LEGISLATIVE ASSEMBLY
FOR THE AUSTRALIAN CAPITAL TERRITORY

STANDING COMMITTEE ON PUBLIC ACCOUNTS
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Inquiry into commercial rates

Submission cover sheet

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Dear Ms Dunne

Commercial Rates Inquiry Submission

The Canberra Business Chamber welcomes the inquiry by the ACT Legislative Assembly's Public Accounts Committee into commercial rates, and the opportunity to review how the current settings are having an impact on Canberra businesses.

The Chamber supports the Territory's ambition to simplify the tax system and create a more efficient and effective taxation structure.

However, the implementation of the tax reform process to date has resulted in a more unstable and uncertain tax system. The lack of any outline over the 20-year period has meant there is uncertainty over where commercial rates will end up during the two decades of transition. This is affecting the profitability of Canberra businesses now, as well as limiting the attractiveness of the ACT as a future investment destination.

The costs being borne by many commercial rates payers is becoming unsustainable and affects business viability.

The current reforms headlined by a transition away from stamp duty to a rates-based system are imposing significant financial burdens on Canberra businesses. Commercial rates have risen by approximately 200% since the policy was first implemented in 2012. Significant stamp duty relief has only been offered to commercial properties below $1,500,000. There is no clarity on future commercial rates increases for the balance of the transition period. This creates uncertainty for long term investment in the Territory, which in turn affects investor confidence.

Much of the increase in commercial rates has or will ultimately be passed onto commercial tenants via existing or future lease structures, or else transmitted by businesses that own commercial property increasing the ongoing tax burden to a range of other Canberra tenant firms.

Over the past few years the large increase in commercial rates has become a significant issue that needs to be addressed.

Commercial property owners, unlike residential owners (which turnover about every 8 years), are typically long-term owners of property and do not trade regularly. Given this, commercial property owners are less likely to get a significant benefit from lower stamp duty but are burdened with the higher annual rates. This particularly inequitable if owners purchased property prior to the start of this reform.

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We recommend that a taskforce is established with representatives from government and industry to undertake a thorough review of the commercial rate settings and the tax reform process. While this occurs commercial rates and stamp duty should be frozen at existing levels to provide businesses with certainty.

The taskforce should have regard to the rate at which commercial general rates will rise over the proposed transition period, the impact on long-term property owners, and consider how this impacts on the Territory's competitiveness in attracting investment and business.

While the government announcement provided a broad outline of the transitional changes, a clear timeline of the transition of rates over the 20 year transition period was not provided.

Current Impacts

When these reforms were introduced, the ACT government stated that *"Importantly, this program will not increase the overall tax burden on the ACT community, with only the foregone revenues resulting from the abolition of inefficient taxes being replaced through the efficient and equitable rates system*[1]."

But in effect, some businesses are now paying more.

The current transition has to date resulted in:

- Commercial properties above $600,000 in land value now pay property rates at 5.1675% per annum on unimproved land value. In effect, owners are paying the equivalent of a stamp duty-like charge every year.
- Commercial rates are approximately nine times higher than residential rates (comparing the highest marginal tax rates of 5.1675% for commercial to 0.57% for residential).
- The highest marginal tax rate for commercial rates are now more than double what they were in 2012 (5.167% compared to 2.361%). Indeed, this marginal rate increases to 6.156% when the City Centre Marketing and Improvement Levy (CCMIL) and Fire and Emergency Services Levy (FESL) is added.
- Similarly, the highest marginal tax rate for residential rates has more than doubled compared to what they were in 2012 (0.57% compared to 0.2727%).
- Some commercial property owners have seen up to 25% year-on-year increases in their 2018 rate notices. These higher tax increases are not being matched with rent growth and are forcing down capital values. On a practical level, lower returns mean there is less money to cover operating expenses and capital improvements, which in turn will reduce the amenity of commercial properties.
- Referring to the 2017-2018 Budget Paper[2], the revenue raised from commercial rates will go from $172m in 2017-2018 to $214m in 2020-21, which is an increase of 7.5% per annum or 24% in 3 years. In contrast, the total stamp duty raised on commercial property will go from $74m in 2017-2018 to $71m in 2020-21 - a small $3m (4%) decrease, which is out of line with the increases in rates.

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[1] www.revenue.act.gov.au/tax-reform

[2] ACT Government *2017-2018 Budget Paper* No.2, table 6.2.1, page 223

There Is A Need For Secure Long-Term Planning & Costing

While a 20 year transitional timeframe for moving from transactional taxes to rates based taxation was outlined in the ACT Taxation review announcements, scant details have been given as to how this rate change will be implemented.

Commercial rental leases are often on a longer basis than residential rents. The inherent lack of knowledge of what rates will apply to commercial properties has resulted in significant impacts of property owners and businesses.

As a simple example:

- A commercial property purchased in 2014 with an unimproved land value of $1.55m would have paid rates initially of approximately $61,272.
- Assuming the unimproved land value remains at $1.55m, by 2019 the applicable rates payable would have increased to $89,696. This is a rating value of 5.78% or an increase of nearly $30,000 over that period.
- An estimate of the rent collected on a property such as this might be approximately $100,000 per annum exclusive of rates ($161,272 inclusive of 2014 rates)
- If these costs were passed onto a business tenant, it would mean the rent would have increased to $189,696 or an increase of 17%. It also means that rates would now represent 47% of the total gross rental income.
- If unable to be passed on (for example, because the tenant is under a 'gross lease' arrangement) this is a significant loss to the commercial property owner who would have entered into rental terms based on the expected property outgoings at the time. Under this scenario the value of the property with all things being equal would also fall by 17%. This significant reduction in value would be unable to be recouped on sale, even if the stamp duty rate for this property was zero (this property would given the above rent levels be worth approximately $1.8m and still subject to a stamp duty rate of approximately 5%).

Commercial properties above $1.5m also do not enjoy the benefit of the reduction in stamp duty cost, remaining subject to a 5% flat duty rate. We understand there are no plans to reduce the top stamp duty rates for commercial property within the current budget forecast period. In 2017-18, total stamp duty revenues (despite the rate reductions) were at 84% of the pre-reform stamp duty revenue base, so property rates will need to keep increasing substantially to transition to a full reduction in stamp duty.

A clear outline of the applicable rates of the remaining transition period will allow businesses in the ACT to adequately plan for reinvestment, rental pricing and business continuity.

An Ineffective System Will Weaken The ACT's Investment Attractiveness

The dramatic increases in rates across all areas of the ACT is having a negative impact on capital values, even where all other issues remain unchanged. Financers will become nervous if capital values continue to be eroded. If the ACT further weakens financing confidence, there will be a strong disincentive to invest in the ACT.

The ACT needs to compete for capital with other comparable states and territories. As an example, the abolition of commercial rates over a 3 year period by South

Australia (which began in 2015) was intended to stimulate business and drive economic growth. South Australia is currently the most confident property market according to the latest *ANZ/Property Council Survey*, with statewide confidence for the March 2019 quarter sitting 21 points above the national average. One of the main drivers of this change has been the combination of stamp duty abolition, as well as a commitment by the SA government to reform land tax, with a budgeted $96m commitment to raise thresholds and lower rates.

Concluding Comments

We believe there are some significant weaknesses in the current system which need to be dealt with.

Such a process is best done in conjunction with the ACT business community, and we believe that a taskforce is well suited to jointly tackling these issues.

We look forward to appearing before the committee to discuss these issues further.

Yours sincerely

Dr Michael Schaper
CEO