NOT ALL TRANSFER DUTIES ARE MADE EQUAL

The distortionary effect that transfer duty can vary, depending on the purchaser, with the impacts on owner occupiers expected to be far more significant than for investors. As investors do not live in the property by definition – the major economic costs associated with transfer duty such as restricting labour mobility do not apply. The tenants renting the investment property are not restricted to changing job or moving house by transfer duty on that property. This therefore implies that transfer duty on investment properties is more efficient than transfer duty on owner-occupied homes.

These differences have a significant impact on the implications of changes to transfer duty taxation. On this basis the NSW Productivity Commission should re-consider its assessment of the marginal excess burden of transfer duty as outlined in its Discussion Paper.

A more informed decision for reform would rely on an assessment of residential transfer duty by type of buyer, and the type of property. Such analysis would reveal that transfer duty on investor purchases in established housing is efficient, and has other positive policy impacts on the housing market. I consider that further analysis by the NSWPC would reveal that increasing transfer duty on this cohort should form the corner of any policy change in this space.

THE THREE DIFFERENT TYPES OF HOME BUYERS

To undertake a fully formed assessment of the efficiency of transfer duty, this analysis should consider the three main types of home buyers in the housing market. These are owner occupiers entering the market (usually but not always first home buyers), owner occupiers already in the market looking to move, and investors. The imposition of transfer duty on these three groups is different, and should be taken into account when considering reform, along with wider housing policy considerations such as home ownership.

MOVERS

The inefficiency of transfer duty on movers is the strongest, for all the reasons that transfer duty is widely labelled as the most distortionary and inefficient tax. As noted in the by the NSWPC, examples of distortions include, workers not changing jobs, or workers not moving home which increases travel times and adds to traffic congestion.[1]

'Empty nesters' were also cited by the NSWPC as they may choose not to downsize due to the transfer duty payable. This is true, but it is important to note that the same distortion applies to all households that have changing needs, a growing family that needs an additional bedroom is also has their purchasing decision distorted by transfer duty. There will be economic costs in both examples, from underutilisation of housing by empty nesters, and by congestion from the family in a home that is too small. Any reform to transfer duty should not be limited to the circumstances of select groups.

[1] Page 97

Movers are already in the housing market, so their purchasing decisions have no impact on rates of home ownership, they are simply moving from one house to another.

INVESTORS

For all the reasons cited as to why transfer duty is an inefficient tax, none of these reasons apply to transfer duty for purchases of property by investors. The owner of the property does not live in the property, it is usually rented out. The consumption of housing is allocated through the rental market, a more efficient mechanism as transfer duty does not apply.

It is unclear from Figure 7.4 of the discussion paper whether the assessment of residential transfer duty reflects this characteristic of transfer duty on investors. The NSWPC should clarify whether or not this is the case. In any case, it would be expected the marginal excess burden of transfer duty on residential investors would be closer to that of the impact of transfer duty on commercial property, as many of the consumption characteristics are the same.

Investor purchases would be expected to reduce home ownership overall when purchasing established housing. The investor is either purchasing established home off an owner-occupier – in which case overall home ownership decreases. Alternatively the home is purchased off another investor, in which case there is no change to the overall rate of home ownership. Where investors purchase new homes – this adds to the housing supply, supporting housing affordability.

MARKET ENTERING OWNER OCCUPIERS

Entering owner occupiers are in most cases, but not always first home buyers. Surprisingly, many of the distortions of transfer duty do not apply to this group. It is a group that is entering the market, therefore it is not creating a disincentive to move. Rather for this group, transfer duty could be considered a price of admission payable to government to enter the home ownership.

Where the distortion for this group lies is if the transfer duty payable distorts the buyer's decision to enter the market, or the choice of home that they elect to purchase. To the extent to which this is the case will depend on how much of an impact the rate of transfer duty impacts on housing prices. There is research and evidence that suggests that reductions in transfer duty will be capitalised into housing values (outlined later in this submission). If this is the case, then the impact of transfer duty on those entering the market will be minimal from an efficiency perspective.

By definition, market entering owner occupiers will increase the overall rate of home ownership when they purchase a home. If they purchase off another owner occupier, then the purchase has no impact. But if they purchase off an investor, then the overall rate of home ownership will increase.

Recommendation: The NSWPC should re-assess the marginal excess burden of residential transfer duty. The analysis should be conducted separately for movers, investors, and market entering owner occupiers (including first home buyers).

TRANSFER DUTY IN THE CONTEXT OF THE HOUSING MARKET

Housing affordability continues to be a major challenge in Australia. Recent analysis from the Commonwealth Productivity Commission shows that owner-occupation is falling and private renting is increasing across Australia. [2]

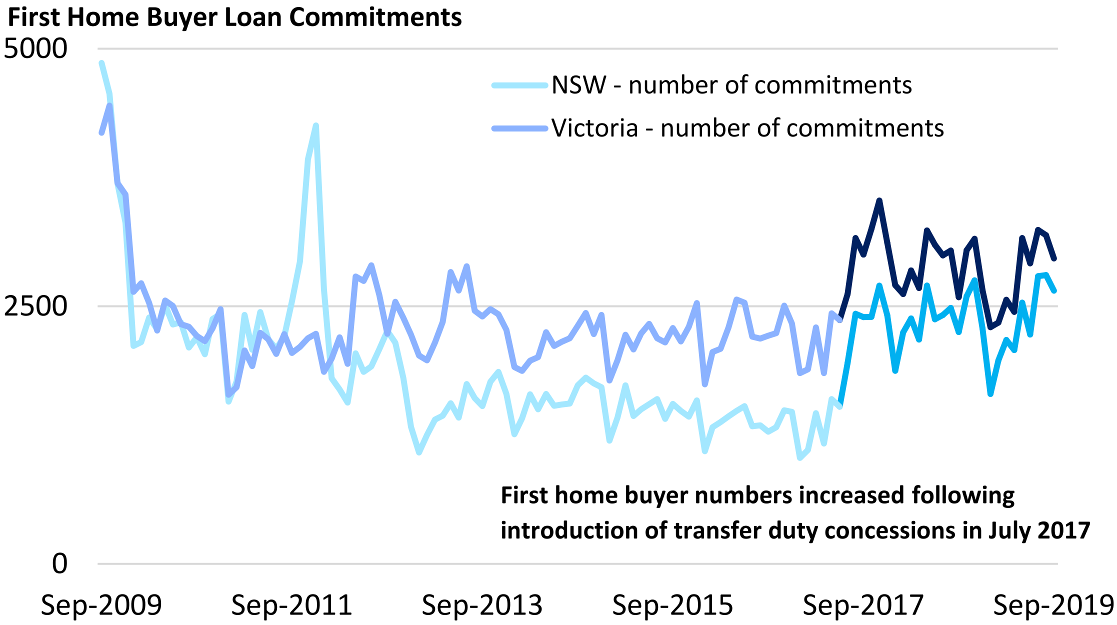
[2] Productivity Commission , Vulnerable Private Renters: Evidence and Options, 2019

State Governments across Australia have introduced policy changes, including reductions in transfer duty for first home buyers, and increases in transfer duty for foreign purchasers.

FIRST HOME BUYER CONCESSIONS

Both the NSW and Victorian State Governments have introduced transfer duty concessions for first home buyers. The scheme in NSW abolishes transfer duty for purchases up to $650,000, the Victorian scheme $600,000. Grants are also available for first home buyers purchasing new homes.

These schemes have had their desired impact, with first home buyer rates in NSW and Victoria increasing significantly after the introduction of these policies – which was their stated intention, to increase the rate of home ownership, which by definition requires an increase in the number of first home buyers.



SOURCE: ABS CAT. 5601

GRANTS AND EXEMPTIONS DRIVE DEMAND AND HOUSE PRICE INFLATION

However, it could also be expected that these policies have had an inflationary effect on house prices, particularly in markets where first home buyers make up a significant proportion of the market.

This impact can be seen when looking at the house price inflation in suburbs favoured by first home buyers. Looking at a selection of the most popular suburbs amongst home buyers according to the first home owner grants provided by government, house price inflation was strong in the period following the introduction of the transfer duty exemption for first home buyers, with house prices in these suburbs increasing by 20-30% in just two years.

Median House Prices, top ranked first home buyer suburbs, Victoria

Selected Victorian Suburbs	2016	2017	2018	$ increase	% increase
CLYDE	435,000	456,000	520,000	85,000	19.5%
CLYDE NORTH	491,000	550,000	600,000	109,000	22.2%
CRAIGIEBURN	425,000	506,000	550,000	125,000	29.4%
KALKALLO	432,500	530,000	550,000	117,500	27.2%
MICKLEHAM	437,000	500,000	521,000	84,000	19.2%
ROXBURGH PARK	435,000	515,000	549,000	114,000	26.2%

SOURCE: STATE REVENUE OFFICE, LANDATA

Analysts have acknowledged this relationship. In the UK when the government introduced changes to stamp duty, the Office of Budget Responsibility expected that cuts in stamp duty would be inflationary for house prices. It estimated that "a 1 percentage point change in the average SDLT rate leading to a 1.4 per cent change in the house price."[3]

State governments in the past acknowledged this inflationary relationship, and in response decided to roll-back the first home buyer grants from all homes to new build homes only.

The transfer duty concessions for first home buyers are no different to a first home buyer grant. They increase the borrowing capacity of the buyer by reducing their costs, which when met with increased lending from banks, contributes to house price inflation, relative to what they would have been otherwise.

The transfer duty exemptions would be expected to have a bigger impact than the first home owner grants, as the value of the transfer duty exemption based on the purchase price will in most cases exceed the value of the typical $10,000 first home owner grant.

Where there is some advantage in these policies is that they give first home buyers an advantage over other groups, which is why first home buyer activity increased in NSW and Victoria following the introduction of these concessions, despite house prices also increasing.

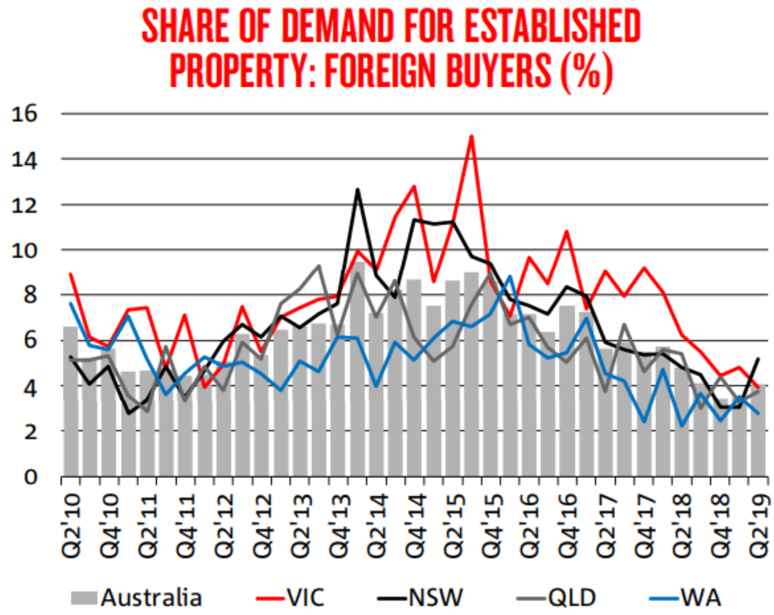
SURCHARGES REDUCE DEMAND AND HOUSE PRICE INFLATION

Just as exemptions for first home buyer have increased demand which has flown through to house price inflation, the opposite is also true where increasing transfer duty for certain cohorts can reduce demand and control house price inflation.

The most obvious example of this in Australia is foreign purchaser transfer duty surcharges - where a higher rate of transfer duty applies to foreign purchasers of property relative to local purchases. This policy has been introduced in order to reduce house price inflation driven by foreign investment. Foreign purchasers now pay an additional 8 per cent transfer duty in NSW and Victoria.

Introduction of these surcharges coincided with a reduction in foreign demand for established property in NSW and Victoria, with the Victorian surcharge first introduced at 3 per cent in July 2015, with NSW bringing in its surcharge on year later.

[3] Office of Budget Responsibility Economic and Fiscal Outlook December 2014, p. 126



SOURCE: NAB RESIDENTIAL PROPERTY SURVEY

Finding: reductions in transfer duty increase demand and add to house price inflation, increases or surcharges in transfer duty reduce demand reduce house price inflation

DIFFERNTIATING BETWEEN NEW HOUSING AND ESTABLISHED HOUSING

The taxation of housing can in some cases treat new housing and established housing differently.

The basis for this differentiation is that new housing adds to the housing supply, which supports housing affordability initiatives. It also supports employment and economic activity through the construction of new dwellings.

Established housing on the other hand does not add to the housing supply by definition, and does not support employment or economic activity in a significant way as the housing has already been constructed. 'Investment' in established housing is not investment in the economic sense, while it may represent an investment of the purchaser's wealth in order to get a return, it does not reflect investment in the economic sense that it adds to economic activity.

POLICY CONSIDERATIONS OF REFORMING TRANSFER DUTY

On the basis outlined in this submission above, reform of transfer duty should reflect the following policy considerations that are priorities for governments:

- improving economic efficiency;
- enabling a housing market where housing is affordable; and
- ensuring that tax settings incentivise and support growth in the housing supply, employment, and economic activity.

With these three policy considerations in mind, governments should reform transfer duty by increasing transfer duty for investors purchasing established housing, and reducing or eliminating it for all other cohorts, as outlined in the table below.

Options for transfer duty reform:

Type of buyer and purchase	Established Housing	New Housing
Movers	Reduce transfer duty because: • transfer duty is highly inefficient for this cohort	Reduce transfer duty because: • new housing adds to the housing supply • it stimulates economic activity, supporting employment • transfer duty is highly inefficient for this cohort
Investors	Increase transfer duty because: • transfer duty for this cohort is relatively efficient • investors purchasing established housing reduces home ownership by definition • investors purchasing established housing does not stimulate economic activity or add to the housing supply	Reduce transfer duty because: • new housing adds to the housing supply • it stimulates economic activity, supporting employment
Market-entering owner occupiers	Reduce transfer duty because: • reducing transfer duty will support increases in home ownership	Reduce transfer duty because: • new housing adds to the housing supply • it stimulates economic activity, supporting employment • reducing transfer duty will support increases in home ownership

Increasing transfer duty for investors in established housing has precedent – it could be implemented on the same basis as the current foreign purchaser surcharge that applies in New South Wales and Victoria. The only difference in this policy would be that the purchasers are Australian residents not foreign residents – this difference would have no impact on the efficiency of the housing market.

The funds raised from such a surcharge could be used to reduce the transfer duty in other cohorts, where the reduction would help promote economic efficiency and achieve other government policy objectives to support home ownership and housing affordability.

Recommendation: introduce a transfer duty surcharge on purchases of established housing by investors. The benefits of such a policy include reducing house price inflation, increasing rates of home ownership, supporting economic activity and growth in the housing supply, and provide additional revenue to reduce the more economically damaging components of transfer duty.

ABOLISHING TRANSFER DUTY ALL TOGETHER COULD UNDERMINE OTHER POLICY OBJECTIVES OF THE HOUSING MARKET

If all transfer duty is abolished then absent of any other change, it could be expected to have the following impacts:

- it would be house price inflationary as it would stimulate demand by increasing the borrowing capacity of buyers; and
- it would reduce rates of home ownership as the current advantage first home buyers have through transfer duty exemptions, relative to investors would be lost.

These impacts could be mitigated through other taxes, such as targeted land taxes for different cohorts. Given investors already pay land tax, land tax rates for investors would need to increase sufficiently over and above the rates for other buyers in order to not compromise rates of home ownership.

CONCLUSION

Not all transfer duties are created equal, and it is important that any reform does not throw the baby out with the bath water. Transfer duty reform provides a significant opportunity to meet multiple policy objectives of state governments.

As outlined above, abolishing transfer duty all together may have negative impacts on home ownership and housing affordability by reducing the tax burden on investors in established housing, adding to housing demand.

Alternatively, increasing transfer duty on purchases of established housing by investors would promote home ownership by making room for first home buyers, reducing demand. It would also incentivise investors to purchase new housing, which adds to the housing supply and promotes economic activity.

And importantly, transfer duty on investors could not be expected to be anywhere near as inefficient as transfer duty on movers, as most of the distortions that arise from transfer duty apply to those that are consuming the housing – which in the case of investors is allocated through the rental market.

To summarise, this reform would support increases in home ownership, support economic growth and jobs through housing construction, and be an economically efficient way of collecting property taxes while still meeting other policy objectives.

ABOUT THE AUTHOR

I make this submission as an individual. I have a background working in state government taxation policy and forecasting, including the forecasting of transfer duty of housing. I have also have undertaken economic research of economic housing policy for third sector housing organisations overseas.