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# Appendix D – Parliamentary Budget Office Costings for a proposed additional stamp duty on foreign purchases

**Parliament of Australia**
**Parliamentary Budget Office**

# COSTING – OUTSIDE THE CARETAKER PERIOD

| Name of proposal: | Stamp duty on foreign investment in housing |
|---|---|
| Summary of proposal: | This proposal would apply a stamp duty to purchases of all types of residential property by non-resident and temporary resident foreign investors.<br>The proposal has four stamp duty options:<br>• 5 per cent<br>• 10 per cent<br>• 15 per cent, and<br>• 20 per cent, of the property purchase price.<br>The proposal includes two options for collection of the stamp duty:<br>• stamp duty would be collected and retained by the States, and<br>• stamp duty would be collected by the Commonwealth and paid to the States.<br>The proposal would take effect from 1 July 2015. |
| Person/party requesting costing: | Kelly O'Dwyer MP, Member for Higgins, Victoria |
| Date costing request received: | 1 September 2014 |
| Date costing completed: | 26 September 2014 |
| Did the applicant request the costing be confidential? | Yes |
| Agencies from which information was obtained: | Department of the Treasury<br>Australian Taxation Office |
| Expiry date for the costing: | Release of the next economic and fiscal outlook report |

**Costing Overview**

Because stamp duty revenue being collected under this proposal is either collected and retained by the States or is collected by the Commonwealth and paid to the States (less collection costs), the stamp duty would have no direct net impact on the Commonwealth budget. The proposal would, however, be expected to have flow on impacts in the property market that would impact on Goods and Services Tax (GST) and capital gains tax (CGT). The GST impact would have no net impact on the Commonwealth budget as GST revenues are paid to the States. This means that, under both

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collection options, the only net impact on the Commonwealth budget would arise through lower capital gains tax (CGT) revenue.

Foreign investors, particularly those who invest purely for financial return, would be expected to be highly sensitive to the introduction of a Commonwealth Government stamp duty as the stamp duty would reduce the potential financial return from investing in Australian residential property relative to alternative investment opportunities[1]. Foreign investors would be expected to respond by switching some part of their investments to other lower cost jurisdictions or to other Australian assets. This means that the introduction of the foreign investor stamp duty would be expected to reduce the number of residences purchased by foreign investors and this effect has been included in the estimate of stamp duty revenue from the proposal in this costing.

A reduction in the number of residences purchased by foreign investors would be expected to have a flow on effect to the broader Australian housing market. The decrease in foreign demand could result in lower domestic prices than would otherwise be the case, a reduction in the amount of housing sold (including both turnover of existing housing and supply of new housing) or a combination of both these impacts. In turn, this would reduce the tax base for the Commonwealth's capital gains tax (CGT) and goods and services tax (GST) receipts as well as reducing the base for existing state and territory stamp duty revenue.

The PBO has included estimates of the impact that this proposal would have on Commonwealth CGT and on GST revenue and related payments to the states and territories in this costing. The impact that the proposal would have on state and territory stamp duty revenues has not been included.

The financial implications of applying an additional Commonwealth Government stamp duty to purchases of Australian residential property by foreign investors under the various options specified is included at Attachment A.

This costing is sensitive to the PBO's assumptions about foreign investor behaviour. The PBO has undertaken a sensitivity analysis that shows how the estimated foreign investor stamp duty revenue may vary when different assumptions about how foreign investors respond to the proposal are used. This sensitivity analysis is included at Attachment B.

All options within this proposal would have an ongoing impact that extends beyond the forward estimates period.

This costing is considered to be of very low reliability as it is based on a number of significant assumptions (detailed below) and is based on incomplete high level foreign investment application data that was obtained from the Foreign Investment Review Board (FIRB) because actual data on foreign investment in Australian housing is not available.

This costing advice is valid until the release of the next economic and fiscal outlook report

[1] Both Singapore and Hong Kong have recently introduced similar stamp duties on investment by foreign investors in residential housing, both at the rate of 15 per cent, with the objective of reducing foreign demand for the housing stock in those countries and reducing housing prices. In both cases it appears too soon for a proper evaluation of the impact of these measures, but reports indicate that these stamp duties have significantly dampened foreign investment in residential housing.

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### Methodology

The revenue gain for this proposal was estimated by calculating the impact of imposing a stamp duty payable by non-resident investors on residential property purchase transactions at the selected stamp duty rate. The impact includes a reduction in the number of foreign investor purchases that could be expected to occur as a result of imposing the stamp duty.

The impacts on Commonwealth CGT and GST revenues were estimated based on the estimated impact on the value of transactions included in the respective tax bases, multiplied by the respective effective tax rates on the transactions.

All estimates have been rounded to the nearest $10 million. Departmental expense estimates have been rounded to the nearest $1 million.

### Key assumptions

Assumptions detailed in the costing request:

- All options under this proposal would have effect from 1 July 2015.
- The proposal would apply to all types of residential property including new and existing housing, and off the plan and residential land purchases.
- The proposal would apply to non-resident individuals, companies, trusts and investment funds. The proposal would also apply to temporary residents.
- The policy would be announced at the time of implementation. This means that foreign investors would not have sufficient time to respond to the announcement by bringing forward the timing of their purchases to avoid paying the stamp duty.
- This costing has been completed on a stand-alone basis and does not include any interactions with other related revenue raising or expenditure proposals that may be implemented in conjunction with this proposal.

The PBO has made the following assumptions regarding this advice:

*Foreign investment base data assumptions*

This costing is based on the number of non-resident purchases that the PBO has derived from the number of FIRB applications that were made in 2012-13.

- In the absence of firm data the PBO has assumed that two-thirds of approved FIRB applications result in purchases.
- All purchases by foreign investors are in capital cities. Average prices paid in the housing market are based on a weighted average of capital city prices. Prices are weighted by the amount of foreign investment in each state and territory.

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- Foreign investment is assumed to account for five per cent of *established* dwelling purchases and 35 per cent of *new* dwelling purchases in the section of the market where foreign buyers are active[1].
  - Based on FIRB data foreign buyers are expected to be active in the top 40-50 per cent of the market (by price) and primarily in Sydney and Melbourne.
- The foreign investor stamp duty would apply to the GST inclusive price of the properties that are subject to the GST.
- If the foreign investor stamp duty were collected by the Commonwealth then it would be paid to the States under similar arrangements as apply to the GST.

*Foreign investor behavioural assumptions*

The behavioural response of foreign investors to the imposition of an additional stamp duty on property purchases is dependent on both the stamp duty rate and whether the property is an existing property or a new property.

- For options with relatively higher stamp duty rates the relative size of the behavioural response is assumed to be larger.
  - This is because higher stamp duty rates further reduce potential foreign investor returns by applying a larger tax wedge between the foreign investor price and the domestic market price for the property.
- Foreign investors have a greater behavioural response to imposing a stamp duty on new property compared to existing property.
  - Foreign investment rules mean that existing dwellings can only be purchased by temporary residents who intend to live in the residence and as such, these buyers are expected to be less sensitive to price changes than other foreign investors.
  - Foreign investors who are not temporary residents are restricted to investing in new dwellings and because they are not resident in Australia, are more likely to be investing in property for purely financial gain. The higher elasticity for new dwellings and vacant land recognises the greater responsiveness of non-resident investors to an increase in the cost of investing in Australia.

*Foreign investor timing assumptions*

- Foreign investors are assumed to become liable for and pay stamp duty on the settlement date for the property. This means that there is no difference between the underlying cash and fiscal impact of this costing.
- Estimated annual stamp duty revenue is assumed to be evenly distributed throughout the year.

[1] These assumptions are based on figures from Treasury's submission to the Inquiry into Non-resident Investment in Residential Real Estate and from the Reserve Bank of Australia's paper *Non-resident Investment in Residential Real Estate*

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*Assumptions related to the broader housing market*

- The broader Australian housing market is assumed to respond to the reduction in foreign investor demand both through a combination of reduced prices and a reduction in the amount of housing available for sale.
- A lower turnover value of housing (whether from lower than otherwise house prices, fewer house sales or a combination of these) in the broader Australian capital city market would reduce revenue from other Commonwealth taxes. Impacts for CGT and GST have been included in the modelling using several basic timing and realisation assumptions.
  - The average marginal tax rate that would apply to these other tax impacts is assumed to be 33 percent for individuals and trusts (less the CGT discount on capital gains) and 30 per cent for companies.
  - The PBO has not included any estimates of the flow on effects of changes in rental income or rental related deductions to personal or company taxable income as these are highly uncertain.
- The PBO has not included the impact of State revenue changes. Therefore, the estimates in this costing do not include flow-on impacts to state and territory based stamp duty revenue that arise because of the changes in the broader Australian housing market prices in response to this proposal. These impacts may be significant.
- The non-resident stamp duty rate would apply to the property purchase price excluding the State based stamp duty.
- The PBO has not modelled any broader second-round economic effects resulting from the reduction in foreign investment from this proposal.

*Administration assumptions*

The proposal includes 2 options for collection of the stamp duty 1) stamp duty would be collected and retained by the States, and 2) stamp duty would be collected by Commonwealth and paid to the States. Under the second of these options the PBO assumes that the cost to the Commonwealth of administering the tax would be directly funded from the tax revenue (the same arrangement as the GST). The revenue implications of the collection methods are expected to be the same. Only the departmental costs of implementing the proposal differ.

- For options where the Commonwealth would collect the stamp duty on behalf of the states, the PBO has estimated departmental expenses to be $5 million per annum from 2015-16. This is based on the cost of implementing other large-scale tax proposals with no pre-existing related departmental infrastructure.
- For options where the States collect the stamp duty, state and territory departmental costs have not been included in this costing. This reflects the fact that the states and territories have existing stamp duties and the administrative mechanisms to collect them.

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**Data sources**

- The number and value of foreign residential investment applications was provided by Treasury.
- Department of the Treasury, Submission to the Inquiry into Non-resident Investment in Residential Real Estate (23 May 2014)
- Reserve Bank of Australia, Non-resident Investment in Residential Real Estate, Bulletin, June Quarter 2014
- Australian Bureau of Statistics, Housing Finance, Australia, June 2014, Catalogue Number 5609.0, Canberra
- Australian Bureau of Statistics, Residential Property Price Indexes: Eight Capital Cities, June 2014, Catalogue Number 6416.0.

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# ATTACHMENT A: ESTIMATED IMPACTS FOR EACH OPTION

Table A1 presents detailed financial implications for each stamp duty rate option assuming the tax is collected by the Commonwealth. For the option where the stamp duty is collected directly by the states and territories and retained, the only Commonwealth financial impact would be the CGT revenue shown.

**Table A1: Stamp duty revenue with a commencement date of 1 July 2015 – $ million (outturn prices)[(a)]**

| Impact on underlying cash and fiscal balances | 2014-15 | 2015-16 | 2016-17 | 2017-18 | Total |
|---|---|---|---|---|---|
| ***Stamp duty at 5 per cent*** | | | | | |
| Foreign investor stamp duty | - | 820 | 880 | 920 | 2,620 |
| CGT revenue | - | -30 | -30 | -30 | -90 |
| GST revenue | - | -140 | -150 | -160 | -450 |
| **Total revenue impact** | **-** | **650** | **700** | **730** | **2,080** |
| Administration costs | - | -5 | -5 | -5 | -15 |
| Stamp duty paid to the States | - | -815 | -875 | -915 | -2,605 |
| GST expense to States | - | 140 | 150 | 160 | 450 |
| **Net impact of the proposal** | **-** | **-30** | **-30** | **-30** | **-90** |
| ***Stamp duty at 10 per cent*** | | | | | |
| Foreign investor stamp duty | - | 1,490 | 1,590 | 1,670 | 4,750 |
| CGT revenue | - | -60 | -60 | -60 | -180 |
| GST revenue | - | -270 | -290 | -320 | -880 |
| **Total revenue impact** | - | 1,160 | 1,240 | 1,290 | 3,690 |
| Administration costs | - | -5 | -5 | -5 | -15 |
| Stamp duty paid to the States | - | -1,485 | -1,585 | -1,665 | -4,735 |
| GST expense to States | - | 270 | 290 | 320 | 880 |
| **Net impact of the proposal** | **-** | **-60** | **-60** | **-60** | **-180** |

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| Impact on underlying cash and fiscal balances | 2014-15 | 2015-16 | 2016-17 | 2017-18 | Total |
|---|---|---|---|---|---|
| ***Stamp duty at 15 per cent*** | | | | | |
| Foreign investor stamp duty | - | 1,190 | 1,280 | 1,350 | 3,820 |
| CGT revenue | - | -260 | -270 | -270 | -800 |
| GST revenue | - | -790 | -860 | -920 | -2,570 |
| **Total revenue impact** | - | **140** | **150** | **160** | **450** |
| Administration costs | - | -5 | -5 | -5 | -15 |
| Stamp duty paid to the States | - | -1,185 | -1,275 | -1,345 | -3,805 |
| GST expense to States | - | 790 | 860 | 920 | 2,570 |
| **Net impact of the proposal** | - | **-260** | **-270** | **-270** | **-800** |
| ***Stamp duty at 20 per cent*** | | | | | |
| Foreign investor stamp duty | - | 940 | 990 | 1,040 | 2,970 |
| CGT revenue | - | -350 | -360 | -370 | -1,080 |
| GST revenue | - | -1,050 | -1,140 | -1,220 | -3,410 |
| **Total revenue impact** | - | **-460** | **-510** | **-550** | **-1,520** |
| Administration costs | - | -5 | -5 | -5 | -15 |
| Stamp duty paid to the States | - | -935 | -985 | -1,035 | -2,955 |
| GST expense to States | - | 1,050 | 1,140 | 1,220 | 3,410 |
| **Net impact of the proposal** | - | **-350** | **-360** | **-370** | **-1,080** |

(a) A positive number for the underlying cash and fiscal balances indicates an increase in receipts/revenue or a decrease in payments/expenditure. A negative number for the underlying cash and fiscal balance indicates a decrease in receipts/revenue or an increase in payments/expenditure.

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# ATTACHMENT B: SENSITIVITY OF STAMP DUTY REVENUE TO BEHAVIOURAL ASSUMPTIONS

Table B1 presents a sensitivity analysis of possible behavioural responses by foreign investors for each stamp duty rate option. The numbers indicate the sensitivity of gross non-resident stamp duty receipts (excluding GST and CGT impacts) to different foreign investor elasticity assumptions.

**Table B1: Sensitivity of stamp duty revenue to behavioural assumptions – $ million (outturn prices)[(a)]**

| Impact on underlying cash and fiscal balances | 2014-15 | 2015-16 | 2016-17 | 2017-18 | Total |
|---|---|---|---|---|---|
| ***Stamp duty at 5 per cent*** | | | | | |
| No behavioural change | - | 890 | 960 | 1,010 | 2,860 |
| 10% decrease in demand elasticity | - | 830 | 890 | 930 | 2,650 |
| **Assumption used in costing** | **-** | **820** | **880** | **920** | **2,620** |
| 10% increase in demand elasticity | - | 810 | 860 | 920 | 2,590 |
| ***Stamp duty at 10 per cent*** | | | | | |
| No behavioural change | - | 1,780 | 1,920 | 2,020 | 5,720 |
| 10% decrease in demand elasticity | - | 1,510 | 1,630 | 1,710 | 4,850 |
| **Assumption used in costing** | **-** | **1,490** | **1,590** | **1,670** | **4,750** |
| 10% increase in demand elasticity | - | 1,450 | 1,560 | 1,640 | 4,650 |
| ***Stamp duty at 15 per cent*** | | | | | |
| No behavioural change | - | 2,670 | 2,870 | 3,030 | 8,570 |
| 10% decrease in demand elasticity | - | 1,340 | 1,440 | 1,520 | 4,300 |
| **Assumption used in costing** | **-** | **1,190** | **1,280** | **1,350** | **3,820** |
| 10% increase in demand elasticity | - | 1,050 | 1,120 | 1,180 | 3,350 |
| ***Stamp duty at 20 per cent*** | | | | | |
| No behavioural change | - | 3,560 | 3,830 | 4,050 | 11,440 |
| 10% decrease in demand elasticity | - | 1,200 | 1,280 | 1,350 | 3,830 |
| **Assumption used in costing** | **-** | **940** | **990** | **1,040** | **2,970** |
| 10% increase in demand elasticity | - | 670 | 710 | 740 | 2,120 |

(a) A positive number for the underlying cash and fiscal balances indicates an increase in receipts/revenue