

2.2.1 NEW SOUTH WALES TAXES ON IMMOVABLE PROPERTY COMPARED TO HOUSEHOLD INCOME

Long term data on Gross State Product (GSP) is not available for NSW or the other states but for the period 1975/6 to 1986/7 NSW taxes on immovable property have shown a steady increase with GSP - Figure 3 - Appendix B.

The only available long term measure of wealth for the states is Household Income. Table 2 below compares taxes on immovable property against Household Income in NSW for the period 1969 to 1986:

TABLE 2

HOUSEHOLD INCOME AND TAX ON IMMOVABLE PROPERTY
NSW 1969/70 - 1986/7 .

\$'000,000

YEAR	HOUSEHOLD INCOME	TAX ON IMMOVABLE PROPERTY	2/1 %
	1	2	3
69-70	9012	159	1.76
70-71	10198	169	1.66
71-72	11414	178	1.56
72-73	13041	189	1.45
73-74	15889	210	1.32
74-75	19348	269	1.39
75-76	22548	358	1.59
76-77	25779	432	1.68
77-78	28478	447	1.57
78-79	31987	473	1.48
79-80	36080	512	1.42
80-81	41103	559	1.36
81-82	47595	632	1.33
82-83	51771	729	1.41
83-84	56519	801	1.42
84-85	62080	869	1.40
85-86	69141	946	1.37
86-87	76022	1023	1.35
		MEAN:	1.47
		STANDARD DEVIATION:	0.13

SOURCE: Australian Bureau of Statistics
National Accounts #5204

Table 2 shows a gradual decrease in the ratio of taxes on immovable property against household income over this period. The ratio of 1.35 % in 1986/7 is well below the mean ratio of 1.47 % over the period. This data will be analysed for buoyancy in Hypothesis 4 (Chapter 7).

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will often directly affect him.

Because the tax expenditure is "visible" the taxpayer has a better understanding of the tax system and this encourages greater voluntary compliance.

4.14 TAX EVASION

Tax evasion is the illegal non payment of taxes while tax avoidan is the attempt to reduce taxes through legal means. This paper is only concerned with tax evasion as the degree of tax avoidance allowed is a political question.

Income tax evasion is much higher as a proportion of total tax revenue than evasion of the property tax. It is very difficult to estimate how much income tax is being evaded in Australia.

The Tax Office estimated that for the period 1984-5, income tax evasion might involve a revenue loss of at least A\$ 3 billion per annum and of this amount nearly half was the understatement of business income - Australian Government, 1985, 36 - 37. This represents 1.27 % of 1984/5's GDP.

However, Norman estimated the real hidden economy to be about 6.00 % of GDP in 1981/2 and Fisher using a different method showed about 5.00 % of GDP in 1980/1 - Fisher, 1982 and Norman,

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1982. Assuming an average tax rate of 30.0 % the evaded tax would be 1.80 % and 1.50 % respectively.

4.15 EQUITY OF INCOME TAX

A supplementary tax to the income tax is required for the better taxing of wealth. In this study the property tax is considered to be the best supplementary tax.

"An excessively complex tax structure, on the other hand, leads to lawful tax avoidance (some taxpayers adapt their activities to minimize liabilities) as well as illegal evasion, which in turn undermines equity. Tax policy, therefore, is an art no less than a science; and equity is to be sought as a matter of degree, rather than as an absolute norm." - Musgrave and Musgrave, 250.

Based on the comparatively high levels of evasion income tax is a much less equitable tax than the property tax.

Opportunities for income tax avoidance and evasion are more accessible to relatively wealthy people. They are mainly recipients of non wage and salary incomes as the burden of personal tax tends to fall most heavily on wage and salary earners. As a result the effective progressivity of the income tax system has been reduced and public dissatisfaction with the

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tax - this is illustrated in Musgrave and Musgrave, 305.

5.1.3 OTHER CHOICES

A similar analysis applies to the choice between goods and leisure and between present and future consumption. The burden is smaller the less elastic is the supply schedule or the future consumption schedule. The obvious advantage of the property tax is the inelastic supply schedule.

5.2 MAXIMUM YIELD AND EFFICIENCY COST

As the rate of taxation increases the efficiency cost or excess burden also rises but revenue may not follow suit. Therefore, it cannot be assumed that by setting a higher rate there will be an indefinite increase in revenue. There is a rate level at which yield is at a maximum so that a further increase in rates would be counterproductive.

An efficient tax system is one which obtains the needed revenue with a combination of taxes such that the marginal dollar derived from each tax imposes the same efficiency cost. Depending on the elasticities involved this will leave the optimal rates of various taxes falling short of maximum yield to varying degrees.

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5.3 GENERAL EQUILIBRIUM VIEW

The above discussion of excess burden was viewed in terms of loss of consumer surplus or of "rent" received by the worker or saver. However, this suffers from being a partial equilibrium approach and a more general view is helpful.

5.3.1 CONDITIONS OF ECONOMIC EFFICIENCY

An arrangement is efficient if resources are used in a way which does not leave a possibility of alternative arrangements under which somebody could be better off without anyone being worse off. This would involve a choice between:

1. The Marginal Rate of Substitution (MRS)

The MRS of X for Z is equal to the amount of Z which the consumer is willing to surrender for an additional amount of X.

2. The Marginal Rate of Transformation (MRT)

The MRT of X for Z is the amount by which the output of Z must be cut to produce an additional unit of X.

The MRS of any two products in consumption should be equal to their marginal rate of transformation (MRT) in production. Such

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will be the case in a competitive market where both rates are equal to the price ratio for the two products.

3. MRS of Leisure for Goods (As an expressing Workers' preferences).

The MRS of leisure for goods should equal the MRT of leisure into goods (via work effort) with both rates in a competitive system equal to the wage rate.

4. MRS of Future for Present Consumption (as valued by consumers or savers).

This should equal the MRT of present into future goods in production.

Whenever the above measures are not met economic welfare can be improved by rearrangements designed to move toward it.

The cause of excess burden may be viewed in terms of interference to the above. For example, selective excises interfere with 1, a general consumption tax with 3 and a general income tax with 2 and 3 - Musgrave and Musgrave, 309.

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5.3.2 CHOICE AMONG PRODUCTS

A selective tax has in addition to a "substitution effect" or replacement of X by Z will cause a relative price change.

The subsequent excess burden will occur with the selective tax only.

5.3.3 OTHER CHOICES

The tax effects on the choice between consumption and saving and between goods and leisure are as follows:

1. If a general consumption tax is imposed becomes neutral and equivalent in its excess burden aspects to a lump sum tax.
2. An income tax however, discriminates against the saver and in favour of the consumer and an excess burden results.
3. Inefficiency results.

5.4 MULTIPLE CHOICES

To arrive at a more realistic view assume that the various choices are available at the same time. This changes the picture.

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The conclusion is that no hard and fast rules can be drawn. The "optimal mix" of commodity taxes, defined as that which minimizes excess burden would comprise a complex set of taxes and rates and even then the outcome would be second best to a hypothetical tax under which leisure could be included in the base.

5.5 PROGRESSIVE RATES AND SUBSTITUTION EFFECT

There should be a distinction between a tax's substitution effect and its income effect. As an income tax is imposed the cost of goods in terms of leisure is increased and the taxpayer therefore, will substitute leisure for goods. This is the substitution effect.

However, the taxpayer is left poorer and therefore, will work harder so as to spread the loss between reduced consumption of both goods and leisure. This is the income effect.

The two effects work in opposite directions so that the net effect may be to lower or raise hours worked. However, what matters for purposes of excess burden is the distortion caused by the substitution effect only.

The level of work effort will be lower and the excess burden higher if the taxpayer is asked to pay the same amount under a

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progressive tax than under a proportional tax. This is because the income effect will be the same in both cases whereas the substitution effect which depends on the marginal rate of tax and will be higher under the progressive schedule.

5.6 OPTIMAL TAX RATES

A more progressive tax rate has the disadvantage of calling for higher marginal rates of tax thereby, imposing a heavier excess burden. However it has the advantage, in meeting the ability to pay criteria better. An optimal rate schedule essentially is to balance these two factors at the margin thereby minimizing the total burden.

5.7 TAX DISTORTIONS IN PRODUCTION

Another criteria for efficient resource use is that whatever is produced should be produced in the least costly way. Taxes may be a further cause of inefficiency by interfering with this requirement.

5.8 DISTORTIONS WITH THE INCOME TAX

1. A Corporation Tax on Capital Income originating in a Particular Sector of Industry Alone.

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Leads to a reallocation of capital from the taxed to tax free industries. Continues assuming flexible markets, until net rates of return in the 2 sectors are equalized.

In the process output in the taxed sector is reduced while that in the tax free sectors increase giving rise consumption distortion.

In addition however, taxed industries will have become less capital intensive while production in the tax free industries will have become more capital intensive thus introducing a distortion in the method of production and a resulting efficiency loss which adds to that imposed by changing the output mix.

Thus if both capital and labour employed in a particular industry were taxed equally this distortion in production would be avoided.

2. Depreciation Rules for the determination of Taxable Income may Interfere with the choice between short and long lived capital assets.

A neutral policy would apply so called economic depreciation where the amounts of depreciation allowed each year = the reduction in the present value of the future income stream during the year. If depreciation is faster the present value of the tax

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is reduced. This reduction is greater for long lived assets so that rapid depreciation favours the acquisition of such assets relative to short lived ones.

Therefore, there will be a bias in technology toward the use of such assets in lieu of assets with shorter lives.

3. Special Treatment Given to Certain Industries

Lowers the tax burden on such industries relative to that imposed on others. It tends to induce overinvestment in that industry.

4. Preferential Treatment of Capital Gains

Offers an inducement for investment in those assets the income from which may be obtained in the form of capital gains.

5. Determination of taxable income permits deduction of interest payments on business debt as a cost of doing business.

Yet no deduction for imputed interest is permitted for the case of equity finance. As a result the corporation tax gives an incentive to use debt rather than equity finance, which may impose an efficiency cost.

6. Deductibility of expense accounts may distort business

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expenditures.

Entertainment outlays are chargeable as costs to the corporation but are not counted as income to the management on its income tax. Thereby, such expenses are encouraged and various (though unsuccessful) attempts have been made at limiting their deductibility under the corporation tax.

5.9 INTERJURISDICTIONAL DIFFERENTIALS

Arises from the effects of tax differentials on product and factor movements between tax jurisdictions.

5.9.1 EFFECTS ON PRODUCT FLOWS

Before a tax local government area A has a comparative advantage in producing producing X while local government area Y has an advantage in producing product Z. As a result A will produce X and export it to B while B will produce Z and export it to A.

However, A imposes a tax which increases the cost of producing X and as a result its comparative advantage is lost. B may find it no longer worthwhile to import from A and trade flows will be distorted.

In practice property tax differentials are very small.

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The disastrous effect of exemptions and allowances is shown in the USA where the numerous deductions, and exemptions has almost completely destroyed any pretence the system may have had towards being an equitable property tax system.

The shortfall in revenue is made up by those who can ill afford property tax increases so that a backlash can occur against the system similar to that in California with the implementation of Proposition 13.

Balk examined the free listin America and concluded that any benefits given to a taxpayer are far outweighed by the disadvantages;

"Such a study could demonstrate empirically the dollar value to the city of the benefits provided by the tax exempt group and contrast this with the tax loss. This would provide vivid proof of the burden inflicted" - Balk, 239.

According to Larson and Lowell exempt real property in the USA rose from 4.6% of all real property in 1880 to 32.6% in 1968. A large part of the increase was for church related lands - Larson & Lowell, 1969, 36.

According to Balk in Buffalo, New York in 1969 32.6% of all real

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property was tax exempt and in Washington it was 54.9% - Balk, 239, 252.

In America the use of circuit breakers which were originally designed to provide relief to the poor and elderly in a number of states has been extended to provide property tax exemption to most of the population. It often now includes non elderly as well as elderly, renters as well as homeowners, and middle income earners as well as poor people - Peterson, 1976, 102.

Some governments reimburse councils for lost rate revenue on government lands. This could be incorporated in a loans formula when determining the amount of loans to local government provided by the central government.

This is better and more equitable method as it does not penalise those local government areas which have a relatively large number of government buildings.

The Victorian Committee of Inquiry had this to say about property tax exemptions:

"(f) It seems to the Committee that there are 3 principal categories of general irritation which emerges from the evidence. First, there is the growing practice of governments -both Commonwealth and State -to enter the field of commercial type

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activity by setting up statutory authorities, boards, commissions and trusts of various types to carry out certain functions akin to those which are or could be carried out by private enterprise. Second, there is the extended definition of "charitable" which obviously has been most unwelcome from the municipal quarter. Third, the councils take exception to the inclusion of properties used as residences within the exemptions, whether they be for ministers of religion, hospital staff, school masters, or for persons who may be construed as having some 'incidental responsibility' by reasons of the dwelling being in the proximity of a post office, bank, etc" - Report of the Statute Law Revision Committee on Property Exempted from Municipal Rating, 1967, Victoria, para 116.

The equivalent Victorian legislation is better in that it requires exempt land which is transferred to be liable for five years of back rates. For example, previously exempt church land which is sold for a commercial land use.

6.4⁵ CONCLUSION

The NSW property tax system use of allowances, and delay of value increases does tend to destroy the equity of the system. The use of circuit breakers can be justified on equity grounds when the taxpayer cannot afford to pay the increase. However, if the taxpayer is reasonably wealthy and can afford to pay the increase

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inequity results and the allowance encourages speculation.

Therefore, the taxpayer should be mean tested.

Otherwise, there should be no exemptions from a property tax as this tends to destroy the tax ideal of universality and leads to inequities.

Where tax exemptions are granted to non profit organizations such as charities the Victorian system should be adopted under which back taxes are paid upon the sale of the land.

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CHAPTER SEVEN

HYPOTHESIS 4: THE NSW PROPERTY TAX FACILITATES THE STATE'S FISCAL POLICIES

7.1 INTRODUCTION

There is a clear distinction between taxes used at the various levels of government in Australia. At the Federal level the income tax dominates the taxes used, at the state level various duties and charges are the main source of income while the property tax is the main tax, and at local level the property tax is the most important single revenue raiser.

The property tax facilitates the state's fiscal policies because:

1. It is a buoyant tax
2. It complements other taxes.

7.2 BUOYANCY

The advantages of a highly buoyant tax are more apparent to government than the taxpayer because governments can use such a tax to impose "hidden" tax increases. On the other hand the use of a less buoyant tax requires the taxing authority to publicly

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revenue appears to be growing at a faster rate than the economy of the state so that the state government does not have to constantly make adjustments to the tax rate. If the x coefficient is equal to or greater than 1.00 the tax is said to be a buoyant tax.

R squared provides an estimate of association between the tax and GSP. Perfect association is achieved with a R squared of 1.00.

The study was based on data of state tax revenue for the period 1977/8 to 1986/7. The actual tax revenue was adjusted to remove the effects of changes in tax rates or the tax base. The adjusted tax revenue was converted to a per capita base and presented as an index with 1977/78 as 100.00. The indexes of per capita tax revenue were then regressed against per capita GSP using the log form:

$$\log Y = a + b \log X$$

where Y = tax revenue and X = GSP.

- NSW Task Force Report, 110 - 113.

The results show that the various taxes have a very close association with GSP, and CPI. Payroll tax, gambling, alcohol, stamp duties and tobacco taxes showed a very high correlation,

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all being above 0.90. Although comparatively low, land tax shows a strong association with GSP with a R squared of 0.77.

A better measure for buoyancy is the x coefficient. This shows that all taxes have grown faster than GSP except tobacco and alcohol taxes. Land tax is shows a high buoyancy with an x coefficient of 1.12 against GSP and 1.23 against the Sydney CPI.

The study stresses that the high associations and buoyancies are achieved on a long term basis - 115.

Using the changes in elasticity per year the study found that land tax had the highest association with GSP with a R squared of 0.50. Therefore, land tax has shown a more reliable association with GSP for any one year - NSW Task Force Report, Table 8.2, 116 - 177.

One problem with the data used in the Task Forces's report is that the nine years time frame may be too short for land tax data when land values tend towards periodic cycles. Daly in his research on Sydney land values found the cycle period to be about five to six years - Daly, 1982, 148.

Instead, using the data in Tables 1 and 2 income tax and property taxes for Australia were separately regressed against Gross Domestic Product for the period 1969/70 to 1986/87 and taxes on

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immovable property were regressed against household income for NSW. Gross State Product is not available for this length of period. A log/log function was used. The results were:

TABLE 7

Income Tax against Gross Domestic Product Australia
1969/70 - 1986/87:

R squared	0.9967
x coefficient	1.1353
standard error	0.0163

Property taxes against Gross Domestic Product Australia
1969/70 -1986/87:

R squared	0.9923
x coefficient	1.1542
standard error	0.0255

Taxes on immovable property against Household Income
NSW 1969/70 - 1986/87:

R squared	0.9888
x coefficient	0.9195
standard error	0.0244

7.3 COMPLEMENTS OTHER TAXES

In NSW the main objective of a property tax system is to raise revenue for local government:

"7.3 The only purpose of fixing valuations for individual properties is to determine the share of the total revenue burden which each owner will bear. The sum of the individual values is not especially significant in relation to a State or local

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government revenue-raising decision, although it may influence the government's judgment about the capacity of landowners to pay taxes. After a general revaluation increases property values in an area, the council usually reduces its rate in the dollar so as to yield total revenues which may be only marginally greater than those obtained in the previous year, when a higher rate was applied to lower values" - NSW Royal Commission, 1967, 76.

The land tax system should be seen as part of a "basket of taxes". In this context it is most important because it taxes a large part of the avoided income tax. Each tax has its own unique advantages and disadvantages and the combination of a number of taxes will tax most of the taxable income or wealth that a single tax will miss.

In Australia, New Zealand, United Kingdom, Ireland, USA, and the Netherlands property taxes dominate local revenue. The property tax in Australia as a ratio of gross domestic product has remained relatively constant at about 1.4 % over the last 6 years - Table 1, Figure 2 - Appendix B.

"If income tax cannot be accepted as the sole source of revenue, it is necessary to look at the attributes of the property tax and its ability to 'sop up' or bridge the gap between tax avoidance and the wealthy owners of real estate" - McGlade, 1985, 481.

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"Property taxes can be an efficient and administratively simple mechanism both for generating public revenues and for correcting gross inequalities in income distribution" - Todaro, 1987, 511.

Since estate and gift duties were abolished during the second half of the 1970s the property tax is the only direct tax on wealth in assets. Using property taxation in the form of state and local government taxes Australia raises a high proportion of tax from wealth that is, by taxing both property and income.

7.4 CONCLUSION

Therefore, from the data available, taxes on immovable property generally have been as buoyant as the income tax in NSW with the exception of taxes on immovable property against household income which is a little below unity. Further, taxes on immovable property for NSW have shown a high association with GDP, Household Income and Gross National Product respectively.

Property taxes are an important part of the "basket of taxes" in Australia and at state and local levels complement the Federal government's large collection of revenue through the income tax.

It is also an important tax as it is the only tax which directly taxes wealth in assets.

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CHAPTER 8

HYPOTHESIS 5: THE NSW PROPERTY TAX SYSTEM IS FAIRLY ADMINISTERED AND EASILY UNDERSTOOD BY THE TAXPAYER.

8.1 THE PROPERTY TAX IS A SIMPLE CONCEPT

The use of a simple gross income base for the assessment of income tax would most likely be readily understood by the layman. However, the income tax act in Australia has become so complex with special and general allowable deductions that a skilled person is necessary for all than the most simple tax assessments.

Therefore, a hidden cost of the income tax system is the cost of engaging experts to prepare the assessment, loss to the government for underassessments, and loss to the taxpayer for overassessments. The incorrect assessment is often unintentional and caused solely, by the complexity of the tax legislation.

On the other hand the assessment of the value of taxpayers' property is carried out by a trained valuer. The cost of the valuer is spread over the total number of assessments within the local government area and particularly if land values are used, lends itself to economies of scale.

Because the income tax assessment varies with the person or

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corporation, each assessment is different and therefore, does not lend itself as readily to economies of scale.

The tax office by assessing mainly the earnings of wage and salary earners has difficulty in itemising and finding the income earned by those taxpayers who wish to hide their income. This is because wages and earnings can be easily hidden either as money or by transformation into assets. The tax office may find defaulting taxpayers but still, it's assessment of their income may be less than that actually earned.

Assessment of the earnings of companies can be even more difficult particularly for multi national companies where a large part of their earnings are derived overseas.

The difference in complexity between the two taxes can be appreciated by the differences in the size of each act. The Income Tax Assessment Act is nearly 2000 pages long compared with the Valuation of Land Act which is about 150 pages.

8.2 PROPERTY TAXES APPLY TO TANGIBLE OBJECTS

Property values apply to tangible objects with which most taxpayers have had some dealings and have lived in or on. Therefore, the subject of the tax is known and understood by the layman.

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frontage were all impracticable:

factors or providing for the assessment of rates on areas or

allocation of points for the productivity of land and other

that the proposed alternative schemes which entailed the

values should be retained as the basis for property taxation and

The Ligertwood Committee in New Zealand recommended that market

purposes" - NSW Committee of Inquiry, 1961, paras 163/4, 167.

understood and required by the general public for various

In addition, market value has the advantage of being easily

the substitute systems of valuation which have been submitted.

other markets, it does possess a factual basis unshared by any of

"167. Although the market for land sometimes fluctuates like

adjustments would be incapable of proof".

arbitrarily without reference to market transactions. These

locations, uses and purposes, would again need to be made

between individual lots and the standards as applied to various

foot of street frontage'. Any adjustments for differences

based upon an arbitrary standard such as a 'norm' or 'economic

would be unsuitable. This would apply to any valuation system

unrelated to market realities, and incapable of being tested

purposes is obvious. Any 'valuation' on an arbitrary basis

"164. The importance of uniformity of valuations for all

rating".

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