

Submission to the ACT Public Accounts Committee

On Rates and Land Tax

2017 Budget Creates Inequalities

Introduction

A significant conclusion of the ACT Taxation Review (May 2012), subsequently described as the Quinlan Review, was that the 'current rates system disproportionately taxes smaller properties' (P175). The changes introduced by the current Government, which have no direct link with the recommendations of the Quinlan Review, mean, from 1 July 2018 on, the change in rating and land tax charging will result in:

1. Only those strata units where the entire complex's AUV (Average Unimproved Value) is less than \$150,001 will pay the same rates as an equivalent freestanding house
2. Every other strata unit in the ACT will be paying more, many considerably more, potentially up to an extra \$940 per unit per year
3. For many small strata unit this will increase further their already disproportionately high taxes
4. Yet until 1 July 2017 both strata and freestanding properties were subjected to exactly the same methodology and thus the same charges.

This change creates substantial inequities in the rates charged on equivalent strata units and penalises strata properties efficient use of land.

Government's Justification

This attack on strata properties has been variously attempted to be justified as better aligning rates on units with those on freestanding homes (Treasury spokeswoman as reported by the Canberra Times 5 September 2017). The spokeswoman goes on to claim there is a significant under payment of rates by units because they represent 29% of properties but paid 17% of rates under the previous charging regime. When the fixed charge per property is \$1,089, what was not acknowledged was that stratas represent considerably less than 17% of the ACT's total residential AUV.

So even before these changes were introduced, if measured by their relative proportion of the ACT's total of AUV, strata properties were being more heavily taxed than houses.

If Treasury want to determine rates so that if stratas are 29% of properties then they pay 29% of rates, then call it for what it is: a Poll Tax on properties!

A different set of reasons to justify these changes were advanced by Dr Jennifer Rayner, Director of Budget and Economic Policy, Chief Minister's Office. Her email of 16 February 2018 is at Attachment 1 where the fundamental justification is explained as: 'Under the previous methodology, someone with a \$500,000 unit in the City paid about \$400 a year *less* in rates than

someone with a freestanding home worth the same amount in Charnwood. We do not believe that was fair or equitable.

Even after the methodology change average rates on units are significantly lower at \$1,352 per year, compared with \$2,295 a year on average for freestanding homes.'

Dr Rayner conveniently omits to acknowledge the extent to which the improved value of the average house exceeds that of the average apartment. If, as I suspect it is, strata units' average improved value (AIV) is less than half that of the average AIV of houses then, by Dr Rayner's measure of fairness and equity, strata units are being overtaxed.

Response

It is difficult to argue rationally with an illogical proposition which charges on one basis but then attempts to determine fairness and equity on other grounds.

The 2 main arguments advanced by the Government and its agencies against the pre 2017 Budget arrangements appear to be:

1. Strata units under contribute to rates bases on a simple comparison of the number of units compared with the number of houses (Treasury spokeswoman as report in the Canberra Times 5 September 2017)
2. Some strata units pay less in rates than some houses which have a lower improved value (Dr Rayner's letter at Attachment 1).

With regard to the first argument there are 2 fundamental points to be made in response. Rates comprise 2 charging components one of which (the most significant part for many smaller properties) is a fixed charge per property. Should the policy objective be to have strata units pay "a more proportional share of the territory's rates revenue" (CT 5 September) then it is a more simple, straightforward proposition to increase the rate revenue derived from this component of the charging regime with a corresponding reduction in reliance on the value based charging (VBC) mechanism.

The logical extension of that approach is, however, the establishment of what would effectively be a poll tax on ACT residences. Yet it does not appear a proposition that would be articulated by the supporters of this argument. It would be illuminating to discover the general community reaction to a proposition that the grandest mansion in Mugga Way should pay almost the same rates as a modest 1 bedroom apartment in a high rise near an outer town centre.

With a poll tax type charging, if strata units account for 29% of total ACT dwellings, then 29% of the residential rate revenue would be paid by strata units and the proportional share would be exactly equal.

Such an arrangement if viewed in terms of either the unimproved or improved value of dwellings would, however, impose a substantially greater burden on strata units. If, as advised by Treasury, strata units paid 17% of residential rate revenue in 2016/17 then, given the

significant fixed charge component, strata unit's share of AUV must be substantially less than 17%.

Without data to assess the circumstances, one's suspicions would be that strata units would also account for substantially less than that this 17% threshold if measured on an equivalent AIV basis. If overall strata units are paying a greater amount than their share of AIV it makes a mockery of isolated examples of one type of strata unit paying less than one type of freestanding house.

It should also be noted that Improved Value has been an integral part of rate determination for some considerable period as it is the basis on which each strata unit's UE (unit entitlement) is calculated. Section 8 (1) of the Unit Titles Act provides that "The schedule of unit entitlement is a schedule indicating (by numbers assigned to each unit) the improved value of each unit relative to each other unit (the unit's *unit entitlement*)."

Under the pre 2017 arrangements, the VBC (Valuation Based Charge) of a strata unit was determined by applying the unit's UE as a percentage of the property's AUV to the tiered VBC. Thus each unit would enjoy the full benefit of the structured charging arrangements. It meant that, as required by the Unit Titles Act, a unit with an improved value of \$500,000 would be charged using a UE exactly half of that of another unit in the same property with an improved value of \$1 million. As a result of the tiered structure of VBC the \$1 million unit would pay more than double that of the other unit (unless both were only charged at the first tier level when it would then be exactly double).

Furthermore under these arrangements a house and a strata unit with the same AUV would pay exactly the same amount of rates. When variable charging is determined based on AUV it is, at first principle, a fair and equitable system.

It is noted that the Quinlan Review went no further than proposing that a "site value" be adopted for rates, land tax and lease variation charges. That is, it specifically excluded the concept of taxing based on "improved value".

Yet this is the very justification advanced by Dr Rayner.

If the government's objective is to better align rates and land tax with the improved values of homes and strata units then, surely, the logical and transparent approach would be to terminate the use of AUV to calculate the VBC component of rates and land tax, instead replacing it with AIV utilising the pre 2017 methodology.

There is logic in transitioning to AIV as such a policy would reflect an element of the prime Quinlan Review recommendation of reducing the reliance on Stamp Duty, a tax based on the improved value of properties. Through the adoption of such a policy the basis on which the variable element of rates and land tax would be broadened to more accurately reflect the actual value of residential properties whilst avoiding the shortcoming of stamp duty which only generates tax revenue when a property is sold.

Why the 2017 budget methodology is unfair

The consequence of this change is that no strata unit will pay less than a house with an equivalent AUV and the vast majority of strata unit will pay more. As noted above, the government attempts to justify this on the basis of an example of a strata unit paying less in rates than a freestanding house which has a lower improved value.

Nothing advanced by the Government demonstrates that this is a universal truth. As an example I noted that the standalone house at 51 Duffy Street Ainslie is advertised (10 March 2018) at \$1.9 million and, based on an AUV of \$737,000, would have a VBC liability of \$3,491, yet my own apartment has a marginally higher VBC liability (\$3,527) but has an improved value of less than 80% of the Duffy Street property.

What is more inequitable is that the house's average VBC level of 0.47% is lower than **every** unit in my property all of which must pay the VBC at 0.6%, over 25% higher.

How is the Government's objective of a "fair and equitable" rating structure achieved when there is such a disparity in these respective property values but so little difference in the rates which must be paid and when the most valuable property, the standalone house, enjoys a tax benefit of a lower VBC rate than even the most modest 1 bedroom apartment? Does that not have the features of a regressive tax?

What is undeniable is that, ignoring the one-off \$100 rebate, no unit can possibly pay less than a freestanding house with the same AUV and every unit where the combined property's AUV exceeds \$150,000 will pay more.

Yet this is not the worse of the unfairness when the full extent of the magnitude of distortion, the disparity in equity, created by the government's shift in methodology is comprehended.

This is not just about the relative taxing of houses V units but the distortions in the taxing of one strata unit compared with another strata unit having a comparable AUV or even, I suspect, a comparable AIV.

Table 1 identifies the VBC component of rates for a single dwelling and a range of strata units with varying AUV's. It is based on an assumption of average value across each strata complex.

**TABLE 1
2017/18 VALUATION BASE RATE CHARGE \$**

AUV PER UNIT	SINGLE DWELLINGS	STRATA UNITS (PER UNIT)					
		2 UNITS	10 UNITS	50 UNITS	100 UNITS	200 UNITS	300 UNITS
50,000	148.00	148.00	210.69	281.84	291.24	295.95	297.51
100,000	296.00	324.20	507.24	582.49	591.89	596.60	598.16
150,000	444.00	528.60	807.89	883.14	892.54	897.25	898.81
300,000	1,057.20	1,333.58	1,709.84	1,785.09	1,794.49	1,799.20	1,800.76
450,000	1,826.70	2,235.53	2,611.79	2,687.04	2,696.44	2,701.15	2,702.41
600,000	2,667.15	3,137.48	3,513.74	3,588.99	3,598.39	3,603.10	3,604.66
750,000	3,569.10	4,039.43	4,415.69	4,490.94	4,500.34	4,505.05	4,506.61
900,000	4,471.05	4,941.38	5,317.64	5,392.89	5,402.29	5,407.00	5,408.56
1,050,000	5,373.00	5,843.33	6,219.59	6,294.84	6,304.24	6,308.95	6,310.51

What this table demonstrates is that, for the same AUV, the amount of rates levied on a strata unit will be greater merely because a unit is part of a larger complex.

At an AUV of \$150,000, the base tier for VBC calculations, the VBC charge on a freestanding house will be \$440.00. This jumps by 19% to \$528.60 for a dual occupancy property (DOP). Yet if the unit is part of a moderately sized complex of 10, the VBC charge leaps to be over 180% of the house's rate and over 150% of the DOP. How can the government claim that is fair?

Should the unit be part of a complex of 50 units the VBC would be almost double that of the house and two thirds greater than that of the DOP.

With an AUV equal to the maximum tier of \$600,000, the 10 unit complex pays over 30% more than the house and 12% more than the DOP. Should the unit be part of a 50 unit complex the respective higher payments are 35% and 14%.

As noted above, Table 1 assumes an across the board average for each unit within a complex but this assumption in no way invalidates the conclusion that, as a general rule, the larger the size of the complex the more each individual unit holder will be forced to pay through this

grossly unfair charging methodology. The possible exception could be a complex where one unit has an unusually high proportion of the UE's relative to the others within the complex, an unlikely situation.

Table 2 identifies the average VBC which will apply to **every** dwelling for a range of AUVs.

TABLE 2 AVERAGE 2017/18 VALUATION BASE RATE CHARGE	
AUV PER PROPERTY \$	PERCENTAGE PER PROPERTY
150,000	0.2960
300,000	0.3524
450,000	0.4059
600,000	0.4445
750,000	0.4759
900,000	0.4968
1,000,000	0.5072
2,000,000	0.5543
5,000,000	0.5825
10,000,000	0.5919
50,000,000	0.5994

This demonstrates how rapidly the average charge increases beyond the \$600,000 threshold so that a relatively modest unit, worth as little as \$300,000 within a strata property with an AUV of \$1 million will pay the same VBC level of 0.5072% as a single multi-million dollar property with an AUV of \$1 million.

This distortion hits hardest where there are relatively modest units, with relatively modest improved values, which are part of middle to large sized strata complexes. For example in Landmark, a 282 unit property in Barton, a one bedroom unit with an AUV of \$108,360 faces a VBC of \$650.16 compared with a freestanding house with the same AUV having a VBC of \$320.75, ie the apartment's charge is more than double that of the house. Yet there is every likelihood that the improved value of the house would be at least comparable if not greater than that of the unit, so how is that consistent with the tests of fairness and equity as articulated by the Chief Minister's Office?

Again if one unit is compared with another unit the absurdity of this policy is utterly compelling. A one bed, one bath, one car park unit in Landmark is liable to pay rates of \$1,823

pa, yet a two bed, two bath, two car park unit in a much smaller complex on the other side of Blackall Street only has a rate liability of \$1,536 despite being worth around 50% more than the smaller property (Allhomes 4 March 2018).

How can the government justify creating the circumstances where one unit is worth 50% more than the other but is required to pay less than 85% of the other unit's rates? How can that be fair or equitable?

It is noted that the Treasury representative quoted in the Canberra Times (5 September 2017) claimed "some 32,783 units or 72% of all Canberra apartments remain in the lowest marginal rating category, below the \$150,000 threshold.

As Tables 1 and 2 demonstrate, for that claim to hold water the aggregate value of each separate complex in which those units are housed has to be below the \$150,000 threshold. That defies credibility!

It leads one to ponder whether Treasury fully comprehends the enormity of the consequences unless such calculations have been "massaged" by strategic utilisation of the "generous" once only \$100 rebate for strata units provided in the 2017/18 budget.

What, however, this Treasury data does highlight is that the overwhelming numbers of strata units in the ACT are relatively modest dwellings and that the so called "foreshore penthouses" comprise a relatively minor component of the strata population.

Consequences

This disproportionate, unjustified increase in charges on those owning modest units in middle to large strata complexes will have three significant impacts:

1. Depress the value of these units relative to equivalent units in smaller complexes and to freestanding houses
2. Increase the financial pressure on many owner/occupiers who are least able to meet these higher charges, particularly those who are new home owners
3. Add to the costs of investors who are faced with the alternatives of:
 - a) seeking to pass on these costs to their tenants as higher rents,
 - b) absorbing these costs thereby reduced their return, or
 - c) exiting the investment.

Canberra already has the second highest strata rents in Australia. Could this be the catalyst to push ACT unit rental levels past Sydney to be the highest in the country?

An Alternative

As noted above, the Quinlan Review focused on reducing the ACT's reliance on stamp duty and increasing the proportion of revenue generated from rates and land tax. In so doing it supported a withdrawal from a tax based on a property's improved value to taxes based on the property's unimproved or site value.

Furthermore the current methodology of calculating the VBC component of rates and land tax which is supposedly based on property's unimproved value is already compromised as the improved value of strata units is the factor which decides each unit's UE and therefore is, at present, an important element in determining all strata properties' rates and land.

If the government is determined that equity is best measured based on a property's improved value then it must move to replace the AUV with the AIV of each property whilst abandoning the grossly flawed, utterly unfair methodology introduced in the 2017/18 budget.

Such a charge would create the opportunity to respond to the Quinlan Review recommendation to recognise past payments of stamp duty by introducing a rebate on rates for owners who purchased before a specified date (1 July 2015 perhaps). Such a scheme could be set at, say, a 10% rebate for 2018/19 reducing by 0.5% per year but lapsing when the property was sold.

Changes to a rating structure based on the improved value of properties would have to be adopted by the Legislative Assembly and accepted by the ACT community.

J R Evans



Barton ACT 2600

Dr Rayner's email letter of

16 February 2018

Dear Mr Evans,

Thank you for your email to Chief Minister Andrew Barr and other members of the Legislative Assembly regarding the changes in calculation methodology for unit-titled properties.

The ACT Government announced in the 2016 Budget that we would be updating the method used to calculate general rates and land tax on units. The intention of this change is to ensure that rates and land tax on units are better aligned with rates on freestanding homes with equivalent market values, as previously unit holders have generally paid significantly less in many cases.

In the ACT, general rates do not only pay for municipal services such as roads and rubbish. Because of our unique single level of government, rates also help to pay for the ACT's schools, hospitals, public transport and many other 'state government' services that all Canberrans access. This is why it is important that everyone in our community contributes fairly.

The general rates and land tax calculations for multi-unit dwellings are now based on the total Average Unimproved Value of the land rather than the AUV of the individual unit. This change is being phased in over the next two years. As a result, general rates and land tax for units are increasing at a higher rate than for freestanding properties during this time as the change takes effect.

Under the previous methodology, someone with a \$500,000 unit in the City paid about \$400 a year *less* in rates than someone with a freestanding home worth the same amount in Charnwood. We do not believe that was fair or equitable.

Even after the methodology change average rates on units are significantly lower at \$1,352 per year, compared with \$2,295 a year on average for freestanding homes.

We do appreciate that many Canberrans are facing cost of living pressures, particularly at a time when other non-Government costs such as utilities are also going up. That is why we offer a range of concessions programs and cost of living assistance, which you can find out more about here: www.assistance.act.gov.au.

You may also be interested to know that the ACT Government offers a rates deferral program for older Canberrans who are on fixed incomes. The program allows eligible residents to defer their rates payments until such time as their property is sold. This can help people who own significant property assets but have fixed or limited income. You can find out more about the rates deferral scheme here: <https://www.revenue.act.gov.au/duties-and-taxes/rates/rates-assistance>.

The petition you referred to has been tabled in the Legislative Assembly this week and the Government supported its referral to the Public Accounts Committee. This will be a good opportunity for the Canberra community to better understand the rationale for these changes and the improved fairness they deliver within the tax system.

Regards,

Jennifer

Dr Jennifer Rayner | Director of Budget & Economic Policy

Office of Andrew Barr MLA

Chief Minister

Treasurer

Member for Kurrajong