



Stamp duty:

Why NSW's proposed property tax reform is as safe as houses

Picture this:

You're presenting two tax systems to a focus group. The first tax is an upfront, lump-sum transfer duty. A punitive tax. It adds tens of thousands of dollars to the purchase price of a property, and then penalises anyone who attempts to downsize or move into more suitable housing down the track, distorting the housing supply and decreasing housing affordability. This tax is complex and inefficient. It taxes transactions and stifles activity. What's more, this tax is the state's largest tax revenue source (even greater than payroll tax) but the burden falls squarely on the small number of taxpayers who buy property each year, making it a hugely inequitable tax. And did we mention this tax was first introduced in NSW back in 1865, at the time of the American Civil War? Hardly cutting-edge legislation.

The alternative is a smaller, simpler tax. An annual tax, similar to council rates. This tax brings home ownership within reach, especially among first home buyers. And it encourages household mobility, allowing people to move as often as they like without paying a penalty for it, and enabling them to live in the right home for their circumstances. This transition from stamp duty to land tax is projected to create an additional 75,000 jobs in NSW and estimated to put an extra \$3300, on average, in the pockets of each household. In fact, it's the single greatest productivity enhancing reform that could be undertaken – more than any single infrastructure investment.

Faced with this choice, you'd be hard pressed selling the first tax – NSW's current stamp duty regime – to any focus group in 2021. If it wasn't already in place, that is.

Of course, stamp duty is still in place, and switching to any new tax regime is never a straightforward process. From franking credits to capital gains tax and negative gearing changes, recent political history is littered with failed tax reform attempts. Familiarity bias and fear of the unknown means people are incredibly wary of tax reform, even when that proposed reform is an opt-in scheme, like the proposed property tax reform is.

The NSW Government plans to give buyers a choice between paying upfront stamp duty or an annual land-based tax. And yet a new survey we undertook, polling more than 800 NSW adults, found there's still significant uncertainty about the plan, with 37% of those surveyed undecided if they'd opt for an annual property tax instead of stamp duty. Buyers' number one concern is that annual rates will increase over time.

The challenge, then, is two-fold: How does the NSW Government assure the electorate that this is good reform? And how does the Government implement the legislation? These two challenges are interrelated and many of the stumbling blocks that apply to one also affect the other. We outline these stumbling blocks below.

As for the path forward, we suggest actions to address concerns about the reform. By educating people on the details of the proposed reform, the Government can assure the electorate that NSW's new property tax regime will be, well, safe as houses.

The case for change

In NSW, we don't move house as often as we should, and stamp duty is a major reason why. Stamp duty is an upfront cost – a sunk cost – that dissuades people from moving house. Potential buyers are put off by the size of stamp duty, while those who've bought feel compelled to stay put to recoup their outlay.

For individuals, this means they overcapitalise on their property instead of moving to a bigger property when needed. It means people are less likely to move in order to change jobs. And it means people stay in their homes longer than necessary, rather than downsizing.

For the state economy, too, stamp duty is a handbrake. It contributes to an inefficient allocation of housing, an inefficient allocation of labour, a stagnant workforce, and a housing shortage. Stamp duty is causing us to spend our capital stock in the wrong place, and this represents a significant opportunity cost for NSW.



Why it's good reform

The proposed annual property tax would be based on a fixed amount plus a rate applied to the unimproved land value of a property. In its [Property Tax Progress Paper](#), the NSW Government says the tax will result in a forecast 3-4% reduction in home prices, and allow more than 300,000 NSW residents to achieve home ownership. At the same time, gross state product could improve by 1.7%. This is good reform.

However, our analysis shows that the Government has work to do in order to convince property owners and would-be buyers of the scheme's merits. Only just over half (57%) of those surveyed had heard about the proposal, and less than a third (32%) said they would take up an offer to forego stamp duty.

What, then, are the main barriers to reform? And how can the Government overcome them?

Stumbling blocks to reform

The following are stumbling blocks from a buyer's perspective.



Concern:
'Tax rates will increase over time'

Our research shows that the greatest obstacle is homeowners' fear of being locked into an annual tax rate that could increase over time. Almost three quarters (73%) of surveyed respondents cited this as the number one reason they'd be reluctant to choose an annual tax over stamp duty. Meanwhile, 30% of survey respondents strongly agreed (and 26% agreed) that they were fearful rates would increase over time. Fewer than 1.5% disagreed this was a concern.

The NSW Government acknowledges this concern, and [explicitly states](#): 'The proposed reform is not designed to increase tax payments over time to raise additional revenue... the reform is not a tax grab.'

To this end, the Government would commit to a rate-locking mechanism or indexation system, like the current cap on NSW council rates. This would ensure payments grow in line with average incomes.



Concern:
'It will cost me more in the long run'

Homebuyers are also concerned that an annualised tax rate will cost them more, in the long run, than a single stamp duty payment would. In fact, if you are an owner-occupier and hold your property for less than 10 years, you will pay less tax overall if you opt for an annualised tax rate. Ultimately, the planned changes will provide greater choice for those looking to purchase a property.



Concern:
'It will cause house prices to increase'

The Government says that we can expect a fall in home prices in the order of 3-4%. Despite this, our research found that fewer than 5% of respondents thought the reform would see house prices decrease. Even if buyers don't expect the switch from stamp duty to result in downward pressure on prices and rents (as the Government projects), they're skeptical that prices will remain stable. Instead, there's a perception the changes will lead to vendors obtaining more for a property.



Concern:
'I'm unsure which option is better for me'

Finally, choice itself is a cause for concern. More than a third (37%) of respondents were undecided about the reform and much of this can be put down to loss aversion. Faced with a choice between stamp duty and an annual tax, homebuyers are fearful of making the wrong choice and so penalising themselves financially. Behavioural economics shows us that people fear losing more than they hope to win, and this makes the choice extra challenging.

Actions that maximise the opportunity for successful reform

Given the hesitancy that our survey uncovered, and given the opt-in nature of the reforms, educating the electorate is key. For the reform to work, the Government needs to clearly demonstrate those situations where choosing land tax would be to a buyer's advantage (for instance, when the property will be held for less than 10 years). They must also give a firm commitment on tax rate caps. Ultimately, the Government must create a compelling narrative.

Practically speaking, the Government should:

- Roll out a plain-English education campaign to explain the reform and its benefits. This should clearly outline the details of the new annual property tax, and emphasise the fact that buyers have a choice. This is not a double tax (i.e. if you do not move, you do not pay property tax as you've already paid stamp duty).
- Demonstrate that any rate-locking mechanism is credible and effective.
- Build broad groups who support the reform, in order to amplify the messaging around the reform to the electorate.

For more information see: [NSW 2020-21 Budget announcements and proposed tax reform](#)

According to our high-level modelling, owner-occupiers who hold their property for less than 10 years will be better off under the proposed property tax regime. This was the case across a range of scenarios.

Sold for \$680,000

Parramatta



For example, a two-bedroom villa in Parramatta, purchased for \$680,000 would incur upfront stamp duty of

\$25,807

Cumulative annual property tax, on the other hand, would be just \$11,795 over 10 years.

Sold for \$720,000

Hornsby



Similarly, a two-bedroom unit in Hornsby (purchase price: \$720,000) would attract stamp duty of

\$27,607

It would take 18 years of annual property tax payments before the owner exceeded this amount.

Sold for \$1.675m

Surry Hills



Meanwhile, buyers of a two-bedroom house in Surry Hills (bought for \$1.675 million) would pay almost

\$77,000

in stamp duty, versus only \$33,425 in annual property tax over 10 years.

(Note: not the case for first-home buyers.)



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