To: Standing Committee on Infrastructure, Transport and Cities
Parliament House, CANBERRA 2600
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The *pons asinorum* of value-capture

A one-page submission to the inquiry into the role of transport connectivity in stimulating development and economic activity

Question: If you want to fund an infrastructure project out of the ensuing increases in land values ("value-capture"), how do you determine how much of the increase in each location is due to the infrastructure?

Answer: *You don't.* You impose a tax on *all* uplifts in land values, and use the revenue to *replace a less efficient, less equitable tax* (e.g., conveyancing stamp duty). The rate of the new tax is chosen so that it will just replace the old tax if land values continue on their present trajectories. But they do not. Each subsequent infrastructure project causes uplifts in land values, expanding the *base* of the new tax, and the resulting increase in revenue amortizes the cost of the project if the benefit/cost ratio is high enough. Thus a large number of projects become self-funding (or better) and therefore proceed. The new tax claws back only a fraction of each uplift; the remainder is an unearned windfall for the property owner. Where the windfall is due to infrastructure, the owner might not otherwise receive it, because the project might not otherwise be funded.

Thus the government receives a revenue *increase* for each well-chosen project that it funds, and the increase *automatically* comes from the owners of properties that rise in value due to the project. *There is no need for bureaucrats to decide what locations are deemed to benefit or to what degree.* Of course the government also receives revenue from owners of properties that rise in value for other reasons. This is no injustice to the owners, for whom the rise is still an unearned windfall. The same cannot be said for most alternative tax bases.

One obvious replacement for conveyancing stamp duty is a *State capital-gains tax (CGT) on property* (or, equivalently, a Federal CGT surcharge, with the revenue from each property remitted to the State in which the property is located). Such a tax captures *uplifts in land values*—not capital works by the owners, because these are deductible. If the CGT is to capture all uplifts in land values after its date of introduction ("**D-day**"), it must apply to properties acquired *before* D-day. But because the CGT replaces stamp duty, the retrospectivity *helps the seller* by providing a hedge: it's better for me (or my heirs) to pay CGT on the sale *only if I make a capital gain* than to pay stamp duty on the next purchase whether I made a capital gain or not. If that argument is not good enough, the seller can be given the *option* of paying the stamp duty that would have been payable on the day before D-day, plus the CGT on the rise in value since then.

Rational property owners would prefer CGT to stamp duty, because: (i) a CGT, unlike a stamp duty on the purchase price, will not turn a profitable purchase-resale cycle into a loss-maker or increase a loss; (ii) the fact that stamp duty is nominally payable by the buyer, and CGT by the seller, does not affect the final incidence of either, due to the higgling of the market; (iii) a CGT causes less discouragement to turnover (less "lock-in" effect) because an owner who "trades up" more frequently does not pay proportionally more tax, but pays tax in a larger number of smaller instalments; and of course (iv) a CGT incentivizes the government to invest in infrastructure that raises property values, and is not payable unless the owner actually receives and realizes a rise in value. These advantages are more robust if the CGT is levied on *real* (inflation-adjusted) gains. It is sometimes alleged that all the low-hanging fruit of tax reform has already been picked. Clearly I disagree.

Another obvious replacement for stamp duty is *land tax*. For a given initial revenue target (e.g., enough to replace stamp duty), land tax captures a higher fraction of uplifts in land values than stamp duty (which is levied on combined values of land and buildings), but a lower fraction than CGT (which is levied only on uplifts). Land tax is superior to CGT in terms of "lock-in" and excess burden (deadweight), but politically more difficult. I expect that a submission by Prosper Australia (of which I am a member) will elaborate on land tax.

Value-capture by *local* government can be enhanced by applying general rates to *land values alone*. It is impaired by any dilution of the land-value base, e.g. by rating combined values of land and buildings, or charging separately for services (which are usually services to *locations*, hence ideal candidates for value-capture), or imposing any sort of "fixed charge" or "minimum general rate" or "rate capping". Note that "rate capping" paradoxically *hurts* ratepayers by impeding infrastructure projects that would raise property values.

All the value-capture mechanisms suggested above are simply *tax reforms*. The supposed need to specify the locations that benefit from an infrastructure project is an *imaginary* hurdle.

— (Dr) Gavin R. Putland, Melbourne.