducted from the price of the minerals that had been sold. It is also acknowledged that a tax on the economic rent has a neutral effect on the landowner or mine owner.[22] A landowner or a mine owner would continue with their activity even though their excess profit or economic rent was subject to tax. The costs of capital and labour are already a factor in arriving at the economic rent.

A simple way of demonstrating the way in which economic rent is calculated is found in the following formulation:

Economic rent = total revenue minus total economic cost[23]

A tax is then imposed on the amount of economic rent derived from the resource at a specific rate. It is in effect a tax on the free cash flow from a resource project. It also takes into account in determining the costs of a project the 'opportunity costs of capital' by incorporating an uplift factor such as a long term bond rate plus a further component.[24] For example, with the Mineral Resource Rent Tax (MRRT) in Australia the carry forward rate for undeducted general project costs is the long term bond rate plus 7 percent. [25]

The Henry Tax Review provides an explanation of how the economic rent is derived from ownership of land.

> Economic rent is the return to the owner above that needed to keep the land in its current use. That is, it is the return once the owner has been compensated for the capital and labour they employ on the land. Economic rent therefore flows from the efforts of others, or simple luck. In particular, the economic rent of an owner's land increases as surrounding land increases in economic productivity (for example, from new roads built nearby), rather than the owner's investment in the productivity of their own land. Land rent is likely to increase in line with future population and economic growth, which increase demand for a fixed supply of land.[26]

In order to eliminate any confusion when discussing a tax on land, the term 'rent' is used in the way in which David Ricardo described it as the 'compensation paid to the owner of land for the use of its original and indestructible powers'.[27] He distinguishes this approach from the 'economic rent' derived from the use of the land which produces a profit after deducting the cost of capital and labour. This is in line with the approach taken by the Henry Tax Review, as stated above, that the owner of land derives 'economic rent' when the value of the land increases as a

[22] Ibid.
[23] G. C. Watkins, 'Atlantic Petroleum Royalties: Fair Deal or Raw Deal?', (2001) *Atlantic Institute for Market Studies*, The AIMS Oil and Gas Papers (2), 5.
[24] Martin Van Brauman and Clifford Mangano, "Resource Rent Taxation as a Basis for Petroleum Tax Policy by Foreign Governments and its Relationship to US Foreign Tax Credit Policy and Tax Law', (2000) 18(1) *Journal of Energy & Natural Resources Law* 19, 20.
[25] Explanatory Memorandum, Minerals Resource Rent Tax Bill 2011, 8.
[26] Henry Tax Review, 249.
[27] David Ricardo, *The Principles of Political Economy and Taxation* (J.M.Dent & Sons, 1911) 34.

result of economic growth. In effect it is the recognition of the unrealised capital gain in the land which is not currently subject to any form of taxation. To some extent this increase in value is captured by the State governments and Local governments by increases in the rate at which land tax is imposed or local government rates are levied, but the whole system is ad hoc and in need of harmonization. However, in terms of mining activities, the Henry Tax Review advocated a mineral resource rent tax to be imposed on the economic rent generated after deducting the costs of capital and labour and allowing for an uplift factor such as the long term bond rate plus a specified percentage to recognise the risk involved in the mining activity.

The idea of imposing a rent tax on land is not new. The classical economists have always advocated the merits of a rent tax and for this reason the following part of this paper will examine the arguments put forward by these economists for the imposition of a land tax. This part of the paper also includes a brief discussion of the contentions raised by Henry George as to the merits of taxing land.

Adam Smith, David Ricardo and Henry George were all advocates of taxing the rent of land.[28] One of the main reasons for supporting land tax was that it is an efficient tax because it does not distort behaviour in the same way that a tax on income or capital distorts employment or investment decisions.

B *Adam Smith*

According to Adam Smith, a rent tax on land would satisfy the requirement of a proportional system because the greater the value of the land the greater the amount of tax paid. The private revenue of individuals arises from three sources: rent, profit and wages.[29] Smith contends that a tax upon rent of land may either be imposed according to the location of the land or on the real rent of the land which is determined by the improvements on the land. Land tax that was imposed in Great Britain at that time was seen by Smith as being tax neutral and the following statement aptly summaries this fact:

> It does not reduce productivity and does not raise the price of what is produced. It does not obstruct the industry of the people. It subjects the landlord to no other inconvenience besides the unavoidable one of paying the tax.[30]

C *David Ricardo*

David Ricardo was critical of the approach that Adam Smith took in determining economic rent. Ricardo was of the opinion that rent took two forms: first, rent from profit derived from the use of land and; second, rent paid ‘to the owner of land for its original and indestructible powers’.

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[28] It should be noted that many other economists also advocated a tax on land such as William Petty, John Stuart Mill and Francois Quesnay

[29] Ibid, 350.

[30] Ibid, 353.

In terms of a land tax, David Ricardo was opposed to a tax that was imposed at a rate commensurate with the value of the produce derived from that land.[31] He concluded that it was in effect a tax on rent and not a tax on land. In other words he reinforced the view that a land tax should be levied on the unimproved value of the land and that a tax on varying rents would be a rent tax and not a land tax.[32] In other words, the economic rent is associated with the unrealised capital gain which is not subject to income tax with properties that are exempt by being a 'main residence'. Land tax is simply imposed on the unimproved value of the land.

D *Henry George*

Henry George advocated the abolition of all other forms of taxation other than the collection of the ground rent from the value of land irrespective of the improvements.[33] George did not advocate the nationalisation of all land by the state in order to achieve this goal.[34] Land was to be left in the hands of the owner. He believed that a land tax would provide the state with sufficient revenue that it would be unnecessary to tax capital or labour.[35] To him, these forms of taxation were inefficient.[36] By abolishing the taxation of capital and labour this would lead to greater incentives for production.

Henry George also believed a land tax would destroy land monopoly by making the holding of land unprofitable unless it being put to a profitable use.[37] Land speculation would cease to exist because of the land tax. This was similar to the original intent of land tax in the Australian States where the tax was seen as a mechanism to break up large land holdings.

The Commonwealth of Australia introduced a land tax with the enactment of the *Land Tax Act 1910 (Cth)* and the *Land Tax Assessment Act 1910 (Cth).* It was contended that the main purpose of the legislation was to control the ownership of land in Australia and to penalise land owners that were not resident in Australia by imposing a progressive rate land tax on the unimproved value of land in excess of five thousand pounds. The High Court of Australia in the case of *Osborne v The Commonwealth and George Alexander McKay* (1910-11) 12 CLR 321 examined the legality of the legislation on the basis that it was not concerned with raising tax but its main purpose was to break up large land holdings in order to promote greater agricultural pursuits and reward returning soldiers from the first World War.[38] Griffith CJ acknowledged that a consequence of the Act may be to prevent large holdings of land but that did not affect the competence of the Act to impose a land tax.[39]

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[31] David Ricardo, 'On the Principles of Political Economy and Taxation' (University of Cambridge, 1951) 181.
[32] Ibid.
[33] Henry George, Social Problems, (1938, The Henry George Foundation of Great Britain) 179.
[34] Ibid.
[35] Ibid, 181.
[36] Ibid.
[37] Ibid.
[38] Ibid.
[39] *Osborne v The Commonwealth and George Alexander McKay* (1910-11) 12 CLR 321, 335.

The land tax that was introduced in Australia in 1910 had, as its main effect, the redistribution of large land holdings to other farmers who at that stage were precluded from obtaining land. The rate of tax was such that it became prohibitive for absent landholders to merely occupy land without producing income.[40] Commonwealth land tax was abolished in 1952 by the *Land Tax Abolition Act 1952* (Cth) and the Australian States adopted this form of taxation. However, there is no constitutional obstacle to the Commonwealth introducing a land tax once again.

III THE HENRY TAX REVIEW AND LAND TAX

The Henry Tax Review provides four specific recommendations on land tax and the abolition of stamp duty on conveyances. Those recommendations are summarised below:[41]

> Recommendation 51 – stamp duty on conveyances be abolished by States and replaced with more efficient taxes such as those levied on consumption or land. Abolishing stamp duty at the same time as increasing the tax on land would have the additional benefit of offsetting the impact on land prices.
>
> Recommendation 52 – land tax should be levied on as broad a base as possible, with few exemptions, and at progressive rates reflecting the value of land to be determined by a per-square-metre value.
>
> Recommendation 53 - in the long run land tax should be levied on all land.
>
> Recommendation 54 – land tax could be improved if it was imposed on each holding and not on an entities' total holding as this would promote investment in land; eliminate stamp duty on commercial and industrial properties in return for a broad land tax; and investigate various transitional arrangements in order to achieve a broadening of land tax.

The ACT government has virtually adopted all of the recommendations as set out above by imposing a land tax on all property in the ACT and in gradually abolishing stamp duty on conveyances. If the ACT experiment with a land tax and the subsequent abolition of stamp duty on conveyances achieves the above objectives of the Henry Tax Review, then there is no reason why this initiative cannot be adopted by other State governments.

A *The land tax initiative in the ACT*

The Australian Capital Territory (ACT) government undertook a review of its tax system in 2012[42] and one of the major recommendations was to broaden the land tax base to all principal places of residence and to gradually abolish stamp duty on the conveyances of real property. By

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[40] A.M. Woodruff and L.L.Ecker-Racz, "Property Taxes and Land Use Patterns in Australia and New Zealand', (1965-66) 18 *Tax Executive* 16, 31.
[41] Commonwealth of Australia, above n 4, Part One, 90.
[42] Quinlan, T (Chair); Smithies, M; and Duncan, A, 2012, *ACT Taxation Review*, Report to the Treasurer, ACT.

the year 2032, it is envisaged that there will be no stamp duty paid by the buyers of real property in the ACT.[43] This approach generally follows the recommendations of the Henry Tax Review. However, the ACT government recognised the benefits of a land tax over other forms of taxation such as stamp duty, but only in terms of the raising of revenue in the ACT.

The ACT does not have local government in the form of municipal councils. Therefore the Territory government acts in the capacity as an equivalent state government and the various local governments found in the States in Australia. The Henry Tax Review examined the issue of stamp duty on the purchase of property and concluded that it discouraged people from moving as it was generally twice the cost of real estate agents fees and removal costs.[44] Similarly, stamp duty acts as a barrier to entry for first home buyers as they have to save the stamp duty up front and discourages older home owners from downsizing as it reduces their equity.[45] The review also contended that stamp duty inhibited people moving for employment purposes which may result in higher unemployment. Basically stamp duty is inequitable and the burden of the tax falls on those who move frequently in their life due to a number of reasons such as divorce, birth of children or work opportunities.[46]

The main policy consideration for the abolition of stamp duty on conveyances was the fact that only 9 percent of the population of the ACT contributed to a quarter of the total amount of tax collected through this source of revenue.[47] The burden of this tax fell on those who were required to move homes or when families could least afford it.[48] The ACT government not only stated that this tax was unfair but that it was an unpredictable and volatile source of revenue.[49] The ACT Taxation Review recognised the fact that the ACT economy was highly dependent on decisions of successive Commonwealth Governments for public expenditure which would have a direct impact on economic activity in the territory.[50] While the high number of public servants employed in the ACT provided some stability, the current Commonwealth budgetary situation is adding to the uncertainty for the future of stamp duty as a reliable tax. This situation facing the ACT is arguably being experienced in all States with a slowdown in the property market. The ACT government intends to abolish stamp duty on general insurance and life insurance over the next five years (20 percent each year) from 2012-2013 as a result of increasing the general rates.

The ACT has both a land tax on investment and commercial property as well as a general rate which is imposed on all property with limited exemptions. By decreasing the level of land tax the government expects a greater level in the supply of investment properties which are then

[43] It is interesting to note that one of the main beneficiaries of this reform will be the Commonwealth government. At present in the ACT the owners of real property used for income producing purposes are able to claim a deduction for stamp duty on the basis that all land in the ACT is leasehold and that s 25-20, *Income Tax Assessment Act 1997* (Cth) provides the basis for the deduction.
[44] Commonwealth of Australia, above n 4, 254.
[45] Ibid, 255.
[46] Ibid, 257.
[47] Quinlan, above n 1, 12.
[48] ACT Tax Reform Fact Sheet – 'Duty on Conveyance – abolishing stamp duty' www.treasury.act.gov/TaxReform/Index.shtml 12 December 2012.
[49] Ibid.
[50] Quinlan, above n 1, 13.

available for rent. However, the level of the general rate increases on a progressive basis similar to land tax. The general rate is levied on all property similar to rates imposed by local governments throughout Australia. The general rate is based on the average unimproved value of the property. The general rate has two components; a fixed charge and a valuation charge. The current fixed charge is $555 and the valuation charge is subject to assessment on progressive rates. The new land tax rates will result in seventy six percent of properties receiving a decrease in land tax and twelve percent an increase due to a change in the progressive rates.

Under the new General Rates system properties with an average unimproved value (AUV) below $200,000, around 33,700 ACT households, will have a decrease in General Rates. Properties with an AUV above $200,000, around 108,000 ACT households, will incur an increase in General Rates. The ACT government allows for the payment of the general rates to be deferred and paid when the property is finally sold. Interest is imposed on the outstanding amount.[51] This provides some relief for retired property owners unable to pay the increase in the general rates especially if the value of their land increases substantially over time. This is in line with the recommendations made by the Henry Tax Review.[52]

The idea of the tax reform is for the general rate on land tax to increase as the revenue from stamp duty declines over the next twenty years. The general rate will increase as the value of land in the ACT increases and the progressive rates are applied to an ever increasing value. Ben Phillips from the National Centre for Social and Economic Modelling (NATSEM)[53] undertook research into the likely level of rates if stamp duty was entirely replaced within twenty years. He found that the general rate on all real property would need to double relative to current levels being imposed on all property owners in the ACT. Allowing for bracket creep with house prices increasing by 6 percent per annum provides an 80 percent increase over 20 years. However, he did not believe that allowing for bracket creep for a 20 year period was realistic.[54]

Therefore it may be concluded that the ACT initiative to abolish stamp duty and replace it with a land tax in the form of an increase in the general rates may not achieve its objective within a twenty year period. The ACT government may need to increase the current progressive rates within the next 20 years or encourage a significant growth in the population of ACT land owners so that more people are paying the land tax. However, the reform does follow the recommendations contained in the Henry Tax Review and the arguments in support of abolishing stamp duty on conveyances are overwhelming.

B *Capital Gains Tax Exemption for the Main Residence*

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[51] The *Rates Act 2004* (ACT), sections 44, 48, 55 and 56.

[52] Commonwealth of Australia, above n 4, 266.

[53] Ben Phillips: Principal Research Fellow, NATSEM, 15 November 2012, Tax Reform in the ACT: Distributional Impacts. http://www.natsem.canberra.edu.au/storage/ACT%20Tax%20Reform.pdf.

[54] Ibid.

Under the Capital Gains Tax (CGT) provisions of the ITAA 97, s 118-110, the main residence is exempt from income tax on any capital gain made while maintained as a main residence by the taxpayer. The taxpayer even has a concession where they no longer live in the main residence for a period of six years, s 118-145, ITAA 97. Arguably this exemption has led to the overcapitalisation of the main residence at the expense of more productive investment such as shares traded on a stock market. This is the situation that exists in New Zealand and by extension, in Australia.[55] However, if a land tax was introduced that satisfied both vertical and horizontal equity, then this concession for owner-occupied housing can be tolerated.[56] As Professor Yates contends, a land tax overcomes any problems associated with the CGT exemption and the non-taxation of unrealised capital gains. The following statement provides an ideal summary of the benefits of a land tax:

> In taxing economic rent, or the unearned incremental increases in the land values arising from increasing demand in light of restricted land supply, land taxes can be used as an alternative to replace capital gains tax on owner-occupied housing. As such, they are beneficial in helping to reduce the demand pressures that drive housing affordability problems. Also, by broadening the base and applying the tax on a per holding basis, rather than on aggregate land holding, the recommendation should result in a reduced land tax burden on rental investments properties and should remove one of the disincentives for large-scale (including institutional) investments in rental housing.[57]

C *Land tax as a means of taxing unrealised Capital Gains*

A rent tax on all land including owner occupied homes is in effect a tax on the unrealised capital gain on the land. This is in line with the theory on the taxation of rents as proposed by David Ricardo and more recently proposed by the Henry Tax Review. As the value of the land increases due to population shifts so does the amount of land tax that is paid by the landowner. The land tax captures some of the unrealised capital gain on the land. As Professor Yates states above, one way in which governments in Australia may compensate for the main residence CGT exemption would be to impose a land tax on the main residence or family home, in just the same way that it is imposed on all property in the ACT. Because it would be on the unimproved value of the land, houses and other improvements may still be overcapitalised but at least additional revenue would be collected just from the increase in the value of the land. It is contended by Mason Gaffney that capital gains are mostly land gains misnamed and as such are a form of taxable rent.[58] He quotes figures from the economist Harry Kahn who in 1973 estimated that unrealised capital gains were ten times the value of realised gains.[59] This may well be the

[55] Jonathan Barrett and John Veal, 'Land Taxation: a New Zealand perspective', (2012) 10(3) *eJournal of Tax Research* 573, 584.
[56] Judith Yates, 'Housing and Tax: The Triumph of Politics over Economics' in Chris Evans, Richard Krever and Peter Mellor (eds), *Australia's Future Tax System: The Prospects After Henry* (Thomson Reuters 2010) 233, 258.
[57] Ibid.
[58] Mason Gaffney, 'The Hidden taxable capacity of land: enough and to spare', (2009) 36(4) *International Journal of Social Economics* 328, 346.
[59] Ibid.

situation in Australia where the older residents are holding assets that have vast unrealised capital gains that will not be realised for many years to come even though the 50 percent discount may apply.[60] Or in the case of the main residence, will never be subject to capital gains tax.

Gaffney argues that the Haig-Simons comprehensive tax system recognised unrealised 'monetised' gains as income and capable of being subject to income tax.[61] On this basis Gaffney argues for a land tax based on the accrual of value each financial year as a means of gaining 'huge amounts of revenue that largely escapes taxation'.[62] According to Gaffney, a 'property tax based on land value, remarkably, taxes both the current rent, and the current unearned increment as it accrues'.[63] From this perspective, a land tax is very effective because the rent from the land, in terms of what Ricardo was advancing and the economic rent, as a result of increased land values, in terms of what the Henry Tax Review proposed, are subject to tax. By having progressive rates of tax applying to the unimproved land value, both forms of rent are subject to tax, namely the rent from owning the land and the economic rent from increases in value.

One of the main objections for the imposition of land tax at progressive rates on all property owners is that some residents may be asset rich but income poor. This aspect of a land tax was recognised in the Henry Tax Review and has been acknowledged by the ACT government with its new land tax initiative. In the ACT property owners that are unable to pay their general rates are allowed to defer payment until the property is finally sold. As has been stated above, the main group of land owners that are most disadvantaged by a higher tax on land are the self funded retires and recipients of the Age Pension. However, it is timely to note that the Commonwealth government is aware of the problems facing those elderly Australian receiving an Age Pension and living in their own home. The family home is exempt from the assets test under the pension regime even if it is worth millions of dollars. These pensioners are asset rich but income poor. They may want to downsize their home and live in more appropriate accommodation but if they sold their home they would no longer be eligible for the age pension. In the Commonwealth Budget of 14 May 2013, the government announced a trial for 3 years whereby the pensioner is allowed to sell their home that they have owned for at least 25 years; to place up to $200,000 in a special deposit account and the interest and funds will be exempt from the assets test. This then allows them to retain the Age pension and at the same downsize their home. This measure starts from 1 July 2014 and at this stage the new government has not made any announcement that this measure will be repealed.

IV CONCLUSION

[60] Division 115, *Income Tax Assessment Act 1996* (Cth).
[61] Cooper, above n 33, 423.
[62] Gaffney, above n 63, 347.
[63] Ibid.

The main question raised in this paper is whether it is possible for a uniform land tax to be introduced in Australia. At present land tax in a limited form is imposed in all States and the ACT and by local governments throughout Australia in the form of rates. As has been stated in the first part of the paper, taxes on land only amount to 9.3 percent of total taxes raised by all levels of government. Land is very lightly taxed in Australia and with an ageing population; the current reliance on income tax instead of land tax should be examined very carefully by all levels of government in Australia.

The ACT has adopted many of the recommendations of the Henry Tax Review and imposed a land tax in the form of a general rate on all owners of property and eventually abolishing stamp duty on conveyances. The ACT general rate is based on the average unimproved value at progressive rates which will result in substantial increases in the amount of land tax being paid by ACT residents in the future. The ACT initiative could be adopted by all State governments with a corresponding abolition of stamp duty which is a very inefficient form of taxation. If all State governments abolished stamp duty on conveyances then the working population could be more mobile in order to secure employment without incurring a financial penalty when they need to purchase another home. Productivity in Australia may increase as a result.

In conclusion, a tax on land is a very efficient form of taxation as it does not adversely affect labour or capital. If as a result of a uniform land tax being introduced, income tax on individuals and companies could be reduced, then the Australian economy would benefit. The arguments in favour of increasing Australia’s reliance on a tax on land are compelling for two main reasons: first, with an ageing population and a decrease in the number of individual taxpayers paying income tax, land tax may provide a solution to the problem of falling revenue, and second; with the increase in house prices and the housing affordability problem facing the younger generations in Australia. The current owners of property are in possession of great wealth that is being untaxed at present. A land tax in the form proposed above would not only tax the original rent of land, in line with Ricardo’s theory, but would also tax the economic rent contained in the unrealised capital gain of property in Australia. This may alleviate the need to introduce a wealth or inheritance tax at some time in the future.

The ACT government also recognises that some form of relief may be needed for asset rich but income poor land owners. The Commonwealth government has also recognized that Age Pensioners may also want to downsize their current homes and has introduced an initiative that may help achieve that goal. However, the arguments in favour of the need for a uniform land tax in Australia are compelling, but the political will and cooperation between all three levels of government may be found wanting. For the sake of future generations wanting to own a home and wanting to see the wealth that is in the hands of the ‘baby boomer’ generation redistributed fairly, the introduction of a land tax on all property in Australia is an imperative.

The need for a uniform tax on all land with very few exemptions is compelling given the benefits that a land tax would bring. The ACT land tax system could and should be adopted by all State governments and if this is not done, then the Commonwealth government may take the initiative and reintroduce a land tax at the federal level.