LOCAL
GOVERNMENT
NSW

LGNSW Submission in Response to NSW Government Consultation Paper – *Buying in NSW, Building a Future*

(Proposed Property Tax, Land Tax and Stamp Duty Reforms)

March 2021

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Introduction

Local Government NSW (LGNSW) is the peak body for local government in NSW, representing NSW general purpose councils and related entities. LGNSW facilitates the development of an effective community-based system of local government in the State.

Local government is a major part of the NSW economy being responsible for the provision of a wide range of essential infrastructure and services. NSW local government is responsible for:

- Spending around $12 billion each year
- Managing and maintaining infrastructure and land assets worth $142 billion
- Employing around 60,000 people, with many of these jobs in rural and regional NSW, where councils are often the single largest employer and underpin the local economy

Local government is a partner of the State Government in the stewardship of the NSW economy and is a key stakeholder in fiscal reform.

LGNSW welcomes the opportunity to comment on the NSW Government Consultation Paper – *Buying in NSW, Building a Future.* LGNSW recognises that the Government's proposal to gradually replace stamp duties and the existing land tax with a new broad-based property tax is a bold reform with far reaching implications, including direct and indirect implications for councils. LGNSW therefore appreciated meeting with the Tax Reform Taskforce and is pleased to accept the invitation to be a member of the Taskforce.

LGNSW has provided comments on the Governments Tax Reform agenda during 2020. LGNSW made a submission in response to the draft report of the NSW Review of Federal Financial Relations (Thodey Review), and also presented comments on tax reform and related issues in our Pre-Budget Submission. Copies are attached.

This submission was endorsed by the LGNSW Board in April 2021.

General Comments

LGNSW commends the NSW Government for elevating tax reform on the economic agenda. LGNSW also acknowledges the economic arguments supporting the removal of stamp duties. However, we are disappointed that the tax reform agenda ignores taxes directly relating to local government. Local government is part of the taxation system of the State through its reliance on rates, a form of land tax, as its primary source of revenue. Local government is also impacted by the taxation and fiscal policies of the NSW and Australian Governments. State policies impacting on local government include rate pegging, the Emergency Services Levy (ESL) on local government, the system of rate exemptions and land valuation methodology.

The pre-eminent challenge facing NSW local government is financial sustainability. Therefore, LGNSW's highest tax reform priorities on behalf of the sector are:

- the removal of rate pegging; and
- in the context of property tax, the replacement of the Emergency Services Levy (ESL) on both councils and insurance policies with a broad-based property levy (or tax).

While the Independent Pricing and Regulatory Tribunal (IPART) was commissioned to undertake a Review of the NSW Local Government Rating System in 2015, the terms of reference specifically excluded rate pegging – a major omission given that rate pegging is a key element of the NSW rating system and a major obstacle to financial sustainability.

LGNSW strongly recommends that the NSW Government's tax reform agenda extend to include:

- the removal of rate pegging and other rating reforms recommended by IPART.
- the removal of the ESL on local government and insurance policies.

End Rate Pegging

NSW has experienced rate pegging for over 40 years now, having been introduced in 1976/77. Local government has strongly opposed the policy since its inception. Rates are considered to be an equitable and efficient form of taxation (e.g. by Productivity Commission and Henry Review of Taxation).

However, LGNSW firmly maintains that rate pegging is unnecessary, results in unintended harmful consequences and should be abolished. The case for the removal of rate pegging is strong:

- Rate pegging has been made redundant/obsolete by the implementation of Integrated Planning & Reporting under the *Local Government Act 1993.* (Community Strategic Plan, Long Term Financial Plan, Resourcing strategies etc).
- The NSW Treasury Corporation's assessment of the financial sustainability of NSW councils undertaken in 2013 indicates that existing revenue restrictions (including rate pegging), severely hamper councils' ability to fund current, let alone future, levels of service.
- The NSW Independent Local Government Review Panel in its 2013 Final Report found there was mounting evidence that around a third of all NSW councils suffer from weak revenues and infrastructure backlogs and connected this with rate capping. According to the Review Panel, over the period 2001/02 to 2010/11, growth in total revenue of NSW councils was 5.7% per annum, compared to an average of 8.0% for the other mainland states, pointing to "revenue foregone" in rates of well over $1 billion over that period.
- Rate pegging leads councils to impose higher user-pays charges which could result in pricing inequities.
- Rate pegging increases reliance on infrastructure contributions creating property market distortions.
- Rate pegging distorts the operation of a land valuation-based rating system. Valuations do not raise net revenue but merely redistribute the rate burden within a council area.
- Councils are democratically accountable, and this keeps rates in check.
- Historical experience of other jurisdictions without rate pegging has shown that rates did not blow out.
- Rate pegging distorts the operation of the rating system and produces negative consequences, including the direct and indirect suppression of the rating effort.

In the long run, rate pegging in NSW has resulted in:

- Under-provision of community infrastructure and services.
- The deferral of infrastructure maintenance and renewal expenditure resulting in massive infrastructure backlog.
- Undermining the financial sustainability of councils.

The NSW Productivity Commission Review of Infrastructure Contributions has also recommended reform of rate pegging. The final report includes the key finding that local government is constrained in its ability to service growing communities due to the long-standing practice of rate pegging. Currently, the formula does not allow councils to increase their rates revenue with population. This has resulted in declining per capita revenue for high growth councils and is a disincentive for councils to accept development. LGNSW notes that the NSW Government has announced its intention to implement the Productivity Commission's recommendation to amend the rate peg to allow councils' general income to increase with population.

The NSW Productivity Commission also confirmed that NSW has the lowest per capita rates as the result of rate pegging and estimated that NSW rates are around 30% below the national average. This has inarguably had a negative impact on the provision of local infrastructure and services in NSW and continues to undermine the financial sustainability of NSW councils.

Business and professional advocacy groups have also been recently calling on the NSW Government to abolish rate pegging as part of the government's post-pandemic recovery plan for the state. The Committee for Sydney and the Sydney and Western Sydney Business chambers say rate pegging should be removed so struggling councils can maintain staff levels, provide essential services and invest in infrastructure.The Planning Institute of Australia supports the removal of rate pegging.

Replace the Emergency Services Levy (ESL)

The disastrous Black Summer bushfire season renews the focus on the funding model for emergency services in NSW (RFS, FRNSW and the SES). It highlights the need for the emergency services to have a strong funding base, but it has also highlighted the need for the funding model to be equitable, transparent, accountable and sustainable.

LGNSW welcomed the Thodey Review's recommendation that the ESL on insurance policies be removed and replaced with a broad-based land tax. LGNSW has long advocated for this. We endorse the arguments that it is inequitable, lacks transparency and distorts the operation of the NSW insurance market. When combined with the cascading effect of the additional taxes - Stamp Duty and GST - that are applied on top of the combined value of the insurance premium and the ESL, insurance can become prohibitively expensive. This has no doubt contributed to higher incidences of underinsurance and non-insurance in NSW. It also distorts the taxation system as these are literally taxes on top of taxes which challenge taxation principles and clouds transparency.

LGNSW is disappointed however that the Review has failed to identify and address the ESL that applies to local government. Local government is required to fund 11.7% of the combined budgets of the RFS, FRNSW and the SES. LGNSW maintains that this is also a distortionary tax that lacks equity and transparency.

The ESL on local councils is inequitable as it does not apply consistently or equitably across all councils. While the levy is now collected centrally through Revenue NSW, each of the services have different budgetary structures and cost allocation mechanisms. There are different regional structures and allocations are variously based on land valuation and/or population. This complex budgetary process is largely incomprehensible to councils and the general public. Apart from the obvious lack of transparency in the budgetary process one of the consequences is that that the cost burden occurs disproportionately across councils and therefore ratepayers. The cost burden on councils is greatest on rural and regional councils with small rate bases and a relatively large RFS component.

For example, the 2.6% rate peg will provide an additional $120,000 in revenue to Tenterfield Shire Council in 2020/21 but $81,000 of the increase will be consumed by the increase in ESL. Leaving little to offset increases in other expenses. This is a common result, particularly among rural and regional councils with small rate bases and high RFS costs.

Upper Lachlan Shire is facing an increase in ESL contributions of $333,000 per annum. The total revenue increase under their 2% rate cap is only $153,000 per annum. The ESL will exceed the increase in general income by more than double (118%). There will simply not be enough funds to cover the ESL even before other necessary costs are covered. The increase in the ESL is likely have devastating consequences for the council including its capacity to maintain essential operations and services.

This situation is not financially sustainable for councils. The ongoing erosion of the revenue base of councils cannot be allowed to continue. Many councils have already been pushed into deficit by the ESL Several will find themselves in serious financial difficulty if the current funding arrangements continue.

The State Government implicitly recognised the impact of the ESL by providing councils by providing rebates to assist councils with large increases in 2019/20 and 2020/21, however, we have been advised that these one-off rebates will not be continued. It should be noted that the increases in those years will form part of the cost base for future years which will have to be fully met by councils.

The ESL on local government also lacks transparency as it is invisible to ratepayers. The levy is not calculated for individual properties but like other council expenses, is embedded in general rates. Ratepayers are not able to identify their contribution to the funding of the emergency services and are generally not aware. Given that the majority of ratepayers are insured they are effectively being double taxed.

The ESL on councils, like the ESL and associated GST and stamp duty on insurance policies, are part of the same hidden tax regime. Ratepayers and the insured are largely unaware of the levies they are paying. There is also a concern that the lack of transparency combined with the fact that the ESL on both insurance and local government funds 85.4% of the emergency services budget, may have enabled the emergency services to avoid the same budgetary scrutiny and accountability that other agencies are subject to.

These views have been supported by numerous inquiries and reviews of fire and emergency services funding over decades. Most notably this includes 2009 Victorian Bushfires Royal Commission which concluded that the lack of equity and transparency in the current arrangements (the Victorian model was similar to the current NSW model) amounts to a good reason for moving to another system and consequently made the recommendation that:
The State replace the Fire Services Levy with a property-based levy and introduce concessions for low-income earners. (Recommendation 64).

Victoria has since introduced a broad-based property tax to fund their fire services. NSW is now the only mainland state that does not fund its fire services by a broad-based property levy. Other states had already introduced variations on this model - Queensland (1985), South Australia (1999), Western Australia (2003) and the ACT (2006–07).

All these States removed levies on local government when introducing the new funding models.

A property-based levy would ensure that all property owners finance the services in an equitable manner; not only owners that are insured. The levy should be based on the rateable value of each property and, for reasons of administrative simplicity, collected by Revenue NSW.

NSW was heading in this direction with the proposed introduction of the Fire and Emergency Services Levy (FESL) in 2017. However, the NSW Government made a last-minute decision to defer the implementation FESL indefinitely. This was despite the new system being fully operational.

LGNSW recommends that the NSW Government use the new property tax to replace the ESL on both local government and insurance policies.

Specific Comments on Proposed Tax Reforms

- LGNSW acknowledges the economic arguments supporting the removal of stamp duties. LGNSW maintains that replacing the ESL with a broad-based property tax is a higher priority tax reform than replacement of stamp duties and the existing land tax. The ESL situation is unsustainable and needs to be urgently addressed.

- LGNSW is firmly of the view that the proposed property tax should be collected by Revenue NSW or through Service NSW as an agent of Revenue NSW. This is to ensure that the new tax is clearly identified as a state government initiative and not part of council rates. It is important to avoid potential confusion. As Revenue NSW already collects the current land tax and has access to the same property and valuation data as councils, this is not a major step up. LGNSW welcomes the Tax Reform Taskforce assurance that the tax will be collected by Revenue NSW.

- Collection by Revenue NSW will also protect councils from the costs and administrative burdens associated with the new property tax, including the need to handle queries and complaints about the tax. However, LGNSW does expect that the initial confusion around introduction of the property tax and the similarity to council rates will result in many queries being received by councils. It will be vital that information is disseminated to councillors and council staff so that they are equipped to deal with initial inquiries and redirect them if needed. LGNSW will be pleased to assist the Tax Reform Taskforce with this.

- In welcoming the assurance that councils will not be required to collect the new property tax, LGNSW also seeks assurance that the Government does not have plans to bundle council rates with the property tax, for collection by Revenue NSW. It is imperative that councils retain the rate collection function.

- Councils are also concerned that the property tax could reduce the capacity and willingness of property owners to pay increases in council rates. The proposed property tax on a property with a modest UCV of $500,000 will be $2,000 per annum, nearly double the typical rates bill on a Sydney residential property of around $1,100 per annum. Property tax on a residential property valued at $ 750,000 will be $2,750 per annum. Despite separate collection arrangements, it is likely that many property owners will still conflate the property tax with council rates. It is also likely that many will quickly forget the stamp duty costs they have avoided by opting for the property tax and simply focus on their cumulative property tax and council rates. There are reports that there has been a push back on rates in the ACT where the government has been phasing in a land/property tax to replace stamp duties for some years.

- The Consultation Paper indicates the ad valorum component of the proposed property tax will grow in direct proportion with land values. This will result in significant growth over time and property tax windfalls for the State Government during property booms. This will further exacerbate the crowding effect on council rates, particularly where councils need to seek increases above the peg via the Special Rate Variation process. It also conflicts with the imposition of rate pegging on councils. LGNSW cannot accept unfettered growth in the property tax while rates remain pegged and potentially subject to pushback. Even with rate pegging removed, council rates would not increase in proportion to increases in land values. The Integrated Planning and Reporting Framework requires councils to determine rate paths in consultation with their communities.

- Local government also seeks clarification on whether the property tax will apply to councils in any way. The consultation paper does not provide this level of detail and representatives of the Tax Reform Taskforce were unable to provide this information. It is vital to local government that councils are not burdened with any additional tax liabilities as a result of the proposed tax reform. This would further impact on financial sustainability. Councils are currently exempt from taxes and stamp duties.

- Local government needs to be closely consulted in developing the debt recovery and hard ship policies and processes associated with the proposed property tax. Given that this is a broad-based tax there is likely to be a higher level of hardship and default than occurs with stamp duties and the current land tax. There is also much more likelihood that property tax defaults will coincide with rate defaults. Councils are concerned about the prioritisation of debts in the debt recovery process and potential coordination of hardship assistance and debt recovery actions

- The property tax will represent a large and growing burden on property owners, particularly those on low and fixed incomes such as pensioners. LGNSW would expect that the NSW Government would accompany the property tax with a system of pensioner rate rebates.

Conclusion

LGNSW calls on the NSW Government to prioritise removal of the ESL with the introduction of the new property tax. This may mean the removal of stamp duties and land tax need to be deferred or made incrementally as the property tax revenue grows. The removal of the ESL from both insurance policies and council would be a major reform that would provide transparency and eliminate the distortions, inequities and inefficiencies that currently prevail. This long overdue tax reform would bring NSW into line with other states. It would also make a significant contribution to the financial sustainability of councils and is essential for rural and regional councils.

Removal of rate pegging is also imperative for building the financial sustainability of councils and can be achieved without directly affecting the property tax related reforms. This in itself would be a major tax reform and eliminate the discrepancy that exists between rates and State Government land and property taxes.

As any reforms to land and property taxes will impact councils directly or indirectly, it is important that local government is closely engaged in the development of related policies and processes. A number of such issues have been referred to above and include the need to educate councillors and council staff on the tax reforms. LGNSW will assist in dissemination of information.

LGNSW therefore welcomes the invitation to take part in the Tax Reform Taskforce. LGNSW also recommends that the Treasury Taskforce broaden local government engagement with the use of working groups, particularly where technical expertise is required. The Local Government Revenue Professionals Association for example, is one source of that expertise.

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