PROPERTY COUNCIL of Australia

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Senate Standing Committees on Economics
PO Box 6100
Parliament House
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By email: economics.sen@aph.gov.au

Dear Chair,

Inquiry into Australia's Taxation System

The Property Council of Australia (the Property Council) welcomes the opportunity to respond to the Committee's inquiry (the inquiry) into Australia's Taxation System.

The Property Council is the peak body for owners and investors in Australia's $670 billion property industry. We represent owners, fund managers, superannuation trusts, developers, and investors across all four quadrants of property investments: debt, equity, public and private.

The property industry is the country's second largest employer, representing a direct gross domestic product (GDP) contribution of $232 billion, or 10.6 per cent of total GDP, as well as 18.2 per cent of total tax revenues totalling $129.6 billion.

Our industry is particularly sensitive to changes in the taxation settings at all levels of government, as they have a direct correlation to attractiveness to invest, the value of property and the liquidity of the market. These factors have a knock-on effect including the value, the volume and the frequency of transactions which take place across the spectrum of residential and commercial assets.

With an economy in transition, anaemic productivity growth and long-term fiscal pressures, it is more urgent than ever that Australia adopts a tax system which facilitates growth and investment additionally, Australian families are labouring under a great housing affordability burden. investment which drives supply. We should not miss the opportunity to address this issue of fundamental fairness and make housing more attractive for greater investment which in turn makes homes affordable for all Australians through additional investment which drives supply.

The property industry is the nation's largest collective taxpayer, contributing around $130 billion across the three tiers of government. Property accounts for over 18 per cent of Australia's total tax take, compared to an OECD average of just five per cent. This submission offers a suite of recommendations that we believe support a fundamental objective of tax reform that will grow the economy.

To do this, it requires reshaping Australia's tax mix to remove our most distorting taxes. The Federal Treasury itself identifies stamp duty as the tax with the highest "cost to living standards and economic growth"[1].

Stamp duty distorts business decisions, locks families out of housing choices, worsens housing affordability, suppresses economic activity and leaves governments with highly volatile revenue streams. It is a tax that is a relic from our colonial past, representing a stamp of the state's authority over property transaction that has no economic relevance in modern Australia. Moreover, stamp duty and the reporting of it is significantly and negatively impacting Super Fund Investment into the real estate asset class.

This submission highlights the opportunities within the economy by reviewing and replacing taxes that add little and detract a lot, like stamp duty with more efficient revenue sources. This submission looks holistically at the taxation system, which will require the close cooperation of federal, state and territory governments if there is to be solutions. The Property Council looks forward to working with Australia's governments to promote prosperity and fairness in our tax system.

A Call for Change

The economic environment in which our tax system operates has changed dramatically over the past 50 years. Over that period, Australia's overall tax mix is heavily weighted towards income taxes on individuals and corporates rather than taxes on consumption (such as the GST) and taxes on savings (such as superannuation). The unsustainability of the tax mix is demonstrated in the Institute for Management Development (IMD) World Competitiveness Report 2023 where out of 64 countries, Australia ranked 57th for individual tax burden and 56th for company tax burden and the IMF continually emphasises the need for structural reform that includes rebalancing the tax system towards more reliance on indirect taxes.[2]

Over the past two years, the government has focused on delivering policy decisions from the Federal Budgets. Many of these measures focus on tax integrity and transparency and tweaks to existing rules rather than setting the tone for more holistic tax reform. However, the short-term fiscal strength of recent budget outcomes masks the current trajectory of problematic and piecemeal law reform that builds on an already unsustainable tax system.

Since 2015, 32 of the 35 amendments to the corporate tax system have been integrity and disclosure measures. None have addressed any of the systemic issues identified in the previous two attempts at tax reform; the 2010 Henry Review and the 2015 Re:think Tax Discussion Paper.

Recommendation 1: The Government make the determination that housing is a critical requirement and that regulatory burdens need to be removed to deliver best outcomes for all Australian's.

[1] Enhancing our living standards through tax reform | Treasury.gov.au
[2] See IMF report on Australia: 2022 Article IV Consultation-Press Release; and Staff Report (imf.org) at pages 12 and 15

Addressing Economic Inequality

Taxation is a cornerstone of Australia's economy, funding essential services such as healthcare, education, and infrastructure (a competing asset class for real estate). However, the current taxation system is facing significant challenges that necessitate reform. These challenges include economic inequality, inefficiencies, and a rapidly changing global landscape. This submission offers options to ensure a fair, efficient, and sustainable system for all Australians.

Australia's tax system has increasingly come under scrutiny for contributing to economic inequality. The current tax system is often criticised for its complexity, leading to inefficiencies that can stifle economic growth. A convoluted system that places a heavy administrative burden on both taxpayers and government.

The global economy is evolving rapidly, through adapting to technological advancements and changes in work patterns, such as the rise of the gig economy, Australia can't be left behind. Our taxation framework needs to adapt to changes to capture new forms of income and ensure all entities contribute their fair share as an over reliance on a specific sector (i.e. property) prevents investment and fails Australians. Australia's long-term fiscal sustainability is crucial for maintaining public services and economic stability.

Foreign Investment

It is well known that foreign investment is crucial to Australia's prosperity and needs to remain a core part of the Government's economic policy and investment strategy. Since the establishment of the Foreign Investment Review Board (FIRB) in 1975, the foreign investment framework has been mostly successful in maintaining Australia's attractiveness as an investment destination while managing risks to the national interest. However, over the past several years Australia's reputation as a stable economy with low sovereign risk and a strong rules-based system that provides the opportunity to safely and consistently invest capital has waned.

Exemption certificate costs have increased and the benefits of them have declined. As we see our cities expand, land development is creeping further away from city centres and into what used to be farmland. As a result, household Australian brands with the backing of global capital have no choice but to look to developing greenfield regions. As farmland is not included within the scope of exemption certificates, applications for these opportunities are long and costly, therefore increasing the costs of the development, impacting the feasibility of the development in terms of jobs, revenue, housing and supporting infrastructure to the region.

Recommendation 2: Introduce a "trusted investor" scheme where global investors that have previously developed within Australia and are known to FIRB have a pre-approval to buy land and develop property in the cities around Australia.

Recommendation 3: Introduce a "concierge" service where large global repeat investors have a dedicated officer who knows the business, where capital is sourced and what projects they have completed to streamline the application process.

The Property Council notes the government's Budget announcement of "A Future Made in Australia", and in principle supports the intent. A Future Made in Australia is about creating new jobs and opportunities by securing Australia's place in a changing global economic and strategic landscape. However, the Property Council remains interested in the outcome with the legislation yet to be introduced. It is critical resourcing and support for FIRB is at the heart of the bill.

Thin Capitalisation

The new thin capitalisation rules have been subject to several iterations since they were announced in the 2022-23 Federal Budget with various consultation processes where the Property Council and other interested parties submitted suggestions for improving these rules. The new rules are highly detailed and technically complex and require careful application, adding time and costs to members to ensure compliance with the rules. This is exacerbated by the new thin cap rules applying to income years commencing on or after 1 July 2023, despite the legislation being passed on 9 May 2024 and still without sufficient guidance being issued. As such, there was not a great deal of time to consider the implications of these new rules before the end of the 2023/24 financial year.

The new debt deduction creation rules will now apply, they will require careful consideration of intra-group debt financing arrangements to determine whether the debt deductions associated with these arrangements will be deductible. This applies to both pre-existing and future arrangements.

Recommendation 3: That Treasury amend the legislation to introduce a “carve out” for the real estate sector, like in the US and UK that will allow for returns to stack up against our global competitors for capital allocations to deliver a greater flow of capital and more developments across Australia.

In the alternative, at a minimum, Recommendations 4A and 4B.

Recommendation 4A: The debt deduction creation rules should not apply to entirely onshore operations and financing arrangements. The broad application of the debt deduction creation rules mean that they capture commercial financing arrangements that are entirely with 100% commonly owned Australian entities with no offshore entities or operations.

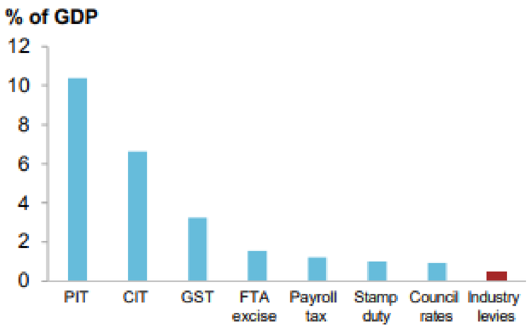
Recommendation 4B: The third-party debt test requirements present significant issues for typical third-party lending arrangements to access the test. Despite its stated aim, the current drafting of the third-party debt test does not allow debt deductions attributable to genuine third-party debt used to fund commercial activity in Australia to be deducted.

State Taxes

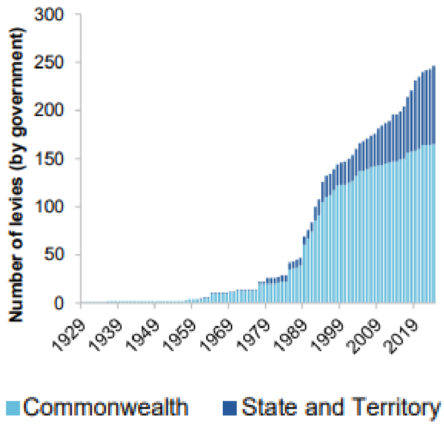
The Productivity Commission’s research paper on levies across the economy highlights the stranglehold taxes and charges are having on industry. In 1960, there were only four industry levies, by 1980 there were 26, today there are 248.[3] Levies now raise more than six times the revenue of tariffs and are imposed on a broader range of firms but have received much less policy attention. What commenced with agriculture has swollen to being imposed on a range of sectors including finance, energy, mining, construction, gambling, aviation, and manufacturing. No guidelines exist for assessing the policy value of individual industry levy proposals. Moreover, little is known about their collective impact on productivity growth, industry behaviour, and the Australian economy.

[3] See Productivity Report Towards Levyathan? Industry levies in Australia Research paper

The graph below[4] shows industry levies are the long tail within the long tail of taxes Revenue collected by select taxes in Australia as a % of GDP



The graph below[5] highlight the additional levies that state and territory governments place on industries and the increase over time.



Efficient tax systems are a key policy foundation for productivity growth. Policy measures that reduce the efficiency of the tax system can be expected to weigh on productivity growth over time. Industry levies generally appear to be at odds with the features of efficient tax system design. They are definitionally narrow in their application, often levied on inefficient tax bases, and can come with high collection costs.

Governments that wish to pursue equity goals through industry levies should do so with awareness of the potential costs to the efficiency, and equity, of Australia's tax and transfer system. Ensuring that certain conditions are met before proceeding with a proposed industry levy, or choosing to maintain an existing industry levy, will be important if industry levies are not to become a growing source of inefficiency in Australia's tax system.

The misalignment of Federal and State/Territory taxation policies play havoc with confidence in the property sector. For investment to be made, the investors need to know what it costs, what the return

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[4] Source: Commission estimates based on ABS (2023, Taxation Revenue, Australia, 2021-22, tables 1-10), Productivity Commission stocktake file (2023). FTA = Fuel, tobacco, and alcohol.

[5] Source: Productivity Commission stocktake file (2023)

will be, and the asset will retain and grow in value over the period to guarantee a buyer when they plan to exit.

Over the past few years there has been 17 new or increased taxes on property in Victoria. This erodes confidence in the market, a recent MSCI report on transaction volumes, highlights that out of 140 cities across the globe, Melbourne ranks 137th.[6] We include the Property Council of Australia Victoria Divisions submission on Inquiry into Land Transfer Duty Fees (Appendix A). Through Victoria's current tax system, property contributes almost 50 cents in every dollar of state government tax revenue.

The over reliance on property taxes is unsustainable, over time development and transactions will dry up and property values across the state will come under pressure. The over opportunity cost as an employer, investment opportunity for our superannuation funds and contributor to GDP will reverberate throughout the national economy.

Victoria is not along in the high taxing environment created for the property industry, we use it as an example, the Property Council of Australia's Queensland Division has also released a report into the harm of foreign surcharging on our industry. Time for a Fair Go – How un-Australian taxes are hurting Queenslanders (Appendix B) explores the impact of the Additional Foreign Acquirer Duty (AFAD) and Foreign Land Tax Surcharge (FLTS) on Queensland since its introduction in 2016.

Recommendation 5: Incentivise states and territories to remove counter-intuitive taxes and charges including Stamp Duty and foreign investor surcharges on residential and commercial property - which can add up to 8 per cent to the purchase price upfront and increase annual land taxes by a further 2 per cent.

The Property Council welcomes the opportunity to discuss this submission in more detail. Please contact Matthew Wales, Policy Manager at [redacted] to arrange a meeting.

Yours faithfully

[redacted]

Antony Knep
Executive Director – Capital Markets

[6] 2024 Trends to Watch in Real Assets, https://www.msci.com/www/blog-posts/2024-trends-to-watch-in-real/04261531542