2019

THE LEGISLATIVE ASSEMBLY FOR THE AUSTRALIAN CAPITAL TERRITORY

GOVERNMENT RESPONSE TO THE PUBLIC ACCOUNTS COMMITTEE'S REPORT

INQUIRY INTO THE METHODOLOGY FOR DETERMINING RATES AND LAND TAX FOR STRATA RESIDENCES

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INTRODUCTION

On 20 September 2018, the Standing Committee on Public Accounts released the report on its inquiry into the methodology for determining rates and land tax for strata residences.

The 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 current methodology for determining rates and land tax for strata residences aims to achieve fairer and more equitable outcomes compared to the previous system. The Government will continue to monitor the operation of the new system to assess whether any improvements can be made.

Reasons for the change in methodology

The change in the methodology was implemented from the 2017-18 financial year as part of Stage Two of the Government's tax reform program[1]. Over a 20-year period commencing in 2012, general rates are increasing incrementally to offset the removal of inefficient taxes such as conveyance duty (stamp duty) and insurance duty. These taxes are widely recognised as being unfair and inefficient, hindering economic growth and activity. Conveyance duty can be a significant barrier to purchasing a property – particularly for first home buyers – as well as making it harder for families and older people to move to housing which best suits their needs.

The 20-year reform timeframe was set to smooth the transition to general rates. The tax reform program is broadly revenue neutral in aggregate — meaning the decrease in revenue from unfair and inefficient taxes is being offset by an increase in general rates revenue. The Government is changing the 'tax mix' without increasing the overall 'tax take' through this tax reform program. Over the long term, the tax reform program will ensure the ACT has a sustainable and stable revenue base for providing services to Canberrans. The Government has been upfront and transparent about this tax reform agenda, including by taking this reform program to two Territory elections.

The review of Stage One of tax reform found that the increases in general rates for houses had been significantly greater than for units because units have relatively lower unimproved values. The average increase between 2011-12 and 2016-17 was 8.8 per cent per year for houses but only 6 per cent per year for units. The disparity meant that the difference between rates paid by houses and units with similar *market* values was becoming greater and would have continued to increase over time if not addressed. This disparity also extended to land taxes as these payments are calculated using the same methodology.[2] Given that rates and land tax are used to fund a broad range of services to the community beyond strictly municipal services, this raised significant fairness and equity concerns.

[1] http://www.treasury.act.gov.au/taxreform/Documents/factsheet_Overview.pdf

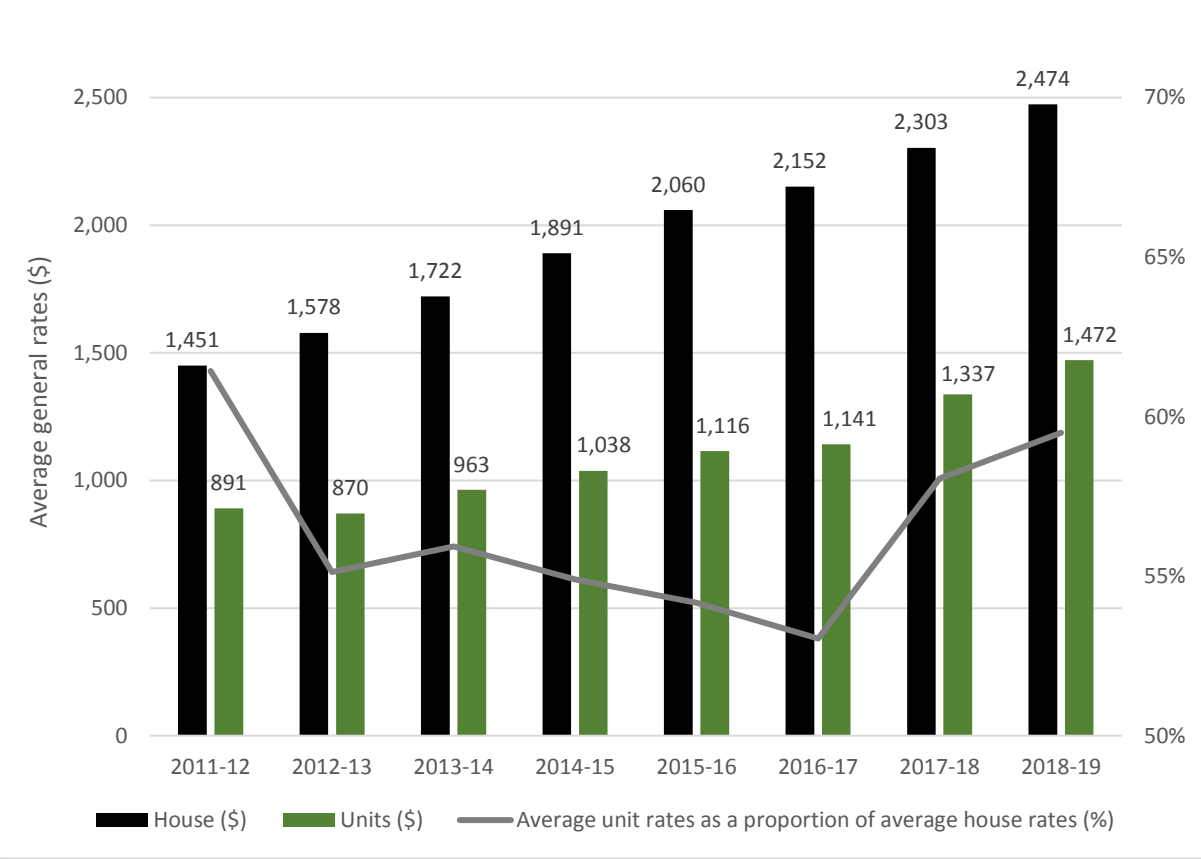
[2] General rates and the land tax calculation methodologies are provided in the Appendix at the end of this document.

As a result, the Government announced a change in the methodology for unit titled dwellings in the 2016-17 Budget, which took effect on 1 July 2017. The marginal rating factors are now applied to the total value of the land, with assessed rates then apportioned between units. Under the previous method, the calculation was based on a land value attributed to each individual unit, which was often very low. The change was designed to provide greater equity between units and houses

Even after this change has been implemented, average rates for houses continue to be higher than units. The average general rates charge for units in 2018-19 is $1,472 compared to $2,474 for houses – a difference of around 40 per cent.

This is illustrated in the chart below that shows the average general rates paid by houses and units since 2011-12, prior to the commencement of the tax reform. Average unit rates as a proportion of average house rates can be seen declining after 2011-12 from 61.4 per cent to 53 per cent in 2016-17. Following the change in methodology in 2017-18, average unit rates as a proportion of average house rates are now around the same in 2018-19 (59.5 per cent) as they were in 2011-12, prior to the commencement of the tax reform program.

Average general rates for houses and units



The change in calculation methodology for units has better aligned the proportions of residential properties that are units to the proportion of revenue contributed from this group. The proportion of units has increased from 24 per cent of residential properties in 2011-12 to 30 per cent in 2018-19, while the proportion of revenue from units has increased from 16 per cent in 2011-12 to 20 per cent in 2018-19.

The Government's response to the Committee's specific recommendations are set out in the remainder of this document.

GOVERNMENT RESPONSE TO RECOMMENDATIONS

RECOMMENDATION 1

2.42 The Committee recommends that the ACT government propose to the Legislative Assembly amendments to Section 8 of the Unit Titles Act 2001 which, if passed, would provide greater transparency on the definition of 'Unit Entitlement' and provide more specific guidance on the calculation of Unit Entitlement.

Government response: Noted

In its report the Committee has expressed the view that the provisions for setting out unit entitlement are ambiguous and should be clarified as unit entitlement is a significant factor in determining liabilities for rates and land tax.

Unit entitlement is defined in section 8 of the *Unit Titles Act 2001* as the improved value of each unit relative to each other unit in the parcel. This definition of unit entitlement is used for a range of purposes, in addition to the calculation of rates and land taxes. For example, section 19(1) of the *Unit Titles (Management) Act 2011* provides that an owners' corporation holds the common property as agent for the unit owners as tenants in common in shares proportional to their unit entitlement. Also, unit entitlement is a key component of the voting process at the general meeting of an owners' corporation. As such, any changes to the definition of unit entitlement requires careful consideration to ensure that unintended consequences are avoided.

The Government is currently undertaking a review of strata laws to support mixed-use new and existing developments and related matters, known as the Strata Reform Project. This project will be considering potential improvements to certain governance frameworks, which may have a bearing on any changes to the definition of unit entitlement in the future.

RECOMMENDATION 2

The Committee recommends that the ACT government devise a new method for determining rates and land tax for unit title properties.

Government response: Noted

The current method for determining rates and land tax for unit title properties was introduced to establish greater equity between units and houses. Under the previous system, the general rates and land taxes charges for units were significantly less than houses with similar market values and rental returns. Noting that rates are used to fund a broad range of services to the community, this raised significant fairness and equity concerns.

The Government notes that many of the submissions raise concerns about equity between owners of units, with rates charges highly dependent upon the number of units in a complex, the associated unit entitlement and the value of the underlying block of land.

The Government acknowledges that there are challenges in appropriately balancing equity across all residential rate payers through the use of a single set of rating factors for houses and units and will consider whether improvements can be made either as part of the 2019-20 Budget process or through the next five-year phase of tax reform commencing in 2022-23.

RECOMMENDATION 3

6.158 The Committee recommends that the ACT government ensures that the ACT general public is aware of the effect of Section 68 of the *Residential Tenancies Act 1997* (ACT) in regulating increases of residential rents by including accurate and relevant information on the website of the ACT Revenue Office.

Government response: Noted

The Renting Book is an ACT Government-published guide to the rights and responsibilities of tenants, landlords and real estate agents, and is available on the rental bonds section of the ACT Revenue Office website. This publication includes guidance on the effect of section 68 of the *Residential Tenancies Act 1997*. Extensive information on the rights of tenants, including downloadable factsheets on potentially excessive rental increases, are also made available on the Tenants Union (ACT) website under an arrangement with the ACT Government.

The Government has recently made changes to the *Residential Tenancies Act 1997*, providing improved rights and protections for tenants. The Government will ensure that sufficient information regarding the rights and protections available to tenants, including in relation to the regulation of rent increases, is made available to tenants, landlords and real estate agents.

RECOMMENDATION 4

8.156 The Committee recommends that the ACT government, in a future review of the ACT methodology for determining rates and land tax, address and respond to perceived disparities between land values attributed to unit title and free-standing dwellings and used as the basis for the valuation based charge component of rates and land tax.

Government response: Noted

The Government notes that following consideration and discussion of alternative valuation methods, the Committee determined that unimproved values should continue to be the basis for determining general rates.

Unimproved values are an efficient basis for general rates. The unimproved value of a block is value of the land subject to its highest and best use under the lease conditions. This basis avoids undesirable outcomes such as disincentives for improvements and does not distort decisions regarding the use of land. Other bases can distort decisions of land owners, reducing the efficiency of the tax system.

RECOMMENDATION 5

9.41 The Committee recommends that the ACT government propose to the Legislative Assembly changes to the regime for rates and land taxes which, if passed, would grant full access to progressive scales for rates and land tax to the owners of unit title properties.

Government response: Noted

The Committee noted that the most significant concern expressed by stakeholders was that the majority of multi-unit blocks now fall within the top rating threshold after the change in methodology.

While this is true, the actual general rates and land taxes paid by individual units within a block, once the valuation-based component of the general rates charge is divided by the number of units in a block, are significantly lower on average than houses of similar market values or rental returns. General rates for around 90 per cent of units are at a level equivalent to a house valued in the lowest two rating thresholds. Less than 1 per cent of unit owners pay rates higher than the owner of a house with an AUV of $600,000. Average rates for units are $1,429 in 2018-19 while average rates for houses in the top rating threshold are $4,789.

The Committee's report includes discussion of the perceived disparity between units within different types of unit blocks, given that the majority of blocks, whether large or small, fall within the top rating threshold.

As noted in the response to Recommendation 2, the Government will consider these issues and whether any further improvements can be made as part of the 2019-20 Budget process and the next stage of tax reform.

RECOMMENDATION 6

10.7 The Committee recommends that the ACT government conduct a public review of the ACT system for rates and land tax, including and especially rates and land tax for unit title properties, to ensure fairness and consistency, and legislate accordingly.

Government response: Noted.

A significant amount of work has been undertaken on the ACT's system for rates and land tax as part of the Tax Reform program to ensure the system is fair, equitable, progressive and consistent. The Government notes that the Committee has also just completed a lengthy public review of the ACT system for rates and land tax for unit title properties.

Stage Two of the tax reform process is due to be completed in 2021-22. As part of preparations for Stage Three, which will commence in 2022-23, the Government will analyse the impacts of the Stage Two reforms. We will make the detail of this analysis publicly available so that it can be scrutinised and discussed by ratepayers, stakeholders and the broader Canberra community.

Appendix – Residential General Rates and Land Taxes calculation methodology

General Rates

The general rates payable for a dwelling is made up of two components:

- *Fixed Charge* + *Valuation charge*
    - The fixed charge is $815 (2018-19).
    - The Valuation charge = *Average Unimproved Value* x *Rating factors*

      or
    - The Valuation charge = *Average Unimproved Value* x *Rating factors* x *Unit entitlement* (For unit titled dwellings only)

Table 1: 2018-19 General Rates Rating Factors

AUV Thresholds	Rating Factor
Below 150,000	0.3130%
150,001 to 300,000	0.4088%
300,001 to 450,000	0.5130%
450,001 to 600,000	0.5603%
Above 600,000	0.5700%

Land Tax

The land tax payable for a dwelling is made up of two components:

- *Fixed Charge* + *Valuation charge*
    - The fixed charge is $1,203 (2018-19).
    - The Valuation charge = *Average Unimproved Value* x *Rating factors*

      or
    - The Valuation charge = *Average Unimproved Value* x *Rating factors* x *Unit entitlement* (For unit titled dwellings only)

Table 2: 2018-19 Land Tax Rating Factors

AUV Thresholds	Rating Factor
$0 to $150,000	0.50%
$150,001 to $275,000	0.60%
$275,001 to $2,000,000	1.08%
$2,000,001 and above	1.10%

Note on Average Unimproved Value (AUV): The AUV is the average of the unimproved value of the property across the last three years. For example, the AUV for 2018-19 is the average of the property's unimproved value over 2016, 2017 and 2018. Note for units the AUV refers to the entire residential block of the complex.

General rates calculation – comparative examples

Example 1 – Detached 3 bedroom house in Charnwood

Market Value: $460,000 approximately

Average Unimproved Value (AUV): $270,000 approximately

2018-19 General rates payable: $1,775

This is based on a fixed charge of $815 and a valuation based charge of $960. This block falls under the second lowest AUV threshold for the 2018-19 general rates rating factors (Table 1 on Page 10).

Example 2 – 2 bedroom unit in Braddon

Market Value: $460,000 approximately (similar to example 1 above)

Average Unimproved Value (AUV) of the block: $2 million approximately

2018-19 General rates payable: $1,299

This is based on a fixed charge of $815 and a valuation based charge of $484. This block falls under the highest AUV threshold for the 2018-19 general rates rating factors (Table 1 on Page 10), being part of a larger multi-unit complex.

Note:

a. The above examples are based on publically available data. The values for the land and property have been modified slightly and the street addresses have not been provided for privacy reasons.

b. Market values have been provided for illustrative purposes noting they do not impact on the calculation of general rates (or land taxes).

c. The General rates calculation excludes the Safer Families Levy (SFL) and the Fire and Emergency Services Levy (FESL). The SFL and the FESL are currently $30 and $336 respectively.