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THE LEGISLATIVE ASSEMBLY FOR THE

AUSTRALIAN CAPITAL TERRITORY

GOVERNMENT RESPONSE TO THE STANDING COMMITTEE ON PUBLIC ACCOUNTS REPORT INQUIRY INTO COMMERCIAL RATES

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INTRODUCTION

On 4 April 2019, the Standing Committee on Public Accounts (the Committee) released the report on its inquiry into commercial rates (the report).

The ACT Government thanks the Committee for its work and has given due consideration to the recommendations it has made. We also thank all those in the community who made submissions and appeared before the Committee.

The Government is currently implementing stage two of the ACT's tax reform program, covering the second five years of this 20-year reform. This second phase runs from 2017-18 to 2021-22. The reforms involve a revenue-neutral tax mix switch from inefficient taxes like conveyance duty and insurance duty to an efficient broad based land tax through the general rates system. As part of the tax reform program, stamp duty has been abolished for commercial property transactions worth $1.5 million or less. This means no stamp duty is now paid on around 70 per cent of commercial property transactions.

In the 2016-17 Budget, the Government announced that general rates for commercial properties would increase by an average of 6 per cent per year during the second phase of tax reform, to offset the reduction in stamp duty revenue. This increase is reflected in the commercial rates revenue estimates in the 2019-20 Budget.

The rating system for commercial general rates is based on a fixed charge and marginal rating factors applied to the Average Unimproved Value of the property. The Average Unimproved Value is the average of the property's unimproved land value for the most recent three years.

As set out in the 2019-20 Budget, the fixed charge for commercial properties is $2,622 in 2019-20. The marginal rating factors applied to the Average Unimproved Value of each property is outlined in the table below:

AUV threshold	Marginal rates %
0 to $150,000	3.2341
$150,001 to $275,000	3.7702
$275,001 to $600,000	5.2615
$600,001 and above	5.3216

Each year the fixed charge and marginal rates are set to achieve the target average increase in rates for commercial properties under the tax reform program, and to distribute rates charges fairly across property owners based on underlying land values.

The *Rates Act 2004* requires an annual land valuation for all rateable property in the ACT. Valuations are determined on the basis of unimproved value as at 1 January and take effect following determination by the Commissioner for ACT Revenue on 1 July of the same year.

The Unimproved Value of commercial properties is determined based on the highest and best use of the land under the lease conditions. The highest and best use principle ensures that the valuation is based on the land's most productive use. This is the main approach taken to land valuations for rates purposes by local governments across Australia.

The valuation approach is a 'direct comparison' whereby sales of commercial land are considered and a broad adjustment is made to all properties if there is evidence of a change in general commercial property values across the Territory. There has not been a blanket increase in

unimproved values across commercial property for the past five years as there has been an insufficient volume of sales evidence across the commercial property sector to support a change.

However, the unimproved values for some properties in pockets of commercial land in the precincts of Braddon (2017, 2018), Phillip (2017), Fyshwick (2017) and part of City (2018) were adjusted through a regrading program. This was necessary as unimproved values of some properties in these areas were significantly out of alignment with market values, relativities within the precinct, and in comparison with properties outside of the precinct. If these revaluations had not occurred, all ACT commercial ratepayers would have been subsidising these properties where the rates payable did not reflect the unimproved value of the land. This is neither fair nor equitable.

The revaluation of a property is determined by location, block size, zoning, rights under the crown lease and an appropriate rate per square metre or per unit as determined by comparable sales evidence.

Individual properties are also revalued where they have had lease variations that increase the development potential of the property. These revaluations seek to reflect the uplift in the unimproved value of the property arising from the lease variation. There are around 100 lease variations approved each year, most of which are for commercial or mixed-use developments. Where a use allowed under the lease for a property is not required because the land is being used for some other purpose, an owner may apply to remove the additional purpose from the lease.

Property valuations undertaken by the ACT Valuation Office for rates purposes do not impact the total amount of revenue collected from rates or average rates increases. Average Unimproved Values are used only to determine how much each individual property contributes to the total rates base. However, individual property revaluations affect how rates charges are distributed among property owners. Where the market value of a property has increased, the unimproved value of the property will increase and the owner of that property will generally pay more in rates relative to other property owners. This is comparable to the process for calculating rates in the residential sector, whereby owners of more valuable residential land pay higher rates than those with lower land values.

Basing rates on underlying land values ensures the distribution of rates is spread fairly across property owners. If a property's value was not adjusted when sales evidence supported a change, this would mean that all other property owners would be paying a disproportionate amount in rates. Again, this is neither fair nor equitable.

Several contributors to the inquiry spoke about the difficulties that can be faced by businesses when their property valuation increases substantially, and their rates then increase as a result. As part of the 2019-20 Budget, the Government has announced that we will take action to help commercial property owners adjust to market-based increases in property values by lengthening the period used to calculate the Average Unimproved Value for commercial properties. The details of this change will be settled through consultation with industry over the coming year, to take effect from 2020-21.

The third five-year phase of tax reform will commence in 2022-23, and the Government has indicated that we will announce the setting for this next phase as part of the 2020-21 Budget. We will consider further changes to the commercial rates system in this context.

Detailed responses to each of the Committee's recommendations are contained in the table below.

RECOMMENDATION	GOVERNMENT RESPONSE
Recommendation 1 The Committee recommends that the ACT Government publish, in each year's budget papers and on the website of the ACT Revenue Office, the rationale for all rating factors determined for that financial year.	**Agreed** The 2019-20 Budget (Budget Paper 3, Chapter 6) outlines that rating factors are set to achieve a target average increase in rates – as determined and announced at the start of each five-year stage of tax reform – and to distribute rates charges fairly across property owners based on underlying land values. The target average increase for commercial rates during stage two of tax reform is 6 per cent, as announced in the 2016-17 Budget and confirmed in subsequent budgets. Target average increases for stage three of tax reform will be announced in the 2020-21 Budget.
Recommendation 2 The Committee recommends that the ACT Government publish, in each year's budget papers and on the website of the ACT Revenue Office, a schedule of anticipated rating factors for the following three years.	**Noted** The Government publishes the target average annual increase in rates for commercial properties at the start of each five-year stage of tax reform, enabling commercial property owners to estimate their rates in following years. However, this recommendation does not adequately consider the connection between rates and land values and may lead to adverse outcomes. Rating factors are largely determined by the structure of the underlying property base and property values, which vary year on year. It is unlikely that publishing anticipated rating factors, which would be subject to change, would provide any further certainty in estimating likely rates in future years than publishing the average percentage increase. Further, as rating factors are applied to a property's Average Unimproved Value, it would not be possible to accurately predict a property's likely future rates bill, as the future Average Unimproved Value would be unknown. This could lead to property owners making business decisions based on an under or over estimate of future rates payable.
Recommendation 3 The Committee recommends that the ACT Government publish, in each year's budget papers and on the website of the ACT Revenue Office, specific information on the rates burden apportioned to each category of rateable property.	**Noted** Each year's budget papers set out the proportion of rates revenue collected from different categories of rateable properties, including commercial properties – see Table 6.2.1 on p.230 of Budget Paper 3. The Government will consider where else it may be appropriate to publish this information as part of future budgets.

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Recommendation 4 The Committee recommends that the ACT Government establish a more predictable and transparent means to calculate the value of properties following changes to use clauses in Crown leases, so that owners are able to anticipate the financial consequences of changes of use.	**Noted** If a property owner undertakes a lease variation which increases the value of their property, this will also generally increase the property's Average Unimproved Value for rates purposes, and therefore the annual general rates payable. Taxpayers are advised of this in writing during the lease variation process. The Government is continuously monitoring processes and information systems in relation to revaluations of Crown leases following lease variations, with a view to ensuring that Average Unimproved Values are updated following significant lease variations. This will improve predictability and transparency for ratepayers. The Government has also announced our intention to increase the smoothing period for Average Unimproved Values to provide greater certainty to ratepayers – see p.4 above.
Recommendation 5 The Committee recommends the ACT Government considers relief to commercial lessees who experience extended vacancies in their properties.	**Not agreed** The ACT's property tax system – including the commercial rates component – is designed to encourage the productive use of land and discourage land banking. Providing tax relief to property owners while properties are vacant for extended periods would undermine this policy objective. The Government notes that property owners who experience extended vacancies in their properties will make their own commercial decisions about the most appropriate way to respond in this situation, with options including reducing the asking rent, making improvements to the property, or considering selling their property. It would not be appropriate for government to provide an incentive for property owners to keep their properties vacant. If property owners consider the underlying value of a property has changed, and this has not been reflected in their property valuation, they are able to lodge an objection to their valuation.
Recommendation 6 The Committee recommends that the ACT Government amend the means by which valuations, after changes to use clauses for Crown leases, so that the relationship	**Noted** Potential changes to the Lease Variation Charge framework were announced as part of the 2019-20 Budget. The Government has announced that we will explore further codification of charges for mixed-use and commercial developments in consultation with industry, and improve the presentation of information on ACT Government websites containing information about the

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between valuations 'before' and 'after' change of use is apparent.	Lease Variation Charge. Such changes would increase transparency and certainty around the charges payable. Further, guidelines for valuers undertaking 'before' and 'after' LVC valuations are available on the ACT Revenue Office website at: https://www.revenue.act.gov.au/lvc/lvc-valuation-guidelines
Recommendation 7 The Committee recommends that the ACT Government amend the ratings regime to allow for further categories of land use for ratings purposes to allow a better match between land use categories and instances of land use in practice.	**Noted** The Government will consider whether additional categories of land use are appropriate as part of the development of stage three of tax reform. This matter will be considered by the Tax Reform Advisory Group, which is currently undertaking a comprehensive analysis of the economic, social and distributional impacts of the first two stages of tax reform.
Recommendation 8 The Committee recommends that the ACT Government introduce a legislative mechanism to allow for apportionment between categories of use.	**Noted** The Government notes owners of properties with both residential and commercial uses can already access apportionment by unit titling their property. Where unit titling is undertaken, the residential units are then charged residential rates and commercial units are charged commercial rates. This ensures that a whole property is not charged commercial rates when only a portion of the property is used for commercial activities. This matter will be considered further by the Tax Reform Advisory Group.
Recommendation 9 The Committee recommends that the ACT Government considers amending the *Rates Act 2004* to provide for commercial rates to be levied on the basis of the actual, activated uses rather than all the possible uses.	**Not agreed** Rates are levied on the Average Unimproved Value of a property determined by the highest and best use of the land under the lease conditions. This is intended to encourage the most productive use of the land and prevent land banking. Levying rates based on actual activated uses would undermine this policy objective. Property owners can make their own commercial decisions as to whether to adjust the Crown lease purpose clauses to more closely reflect their actual usage. It is possible to remove unutilised purposes; where purposes are removed this may impact the Average Unimproved Value of a property and therefore the rates payable.

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Recommendation 10 The Committee recommends that the ACT Government clarifies the process used by the Commissioner for ACT Revenue to value Crown leases in the ACT under Section 10 of the *Rates Act 2004* and publish the process on the ACT Revenue Office's website and include it in information provided to leaseholders about the lease variation process.	**Agreed** The ACT Revenue Office website provides a range of information about property valuation processes for both rates and lease variations. The Government will continue to review the information on the ACT Revenue Office website regarding land valuations, and information provided to leaseholders during the lease variation process and make improvements as necessary. Information on land valuations is available on the ACT Revenue Office website at: https://www.revenue.act.gov.au/rates/land-valuations. Information for valuers undertaking 'before' and 'after' LVC valuations is available at: https://www.revenue.act.gov.au/lvc/lvc-valuation-guidelines.
Recommendation 11 The Committee recommends that the ACT Government amend the *Rates Act 2004* to clarify the timing of—and relationship between—the method used to value properties under mass appraisal and the method used to value individual or groups of properties where it is perceived that there has been a significant change in value in a particular area.	**Noted** The Government will review the information available to property owners regarding land valuations and make improvements as necessary. The Government notes that legislative change is not necessary to clarify the relationship between valuations occurring under the annual process and periodic revaluations of commercial properties of a particular type or in a particular location.
Recommendation 12 The Committee recommends that the ACT Government consider the appropriateness of long-term retrospective determinations of commercial rates.	**Noted** It is the Government's responsibility, on behalf of all Canberrans, to ensure all taxpayers pay their fair share of tax and that taxation is administered in accordance with the laws of the Territory. Taxpayers also have a responsibility to ensure they provide the correct information to the ACT Revenue Office. The power to retrospectively apply and adjust taxation is common in all tax laws. The widely-accepted principle is that taxation will be reassessed when new facts are presented.

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	In some instances, this will favour the taxpayer and in other circumstances it will not. Where a taxpayer considers the ACT Revenue Office has unfairly or incorrectly administered the Territory's tax laws, they have objection and appeal rights they can exercise. The Government is continuously monitoring processes and information systems to ensure any changes to valuations for rating purposes are identified as early as possible, so that retrospective determinations are minimised. This includes improving the flow of information between the ACT Revenue Office and the ACT Land Titles Office.
Recommendation 13 The Committee recommends that the ACT Government considers compensating rate payers who have experienced sudden large increases in rates because they have had long-term retrospective rates reassessments or have been required to pay rates on the basis of un-activated uses.	**Not agreed** The Government notes this recommendation did not receive majority support from the Committee. Compensating ratepayers who have experienced increases in rates or have had rates assessed on the highest and best use allowed under their lease would effectively be asking all ACT ratepayers to pay for commercial decisions made by commercial property owners, which have often increased the value of their property through lease variations. Taxpayers have a responsibility to ensure they are paying the correct amount of tax. Rates are levied on the Average Unimproved Value of a property determined by the highest and best use of the land under the lease conditions. Property owners can make their own commercial decisions as to whether to adjust the Crown lease purpose clauses to reflect more closely current usage. This can include removing unutilised purposes, which may impact the Average Unimproved Value of the property and the rates payable. Where a taxpayer considers the ACT Revenue Office has unfairly or incorrectly administered the Territory's tax laws, they have objection and appeal rights they can exercise.
Recommendation 14 The Committee recommends that the ACT Government review the mass appraisal and periodic revaluation processes to determine	**Noted** The Government notes concerns raised in the inquiry about the impact of unanticipated increases in Average Unimproved Values. The Government has announced that we will lengthen the period used to calculate the Average Unimproved Value for commercial properties to help commercial property owners adjust to large,

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whether the current mix meets the tests of equity and fairness.	unanticipated, market-based increases in property values. These changes will be implemented in consultation with industry over the coming year. The Government notes that it would not be feasible to value every property on an individual basis, and the direct comparison approach is a widely accepted practice used in many jurisdictions.
Recommendation 15 The Committee recommends that the ACT Government prepare a reconciliation of revenue foregone and raised in the transfer from duties to a broad-based property tax.	**Agreed** The Government is currently implementing stage two of the ACT's tax reforms, covering the second five years of the 20-year reform program, from 2017-18 to 2021-22. The reforms involve a revenue-neutral tax mix switch over the period of the reforms from inefficient taxes like conveyance duty and insurance duty to an efficient broad-based land tax through the general rates system. As part of preparations for stage three of tax reform, the Government is commissioning detailed analysis on the progress of the tax reform program to date, including ensuring that the program is meeting the objective of revenue neutrality.
Recommendation 16 The Committee recommends that the ACT Government introduce a valuation mediation system between affected land-owners and the valuation service to provide a cost-effective alternative to the current ACAT objection process.	**Noted** The Government notes ACAT already provides a low cost and easily accessible mediation process, as a first step before a hearing is scheduled to resolve a valuation dispute. The Government notes the main reason the ACAT process can be costly is that parties will often choose to engage lawyers and professional valuers to assist them to present their case. This is a choice, not a requirement. An alternative mediation system will not be of significant benefit if parties continue to choose to engage professional advisers.
Recommendation 17 The Committee recommends that the ACT Government breaks the connection between the Revenue Office and the Valuation Office, ideally by establishing an independent valuation service for the ACT.	**Not agreed** Establishing a separate valuation office would be more costly than current arrangements and would not generate additional benefits. Further, under current legislation the Commissioner for Revenue (an independent statutory office holder) determines unimproved land values for rates purposes. The role of the ACT Valuation Office is to provide advice to assist the Commissioner to fulfil this statutory obligation.

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Recommendation 18 The Committee recommends that the ACT Government reassess resourcing for the ACT Valuation Office, and introducing Attraction and Retention Incentives (ARIns) to foster the recruitment and retention of valuers.	**Noted** The Government notes there is a shortage of valuers across Australia. The Government routinely considers options to foster the recruitment and retention of staff in areas where there is a skills shortage.
Recommendation 19 The Committee recommends that the ACT Government liaise with the Property Council of Australia, the Australian Property Institute, tertiary education institutions and other interested parties to reassess the feasibility of introducing a valuation course in the ACT.	**Agreed** The Government will discuss with relevant stakeholders the feasibility of introducing a valuation course in the ACT. However, choices about what courses to offer are ultimately a matter for individual educational institutions.
Recommendation 20 The Committee recommends that the ACT Government redesign commercial rates notices to give commercial ratepayers more information, transparency and certainty. In doing so, the ACT Government should give consideration to the inclusion of the following: i) more information about flexible payment options for ratepayers charged retrospectively due to revaluations; ii) more information about the valuation of land and how that value was calculated;	**Agreed** The Government has listened to community feedback and re-designed rates assessment notices for 2019-20 to improve the layout and readability. The Government will continue to ensure rates notices provide appropriate information, including on how a property's rates are calculated and the available payment options. Information about how rates are set is published in each year's budget papers. Information about how rates are calculated, including a rates calculator, is available on the Revenue Office website. While property owners should seek to maintain their own tax records, they are also able to contact the Revenue Office to obtain previous rates bills if they no longer have access to them. As noted in the response to Recommendation 2 above, the Government publishes the target average annual increase in rates for commercial properties at the start of each five-year stage of tax reform, enabling commercial property owners to estimate their rates in following years.

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iii) more information about the applicable tax threshold; iv) a list of past payable rates for context; and v) an indication of likely future rates, with a disclaimer that this estimation is subject to change.	
Recommendation 21 The Committee recommends that the ACT Government give consideration to an education and information campaign for new and existing ACT ratepayers to ensure existing and future commercial property owners have a sufficient understanding of the commercial tax system in the ACT and how the reform is being achieved.	**Agreed** It was clear throughout the inquiry that there is not a good level of general understanding within the Canberra business community or more broadly about how the commercial rates system works. The Government will consider the current information available on commercial rates and how it could be improved, including whether an education campaign is necessary.
Recommendation 22 The Committee recommends that the ACT Government provides commercial rates concessions on heritage-listed properties, to take account of the distinct set of planning rules that regulate their use.	**Noted** All material factors that affect highest and best use are considered when determining the property's Average Unimproved Value for general rates.
Recommendation 23 The Committee recommends that the ACT Government investigate ways to overcome the long-term anomalies relating to Block 44, Section 11, Fyshwick.	**Noted** The ACT Government is unable to comment further on this individual taxpayer matter in this public report due to the taxpayer privacy provisions of the *Taxation Administration Act 1999*.

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Recommendation 24 The Committee recommends that the ACT Government: (i) establishes a taskforce to review commercial rates in the ACT with regard to improving transparency, certainty for property owners and having regard to the overall economic impact of the rating system; and (ii) liaises widely with the community in the setting up of the task force to ensure wide and balanced representation of all interests in the ACT community.	**Noted** A significant amount of work has been undertaken on the ACT's rates system as part of the tax reform program to ensure the system is fair, equitable, progressive and consistent. The Government notes that the Committee has just completed a public review of commercial rates in the ACT, as well as undertaking an inquiry of the system for setting rates and land tax for unit titled properties in 2018. The Government will announce the settings for stage three of tax reform in the 2020-21 Budget. In determining the appropriate settings for commercial rates, the Government will consider the Committee's report and the evidence provided to the inquiry by its contributors. The Government has established a Tax Reform Advisory Group to review the existing taxation reforms and provide input into the next five-year phase of the program.
Recommendation 25 Some Committee members recommend that while the taskforce is deliberating, the ACT Government returns the system for existing commercial and residential rates in the ACT to the situation as it stood in 2012, immediately after the passage of the initial rates reform legislation.	**Not agreed** The Government notes this recommendation did not receive majority support of the Committee. The changes to commercial rates have been implemented in accordance with the Government's tax reform program, which, over the period of the reforms, involves a revenue-neutral tax mix switch from inefficient taxes like conveyance duty and insurance duty to an efficient broad-based land tax through the general rates system. The Government estimates that returning commercial rating factors to 2012 levels would result in revenue forgone in the order of $100 million in 2019-20. Stamp duty would need to be increased and insurance duty reintroduced to replace the forgone revenue.