



THE UNIVERSITY OF  
**SYDNEY**

**The Henry  
Halloran Trust**

# **Submission to the NSW Federal Financial Relations Review 2020**

Dr Cameron K. Murray  
The Henry Halloran Trust  
July 2020

## **Summary**

- A major recommendation of the Draft Report is to replace transfer duty (stamp duty) with a broader-based and higher rate land tax.
- It is reasonable and desirable to increase land value taxes and broaden their base while retaining stamp duties in some form, even at a lower rate.
- While a land value tax is economically efficient and fair, the claims about the poor economic performance of stamp duties are ill-informed.
- The near unanimous agreement by analysts should be no indicator of the quality of their analysis.
- The evidence does not support the four major economic claims about stamp duty that are used to justify the proposed tax swap. In reality
  1. The economic efficiency costs of stamp duty are low, not high.
  2. Removing stamp duties may increase the price of housing.
  3. Lower churn of housing assets is an economic benefit of stamp duty.
  4. Stamp duty revenue volatility helps stabilise the macroeconomy.
- The CGE models used to assess the efficiency costs of stamp duty do not have transactions and therefore cannot model transaction taxes. Instead, the two main approaches have been to instead assume that stamp duty is a tax on housing construction (KPMG model) or a tax on legal and real estate services (COPS model). Neither makes any sense, yet these hidden assumptions are the source of the high efficiency cost estimates.
- The price effects of removing stamp duty without other tax changes will be to increase housing prices. Whether this is the net effect depends on the amount of tax raised through land taxes, the capitalisation rate and turnover rate. In general, the price effects of this tax swap are ambiguous.
- Lower costs of housing turnover will mostly benefit investors who more frequently trade housing. These additional investor trades come at costs to tenants by way of forced moves, which are always ignored in the analysis. The evidence shows that homeowners do not have a large moving response to lower stamp duties. Nor does downsizing increase—instead experience in the ACT shows that many elderly homeowners upsize to shield more of their assets from the pension assets test when stamp duties are removed.
- Tax revenue stability is not a desirable economic objective. The additional volatility of stamp duty revenue is a feature in terms of macroeconomic management as it provides a better economic stabiliser.

# Detailed Comments

Most think-tanks and policy groups in Australia think that a policy to swap 'stamp duties for land value taxes', or what I will call SD4LVT, is going to provide some impressive economic and housing benefits. But layers of bad economics hide beneath the new populism of SD4LVT.<sup>1</sup>

It is extremely frustrating to me that leading minds in Australian policy have smashed their heads together and decided that the best reform they can think of is to replace one good tax on property with another good tax on property that is politically unpopular.

The better minds in this game don't even think SD4LVT will have any effect on reducing housing prices or making housing at all more affordable, yet still put it forward as the 'holy grail' of state tax reform.<sup>2</sup>

**It is completely reasonable and desirable to increase land value taxes and broaden their base while retaining stamp duties in some form, even at a slightly lower rate. This will increase overall state own-tax revenue to help meet public investment objectives while retaining the economic benefits of both taxes.**

An explanation of the four wrong assumptions about stamp duty that have been used to justify it as a target for reform is provided below.

## 1. Wrong assumptions about economic efficiency

The metrics of economic disaster caused by stamp duties are derived from economic analysis using computational general equilibrium (CGE) models of the macroeconomy. The below table from the Draft Report shows that multiple assessments conclude that there are high economic costs to raising revenue from stamp duty.

	Residential transfer duty	Existing Land tax
Australia's Future Tax System Review (Henry Review) modelling <sup>xxxiv</sup>	34 cents	9 cents
Modelling commissioned by CPA <sup>liii</sup>	85 cents	9 cents
2015 Commonwealth Treasury tax review <sup>liv</sup>	72 cents	-10 cents <sup>30</sup>
ANU Tax and Transfer Policy Institute paper <sup>lv</sup>	87 cents	48 cents
Centre of Policy Studies working paper <sup>xxxv</sup>	107 cents	8 cents

---

<sup>1</sup> These comments are based on two articles:

<https://theconversation.com/stamp-duty-fever-the-bad-economics-behind-swapping-stamp-duty-for-land-tax-106841> and <https://www.fresheconomicthinking.com/2018/11/bad-economics-of-stamp-duty-discourse.html>

<sup>1</sup> <https://grattan.edu.au/wp-content/uploads/2017/10/SA-Federalism-and-Tax-Future-Directions-for-Property-Tax-Reform-for-web-28-August-2017.pdf>

<sup>2</sup> <https://grattan.edu.au/wp-content/uploads/2017/10/SA-Federalism-and-Tax-Future-Directions-for-Property-Tax-Reform-for-web-28-August-2017.pdf>

However, these studies all use CGE models that assess the effect of transaction taxes because there are no transactions in the models. Instead of using a better tool for the job, or admitting the limits to knowledge, modellers have simply pretended that stamp duties are a different tax that applies to a tax-base that is in their model.

There are two main approaches to this. First, in the KPMG models, rather than stamp duty being a transaction tax that is incident on the seller (and therefore incident on land values), as it is in reality, they assume this instead.

*...conveyancing stamp duties are modelled as a tax on investment in residential and commercial structures (p.125)<sup>3</sup>*

They assume that stamp duty is not a tax on transaction where the economic incidence is on land. Instead, they assume that stamp duties raise the cost of housing to all buyers and renters because it is modelled as a tax on construction. The model assumption requires that stamp duties raise the cost of building new houses without affecting land prices, leading to reduced new housing construction in general. This is a classic example of garbage in, garbage out.

A second **approach is in the COPS model** is to pretend that stamp duty is a tax real estate agent fees and legal services used in housing transactions.

*Stamp duty on conveyancing or property transfers in Australia are taxes that apply to the transfer of ownership of most properties. While the duty base is the sale value of the property purchased, the resources used in transferring property ownership is usually only a fraction of the value of the property transferred. To model transfer duties on residential property ownership in this way, we introduce a new bundle of goods into the household decision problem in VURMTAX, called Moving Services. This bundle consists of goods produced by the Real Estate Services, Other Business Services and Public Administration industries, and represent the real estate agent, legal and public administration goods demanded by households when transferring property. (p17)*

*...we have \$8,367 million of stamp duty being levied on an activity with a resource cost of only \$1,881 million. This implies a tax rate on the activity of transferring property of 445 per cent (=8367/1881). (p.80<sup>4</sup>)*

This means that instead of the tax being a small percentage of a large base (property turnover value) they are instead suggested that the tax is a 445% tax on real estate agents and conveyancing.

If that sounds crazy, that's because it is. Any tax at this rate is going to look costly and inefficient in a CGE model. The more bizarre part of it is that if you believe this modelling approach is an accurate representation of stamp duties, then the cheaper real estate agents and lawyers become, the more economically inefficient stamp duties are.

**The claims about the economic inefficiency of stamp duty that are relied upon to justify its removal have no plausible economic basis.**

## 2. Price effects

The economic incidence of stamp duty is on the seller. This means that if you remove stamp duty, all else equal, prices will rise by exactly the amount of the duty. Good analysts know this, even if they rely on poor analysis by others that assumes stamp duty "increases the price

---

<sup>3</sup> KPMG. 2010. CGE analysis of the current Australian tax system. Report for the Australian Government the Treasury, March, Canberra.

<sup>4</sup> <https://www.copsmodels.com/ftp/workpaper/g-289.pdf>

that property buyers pay.”<sup>5</sup> If the average home price is \$500,000, and stamp duty is 5%, prices will immediately rise to \$525,000 when you remove the duty.

But if you want to replace the same tax revenue from stamp duty with revenue from land value taxes, you could wind up inflating prices and inadvertently creating an economic transfer to property owners.

Imagine an example economy with:

- 20 houses
- Turnover of 1 house each year (a turnover rate of 5%)
- Average rent of \$25,000 per year (5% gross yield)
- An average home price of \$500,000
- Land price component of \$250,000 per house (total land value of \$5 million)
- Total stamp duty revenue of \$25,000 per year.

To replace the \$25,000 stamp duty revenue with a land value tax requires taxing all twenty homes at \$1,250 per year each.

Whether the market price of homes rises or falls depends on whether buyers think the upfront present value of \$1,250 per year is lower or higher than the \$25,000 upfront stamp duty they would have paid. At a 5% capitalisation rate in this example, \$1,250 per year in perpetuity is equivalent to \$25,000 and the taxes replace each other perfectly with no price effect.

But what if turnover is half that, say 2.5%, which in this example would be where one house is sold every two years? Here, the total tax revenue to be replaced is \$12,500, which equals just \$625 per house in land tax.

If we capitalise the perpetual cost of \$625 per year at 5% we get a present value of only \$12,500, which is half the stamp duty rate. A new buyer can now pay \$512,500 for the house plus \$625 per year in land tax and be equally as well off as paying \$500,000 for the house plus \$25,000 upfront in stamp duty. The net effect in this case is a land price increase from \$250,000 to \$262,500, or 5%.

If this situation happened nationally in Australia, that would be nearly a \$200 billion economic transfer to landowners, which would completely offset the value of their new land tax obligations.

**Replacing stamp duty revenue with land tax will increase prices if the capitalisation rate is higher than the turnover rate, and decrease prices if the opposite holds. Price effects are ambiguous for SD4LVT.**

### 3. Asset churn

Taxing capital gains only happens when a transaction is made that realises gains. Thus, it is a transaction tax, just like stamp duty, though the size of the tax is related to historical changes to property values rather than current values.

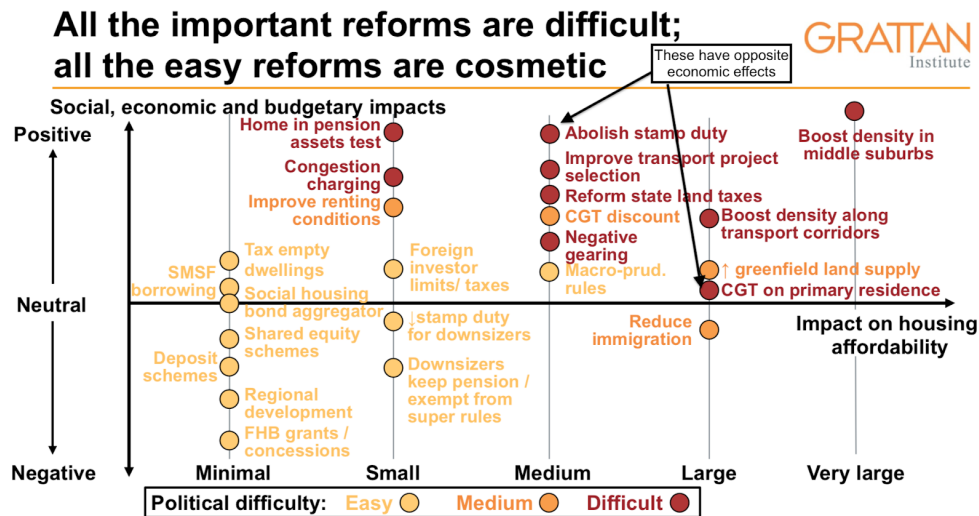
Many in the housing discourse, such as the Grattan Institute, want to increase transaction taxes on housing by increasing capital gains taxes and expanding their scope to apply to owner-occupiers. At the same time, they want to decrease transaction taxes on housing by eliminating stamp duty because apparently transaction taxes stop people relocating (see below

---

<sup>5</sup> [https://www.cpaaustralia.com.au/~/\\_media/corporate/allfiles/document/professional-resources/taxation/kpmg-econtech-final.pdf](https://www.cpaaustralia.com.au/~/_media/corporate/allfiles/document/professional-resources/taxation/kpmg-econtech-final.pdf)

diagram).<sup>6</sup>

Somehow abolishing a transaction tax in the form stamp duty is good because it reduces the cost of owner-occupiers relocating, but then putting back a large transaction tax in the form of a capital gains tax specifically on owner-occupiers is also good.



Source: Grattan analysis.  
Notes: Prospective policies are evaluated on whether they would improve access to more affordable housing for the community overall, assuming no other policy changes. Assessment of measures that boost households' purchasing power includes impact on overall house prices. Estimates of the economic, budgetary or social impacts should not be treated with spurious precision.

There are two problems with the 'transaction costs impede household mobility and are bad' view. First is the simplest. People who relocate for work generally don't buy and sell houses to accommodate that move.

*Moving for work is not a common reason for buying a home, regardless of age, which might reflect a view by some households that work is a temporary reason for moving and therefore not sufficient to commit to homeownership. (p.22)<sup>7</sup>*

Thus, the effect of stamp duty on reducing housing turnover is likely to fall mostly on investors, who make up nearly half of housing transactions and can easily time their decisions. Transaction taxes make it more expensive for people to quickly buy and sell and deters speculative buying that seeks only to capitalise on short bursts of capital growth before selling, which itself fuels the capital growth and accentuates the bust. Many investors fall in this category, and many homeowners also make their location and purchase decisions based on expectations of capital gains rather than housing need. Go on, ask new homebuyers about property prices. See if they bought where they did for housing need or capital growth?

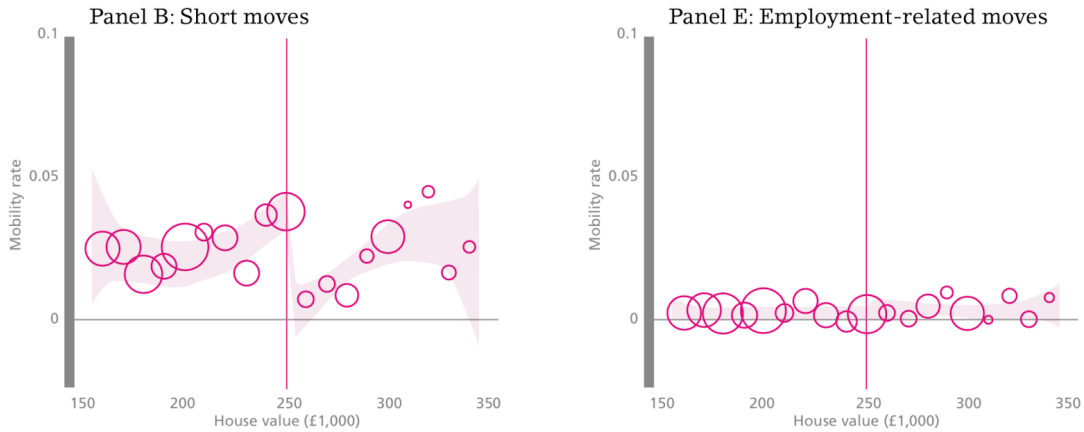
The evidence on stamp duty deterring moving shows pretty clearly that moving for work is unaffected, as the below plot shows, with the main effect being from people making 'short moves' by relocating less than 10km.<sup>8</sup> Indeed, the best evidence on turnover effects estimates only the size of the short-term shock as people adjust to the new price equilibrium.<sup>9</sup>

<sup>6</sup> <https://grattan.edu.au/news/supply-sceptics-beware-without-more-housing-it-wont-be-affordable/>

<sup>7</sup> <https://www.rba.gov.au/publications/bulletin/2017/mar/pdf/bu-0317-3-housing-market-turnover.pdf>

<sup>8</sup> <http://cep.lse.ac.uk/pubs/download/cp516.pdf>

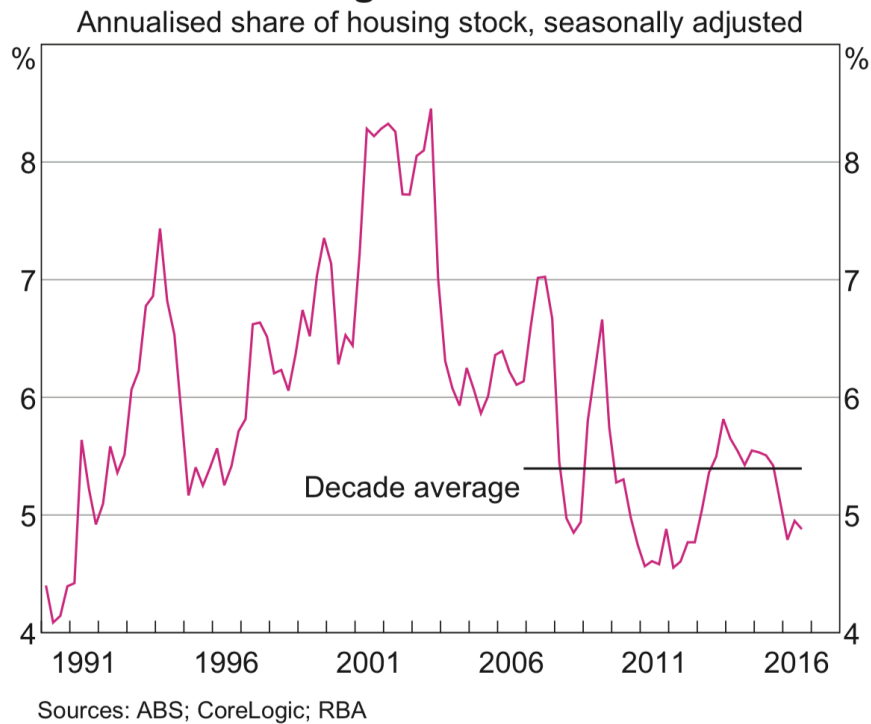
<sup>9</sup> <https://www.semanticscholar.org/paper/How-Do-Stamp-Duties-Affect-the-Housing-Market-Davidoff-Leigh/e474b5b88da71ff5a3af1f1499515b03dac0bcac?p2df>



In terms of the claim lower stamp duty helps more efficiently use the stock of dwellings, as it reduces the costs to older people downsizing, freeing up large homes for families, the evidence here is the opposite. When the ACT scrapped stamp duty for over-65s, the retirees who utilised the exemption bought bigger homes, rather than smaller ones, requiring them to implement a low value-cap on the exemption. After all, the distribution of homeownership is not driven by housing need, but primarily by wealth. Reducing the cost of redistributing housing by wealth will not suddenly make housing ownership less unequal.

Regardless, turnover as a whole seems relatively unaffected by stamp duties. The early 2000s boom also saw massive stamp duty increases yet turnover shot up dramatically (see below chart).<sup>10</sup> The role of stamp duty in these patterns of housing turnover is tiny compared to other factors.

## Housing Turnover Rate



<sup>10</sup> <https://www.rba.gov.au/publications/bulletin/2017/mar/pdf/bu-0317-3-housing-market-turnover.pdf>

Indeed, if you want people to move more frequently for a lower cost, then implement a 'house-moving subsidy', which could also apply to renters. The benefit of this approach is that it would also help renters forced to move unnecessarily due to investor turnover. The cost of high turnover on renters being forced to move more frequently is never considered in the analysis of stamp duty.

Second, taxing capital gains on owner-occupied housing will be a far bigger transaction tax than stamp duty for most homeowners. Stamp duties are typically around 5% of the property price. For a homeowner who bought a home prior to 2012 in Sydney or Melbourne, their home has appreciated in value about 50%, or to put it another way, 33% of the current price is capital gain.

If a capital gains tax applied to their sale, the tax rate as a proportion of the current value would be:

Capital gain (33%) x Marginal tax rate (45%) = 14%

This is triple the stamp duty for most properties. Even if the capital gains tax was discounted 50%, the nearly 80% of homeowners who bought prior to 2012 would still have much higher transaction costs from capital gains taxes than from stamp duties.

In effect, stamp duties are taxing some of the capital gains during a boom that would otherwise accrue to homeowners, particularly owner-occupiers who are exempt from the capital gains tax. This seems like a good thing to me.

So while stamp duties are often claimed to be economically costly because they deter households relocating, their main effect is actually reducing investor churn, which is a good thing for property market stability. Additionally, the costs of relocating are probably less than the costs from other property transaction taxes that opponents of stamp duty support.

## 4. Tax revenue stability

Another concern is that "stamp duty revenues are much more volatile than other taxes."<sup>11</sup> During a boom, revenues rise more than proportionally to prices since they depend on prices and turnover. Vice-versa in a bust.

But what are the desirable characteristics of taxes from a macro-economic standpoint? The standard economic answer is taxes that are pro-cyclical, meaning they automatically increase tax revenues during an economic boom, and decrease them in a bust. On this metric stamp duty is a terrific tax to help stabilise the economy, which is quite useful in Australia as our economic cycles are closely tied to the housing market.

The land value tax that many propose to replace stamp duty would have smaller automatic stabiliser characteristics, meaning the tax system as a whole would be less stabilising.

From what I can tell the call for more stable state tax revenues is not driven by economic reasoning. At best it appears to rest on some kind of political preference for state governments not to be involved in macroeconomic objectives, or some kind of budget preference. But any good economist knows that policy should be focussed on balancing the economy, not balancing government budgets.

---

<sup>11</sup> <https://www.smh.com.au/national/nsw/the-state-s-worst-tax-has-to-go-20181105-p50e0y.html>