



# KEEPING RATES FAIR

WHILE WE REFORM  
THE ACT TAX SYSTEM

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# EXECUTIVE SUMMARY

The ACT Greens, and the majority of economists, believe our economy would be better off if we phased out inefficient taxes like stamp duty and replaced them with broader taxes on property like rates.

The ACT has been leading the nation in tax reform since 2012. This tax reform has been successful so far and the ACT Greens have supported these reforms.

Because we are the first jurisdiction in Australia to deliver this tax reform, we are also the first to uncover some of the downsides. The ACT Greens are concerned that if these difficulties are not fixed now, the ACT may not be able to keep up its tax reform program over the next 10 to 20 years.

The ACT Greens support economic efficiency, but we believe this must be balanced with fairness. Our rates system has had inequities for many years.

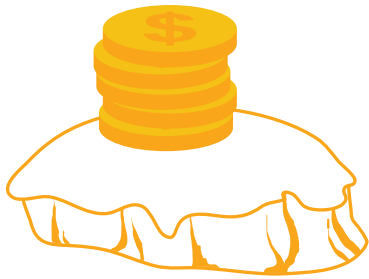
However, rates were only a small expense for most people, so these issues were largely hidden.

# THE MOST IMPORTANT PROBLEMS ARE:



## **Low income in an older suburb**

A single aged pensioner in an older suburb like Garran could be paying over 14% of their income on rates, compared to a median-income household paying median rates, which is around 1.7% of income.



## **Units have no simple land value**

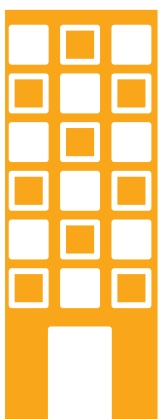
Rates are based on estimated land value (which excludes improvements like buildings and gardens), not market value of the property.

Individual apartments that may be many floors off the ground don't have a simple land value the way a house does, so they can end up paying too much or too little rates.



## **Expensive houses paying less than lower cost houses**


A small, old house can be paying higher rates than a nearby large house worth \$500,000 more, because the old house is on slightly-larger block.



## **Less expensive units in the highest tax bracket**

Many units are in the top rates bracket, including units in some of Canberra's least well-off suburbs.

## WE WANT TO HEAR FROM YOU



The ACT Greens want to hear from the community on a proposal we've developed for keeping the rates system fair while tax reform continues over the next 10 to 20 years.

This proposal would change rates from being calculated on land value to being calculated on property (market) value.

We believe our proposal would address most of the fairness issues with the current rates system. Property-value based rates have also received strong support in recent major reports into rates and tax reform. However, there would be implementation costs and it would introduce an economic 'disincentive to make improvements'.

# INTRODUCTION

## TAX REFORM

Almost all economists – including independent groups like the Grattan Institute and the Australia Institute – believe our economy would be better off if we phased out inefficient taxes like stamp duty (officially called Conveyance Duty in the ACT) and replaced them with broader taxes on property like rates.

The ACT is leading the nation in this type of tax reform.

Since 2012, the ACT Government has been phasing out inefficient taxes like stamp duty and insurance duty, while increasing rates to make up the revenue needed to deliver government services.

This tax reform has been successful so far, but because we are the first part of Australia to do this reform, we are also the first to uncover some of the difficulties of such a major change. The ACT Greens are concerned that if these difficulties are not fixed now, the ACT may not be able to keep up its tax reform program over the next 10 to 20 years.

The ACT Greens support economic efficiency, but we believe this must be balanced with fairness. We want to see a tax system in the ACT that is fair for residents, as well as providing reliable revenue for the ACT Government.

With tax reform now six years old, we believe it is time to identify those areas where fairness is not being achieved and work out ways to fix them.

## CONSULTATION ARRANGEMENTS

This Discussion Paper is about keeping the rates system fair while tax reform continues over the next 10 to 20 years. Your input would be welcomed.

We have provided some questions below we would appreciate your response to. Please send feedback to [LECOUTEUR@parliament.act.gov.au](mailto:LECOUTEUR@parliament.act.gov.au) **by 12 October 2018**.

Please include whether you would like your submission to be kept confidential.

### Questions

- **Is the solution proposed a good way to keep the rates system fair?**
- **What other options do you think we should consider for making the rates system fairer while the tax system is reformed?**
- **Should this proposal also be applied to land tax as well as to rates?**

## NEXT STEPS

The ACT Greens are committed to making our rates and tax system in the ACT as fair as possible, and we will use your feedback to help us decide the best way forward.

# THE PROBLEM

## WHAT'S WRONG WITH OUR RATES SYSTEM?

Our rates system in the ACT has had inequities for many years. However, rates were only a small expense for most people, so these issues were largely hidden. Some inequities were also reduced by the concessions and deferrals system that help low-income people like pensioners to pay their rates.

The ACT cannot charge taxes based on a person's income or wealth (apart from ownership of ACT real estate), so it is important that the taxes it can charge, like rates, are as fair as possible.

Tax reform is causing rates to grow faster than most people's incomes and this is turning the small inequities into a broader fairness problem. Over the last two years, we have seen this in the debate over changes to the way rates are calculated for units.

To fully scrap stamp duty, rates will have to rise at a faster rate than most incomes for many years to come. It will be increasingly hard to patch over the inequities built into the existing rates system. Thus the Greens believe that it is important that we look at these equity issues now.

# HOW DOES THE CURRENT SYSTEM WORK?

Rates in the ACT have two parts, a fixed charge and a variable charge. The variable charge is based on a valuer's estimate of your property's land value – not the property's market value (valuers call this system 'Unimproved Value', UV or AUV). That means it excludes the value of the buildings. This sounds simple, but comes with a lot of complications.

The ACT's variable rates charge is 'progressive'. That means properties with a lower land value pay a lower tax rate and properties with a higher land value pay a higher tax rate. This is intended to make sure that people with lower incomes get a lower rates bill than people with higher incomes. On top of that, there are concessions and deferrals that help people on lower incomes. These features are helping with fairness – but they are far from perfect.

## SO WHAT ARE THE PROBLEMS?

**There are two key problems with our current system:**

1. The affordability of rates for people on low incomes; and
2. The inequities caused by technical problems around using land values to calculate rates.



# FAIRNESS FOR LOWER INCOME PEOPLE

## Low income in an older suburb

Research shows that while most properties with a high land value are owned by people with an ability to pay higher rates, there are some people who live on higher value blocks but have lower incomes.

An obvious case of unfairness hits people on a low income who own a small, old house on a large block in an older suburb. Often, these are aged pensioners who have lived in the house for many decades and bought before the suburb became expensive.

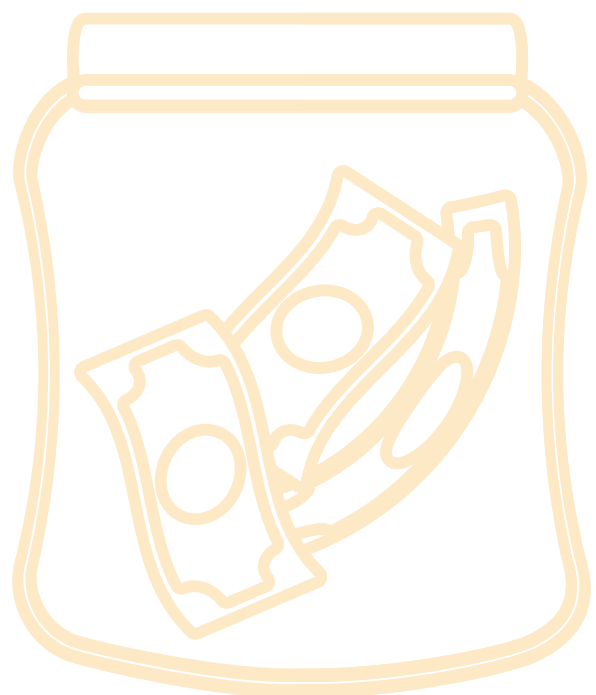
For people in this situation, rates can become a very large bill. ACT Government data shows that a single aged pensioner in an older suburb like Garran could be paying over 14% of their income on rates, even after concessions are included. In comparison, a median-income household paying the median rates will only pay around 1.7% of their income on rates.

Research interstate shows that if rates were based on overall property value, rather than land value only, this would more closely match people's ability to pay.

## Concessions miss people

The concessions system helps with fairness, but it has gaps. The ACT Government is unable to do its own means testing as the Federal Government is the only level of government that has detailed information about people's incomes.

That means the ACT Government usually relies on people having a Federal Government concession card to get the rates concessions. This misses people like those with minimum wage jobs or casual jobs that pay an unreliable wage.



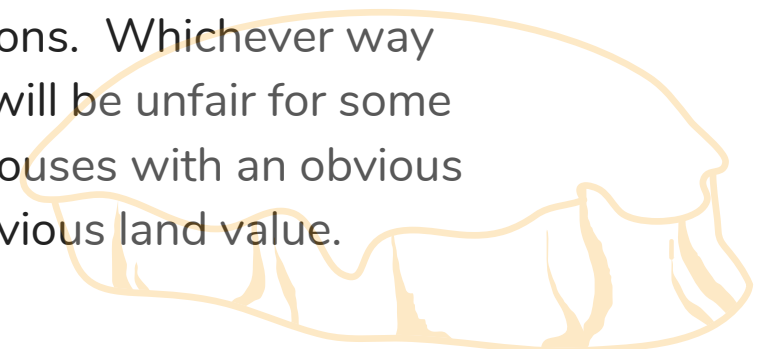
# INEQUITIES FROM USING LAND VALUE TO CALCULATE RATES

## Units have no simple land value

More Canberrans are now living in townhouses, duplexes and apartments, collectively called 'units' in the rates system. While houses have an obvious piece of land that can be valued, there is no obvious 'land value' attached to each unit. For example, what land does a unit on the third floor of an apartment block own?

The rates system has to make an estimate of what land value should apply to units. The system was changed in 2017 to try to make this estimate fairer, but many unit owners think the new system is less fair. The system used since 2017 works out the land value for the whole block of land, calculates the variable charge for the whole block, then divides that charge between the units.

Before the 2017 change, there were examples where a unit was underpaying rates compared to a particular house and also examples where a unit was overpaying compared to a particular house. The new system also includes examples in both directions. Whichever way land value is estimated for units will be unfair for some people because it is comparing houses with an obvious land value to units without an obvious land value.



## **Expensive houses paying less than lower cost houses**

Using land values to calculate rates also causes unfairness in areas that have a mix of small, less expensive houses and larger, more expensive houses. Under the current system, as long as the block sizes are the same, the worst house in the street pays the same rates as the best. In some cases, a small, old house on a larger block is paying higher rates than a nearby large house that is worth \$500,000 more.

## **Less expensive units in the highest tax bracket**

The top tax bracket for rates is for properties with a land value of over \$600,000. That catches a small number of the most expensive homes in Canberra, in suburbs like Red Hill and Forrest. However, because unit blocks are often on large areas of land, many of them also fall into the top rates bracket, including units in some of Canberra's least well-off suburbs. This high rates bill is split across the units, so no individual owner pays it all, but there have been many complaints that putting units in the top tax bracket is unfair.

This also creates a problem for the future of our rates system. If a Government wants to make the rates system more progressive by raising the top rate and dropping the bottom rate, many unit owners will be affected by rates rises even if they are on lower incomes.

## Land value is not transparent

Most established suburbs have no sales of vacant blocks, so the Government needs to estimate the land value without having any land sales to use in the calculation. Even when there are a few land sales – like Mr Fluffy blocks – Government valuers have to try to remove problems like a hot auction that sees a block sell for a value that would not be repeated and is over market value.

ACT Government data shows that very few people challenge the land value their rates bill is based on – in some years, there are no appeals. The Greens believe this is because land values are too complicated to understand, not because the values are always right.

## Old units and new units

In the past, most unit complexes included courtyards for each dwelling or large common areas for the driveway and carports. Now, tall apartment complexes are becoming common and basements mean large driveways are not needed. These trends mean less land for each home. Because rates are calculated by land value, in some cases, small, old units are paying higher rates than larger new apartments which sell for a higher price.



# PROPOSAL

## CHANGING TO 'PROPERTY VALUE' RATES

There are a number of possible options for keeping rates fair while we reform the tax system. After investigation and research, we think changing our rates system from a land-value tax to a property-value tax is likely to be fairest for ACT residents.

## WHAT IT MEANS

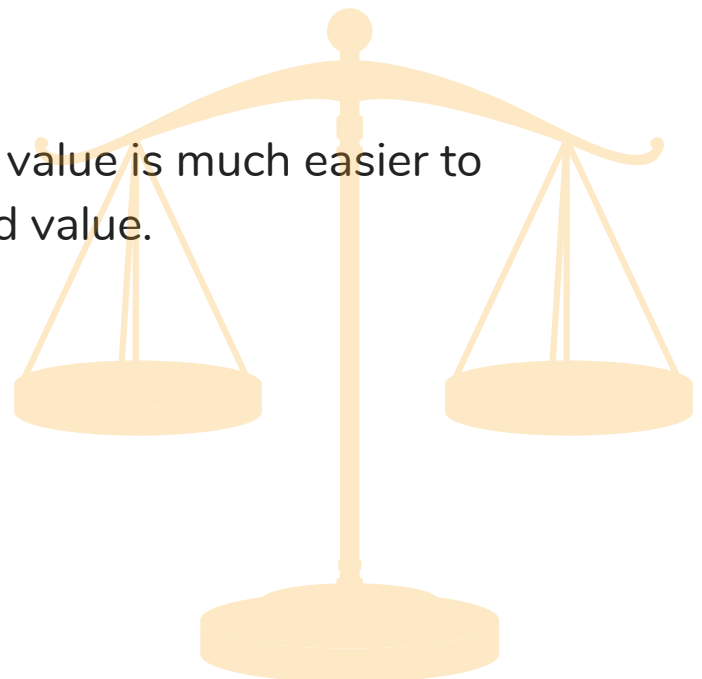
This proposal would change the way our rates are calculated from land value only to a property value charge (similar to market value) that includes buildings and other improvements. Valuers call this system 'Capital Improved Value', CIV or ICV. It would mean that rates are higher for people with an expensive home and lower for people with a less expensive home.

This system is widely used by local governments in Victoria, South Australia and New Zealand.

# PROS AND CONS

## Pros

- ✓ Property value rates are usually a better match to what property owners can afford to pay, so this proposal would improve the overall fairness of the rates system.
- ✓ Fixes the need to estimate a land value for units. Rates on houses and units would be based on their value on the market.
- ✓ Units would no longer be in the highest tax bracket, unless they were genuinely expensive units.
- ✓ Fixes the current unfairness between large expensive houses and small, old houses on the same street. A large, new house would pay higher rates than the small, old house next door.
- ✓ Fixes the current unfairness between old units with more land and new units with less land. Less expensive units would pay lower rates.
- ✓ Much more transparent. Property value is much easier to understand than an estimated land value.



## Cons

- ✘ There would be a substantial administrative cost to transfer the system over, as well as a change-over period in which some people's rates rose and other people's fell.
- ✘ Because property value rates include the building, your rates could go up if you renovate or extend your home. Economists describe this as being a 'disincentive to make improvements'.
- ✘ Because of this disincentive, economists believe that rates based on property value are a little less economically efficient than rates based on land value. However, they are still much better than stamp duty.





# CONCLUSION

We believe that this proposed change would solve most of the equity problems with the current rates system. Property-value based rates have also received strong support in recent major reports into rates and tax reform.

A recent review of local government rates by the NSW Independent Pricing and Regulatory Tribunal supported NSW local governments changing over to property-value based rates, saying that it is “generally more consistent with tax principles, and allowing its use would overcome the major shortcoming of the current system”.<sup>1</sup> The respected Australian Housing and Urban Research Institute argued recently that tax reform should be based on replacing stamp duty with rates-style taxes based on property value, not land value.<sup>2</sup>

An important possible downside to consider is the impact of taxing ‘improvements’ to the building. This can be thought out by considering your own home.

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1. NSW Independent Pricing and Regulatory Tribunal, 2016, Draft Report of the Review of the Local Government Rating System. The NSW Government has refused to release the final report. [https://www.ipart.nsw.gov.au/files/sharedassets/website/shared-files/investigation-section-9-legislative-review-of-the-local-government-rating-system/draft\\_report\\_-\\_review\\_of\\_the\\_local\\_government\\_rating\\_system\\_-\\_august\\_2016.pdf](https://www.ipart.nsw.gov.au/files/sharedassets/website/shared-files/investigation-section-9-legislative-review-of-the-local-government-rating-system/draft_report_-_review_of_the_local_government_rating_system_-_august_2016.pdf)

2. Australian Housing and Urban Research Institute, 2018, Pathways to Housing Tax Reform. [https://www.ahuri.edu.au/\\_\\_data/assets/pdf\\_file/0023/23828/AHURI\\_Final\\_Report\\_301\\_pathways\\_to\\_housing\\_tax\\_reform.pdf](https://www.ahuri.edu.au/__data/assets/pdf_file/0023/23828/AHURI_Final_Report_301_pathways_to_housing_tax_reform.pdf)

If you did a full renovation, including carpets, kitchen and bathroom, which raised your home's value by \$100,000, this would raise your rates once it was noticed by the valuation system. For a tax rate of 0.3%, the extra rates paid would be \$300 per year, or around \$5.76 per week.<sup>3</sup>

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3. Adding the buildings into the rates system means the value of properties that pay rates are much higher. For example, a land value of \$300,000 could mean a property value of \$600,000. That will mean the percentage tax rate needed to collect the same revenue will fall. It is likely that average values would approximately double and tax rates charged would halve. The example of 0.3% is therefore equivalent to the current top tax rate.

# APPENDIX

## Further reading on rates and tax reform

### Major NSW Government review

NSW Independent Pricing and Regulatory Tribunal, 2016, Draft Report of the Review of the Local Government Rating System.

[https://www.ipart.nsw.gov.au/files/sharedassets/website/shared-files/investigation-section-9-legislative-review-of-the-local-government-rating-system/draft\\_report\\_-\\_review\\_of\\_the\\_local\\_government\\_rating\\_system\\_-\\_august\\_2016.pdf](https://www.ipart.nsw.gov.au/files/sharedassets/website/shared-files/investigation-section-9-legislative-review-of-the-local-government-rating-system/draft_report_-_review_of_the_local_government_rating_system_-_august_2016.pdf).

NOTE: The ACT Greens have sought the Final Report under Freedom of Information laws, but access was refused by the NSW Government.

### Recent research reports

Australian Housing and Urban Research Institute, 2018, Pathways to Housing Tax Reform.

[https://www.ahuri.edu.au/\\_\\_data/assets/pdf\\_file/0023/23828/AHURI\\_Final\\_Report\\_301\\_pathways\\_to\\_housing\\_tax\\_reform.pdf](https://www.ahuri.edu.au/__data/assets/pdf_file/0023/23828/AHURI_Final_Report_301_pathways_to_housing_tax_reform.pdf)

Daley, J. and Coates, B., 2015, Property taxes, Grattan Institute. <https://grattan.edu.au/wp-content/uploads/2015/07/826-Property-Taxes.pdf>

## **Other reports**

Access Economics, 2010, Valuation and local government rating in Tasmania: a robust framework for the future.

<http://www.stors.tas.gov.au/au-7-0095-03793>

NOTE: Tasmania uses a different rates valuation system to the ACT, however this paper has a good comparison of land value and property value as a basis for rates.

**Please send your feedback to [LECOUTEUR@parliament.act.gov.au](mailto:LECOUTEUR@parliament.act.gov.au) by 12 October 2018.**

**You can access this discussion paper online at [www.carolinelecouteur.com.au/keeping\\_rates\\_fair](http://www.carolinelecouteur.com.au/keeping_rates_fair)**