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CONTENTS

CONTENTS CONTINUED

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Filling the land tax void: New Zealand standpoint

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Abstract

This paper investigates land taxation from a New Zealand perspective and examines the principles of economic efficiency and equity behind three common property valuation methods for taxation. The primary question is whether using land value as the base on which to assess property tax remains the most efficient and equitable tax mechanism compared to capital value tax on improvements and annual value tax on estimated income earned from the property. The paper briefly assesses the challenges confronting valuation and the impacts that may arise from a levy of property tax in jurisdictions with different features. While issues exist in the determination of any basis of value, it is asserted however, that there is a need for considering exemption provioeh, which has a significant potential to

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The author would like to thank the anonymous referees for critical advice on an earlier draft which significantly improved this paper. Any remaining errors are naturally those of the author.

2.3 Land value (LV)

Land value or site value (SV) tax is a one off tax on the existing wealth in the form of property[31] and only targets landowners. At the time of sale, a tax decrease will increase the market value of the property, allowing the owner to benefit from a windfall gain. A tax increase will reduce the value of the property causing a loss borne entirely by the landowner. It is a tax on a certain form of wealth, for business it is a tax on capital assets and for private owners it essentially targets savings. Those who do not own land will not be impacted directly by the tax. However, tax shifting opportunities are available for types of properties and industries. For example, business owners can pass on part of the tax burden to customers, suppliers, even employees in the form of reduced benefits or wage cuts. Apartment owners can increase rents. Owner-occupied homes will bear all the costs.

Adam Smith's canon of economy states that 'every tax ought to be so contrived as to take out and keep out of the pockets as little as possible, over and above that which it brings into the public treasury of a state'.[32] To satisfy a cost-benefit analysis, the tax system must be able to raise substantial revenue at a relatively low cost.[33] It is said that, '[f]or any given tax, the larger the price elasticities of demand and supply, the larger the change in consumption and production. Therefore, the larger price elasticities of demand and supply are associated with larger deadweight loss'.[34]

Land tax is a tax levied on the unimproved[35] or rental value of land (but there are some variations that include improvements to land). Land tax is a cost of owning land, and taxes an immobile factor.[36] In a perfect functioning market with no transaction costs and a fixed supply of land, the full burden of the tax falls on the landowner at the time the tax is levied. This has been mathematically proven; the new market value for a piece of land is reduced by the tax. The purchaser is compensated for all future tax payments through a reduced purchase price for the land.[37] Any attempts by the landowner to increase property price will result in lower demand for the land and excess supply of land. Thus, the market price is set by the purchaser rather than on the basis of expenses born by the landowner. The fixed supply of land enables high revenue from low rates.[38]

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[31] Coleman and Grimes, above n 4.

[32] Smith, above n 19.

[33] I Vlassenko, 'Evaluation of the Efficiency and Fairness of British, French and Swedish Property Tax Systems' (2001) 19(5) Property Management 384, 386.

[34] J P Cohen and C C Coughlin, 'An Introduction to Two-Rate Taxation of Land and Buildings' (2005) 87(3) Federal Reserve Bank of St Louis Review 359, 364. Deadweight loss (an excess burden) in economic terms is the measure of inefficiency.

[35] The term 'unimproved land values' refers to the value of bare land, that is, exclusive of the value of any man-made structures or improvements.

[36] T Dwyer, 'The Taxable Capacity of Australian Land and Resources' (2003) 18 Australian Tax Forum 1, 21, 41 '[A] world that is mobile and labour supply is shrinking in line with demographic decline, an immobile tax base is the only tax base which makes economic sense'.

[37] W E Oates and R M Schwab, 'The Simple Analytics of Land Value Taxation' in R F Dye and R W England (eds), Land Value Taxation: Theory, Evidence and Practice (Lincoln Institute of Land Policy, Massachusetts, 2009) 51, at 71.

[38] Tax Working Group, above n 5, 30.

Land value taxation is a conceptually sound method because it is theoretically efficient and neutral.[39] Tax on improvements such as capital value taxing could affect a landowner's decision to develop property. Land tax will continue to apply post development and will be a fixed cost to owning land rather than a hindrance to development. The imposition of the tax will still (o)2.7 (t)1p0g10.3Tj 0.005 Tc 0.2do-4. 1

Horizontal equity can simply be defined as the equal treatment of equals.[46] In the context of a land tax, the system is considered to have achieved the horizontal equity principle if two pieces of land with the same value are taxed at the equal amounts. Assuming that the tax is low rate, broadly applicable, with no exemptions, this goal would be satisfied. However, the assessment of horizontal equity extends beyond a mere equality test to judge how the tax fits within the existing taxation system. Given that a land tax extends the tax base only to one type of wealth, while helping to solve the 'ability to pay' problem, it is discriminatory. Wealth may be stored in many forms, and the principle of horizontal equity requires them to be treated alike. The introduction of a land tax only taxes wealth stored in the form of land, and thus cannot be said to be equitable. Such discrimination cannot be justified, and is likely to result in public resistance due to its perceived 'unfairness'. A broader wealth tax, such as capital gains tax on the real estate market,[47] may overcome this problem, however, it is beyond the scope of this research paper to set out the implications of capital gains tax in New Zealand.

Vertical equity requires the appropriate differentiation of unequal circumstances.[48] A tax system is considered fairer when a higher burden is paid by those who are most able to pay. While this principle is desirable in theory, its practical application can be difficult. The justification and definition of who has a better ability to pay is complex and somewhat subjective with the decision generally being made by politicians. It is then reflected in the workings of the tax system through the utilisation of exemptions, reliefs and progressive taxes.

Compliance with horizontal and vertical equity should be synonymous, not alternative. Together they represent the broader principle of equity and essentially represent alternative sides of the same coin.[49] Without the appropriate differentiation of people (through vertical equity measures), horizontal equity is merely a tool to safeguard

3. HISTORY OF PROPERTY TAX IN DIFFERENT JURISDICTIONS

3.1 Australia

Land value taxation is an important source of tax at the state and the local government levels in Australia. State tax is imposed on owners of land used for income producing purposes. The Australian Local Government Association website shows 563 local authorities that rely exclusively on the land value tax as own-source revenue. Australia has a long history of land value taxation which has achieved consistent results.

Table 1: Land value taxation at the state and local government level[51]

Australian States/Territories	State tax first introduced	State Government Land Tax	Local Government Council Rates
Australian Capital Territory	1987	Unimproved Value	Unimproved Value
New South Wales	1895	Land Value (replacing unimproved value in 1978)	Land Value
Northern Territory	None	None	Unimproved Capital Value
Queensland	1915	Site Value	Site Value
South Australia	1884	Site Value	Improved Value*
Tasmania	1910	Land Value	Gross Rental Value*
Victoria	1910	Site Value	Improved Value
Western Australia	1907	Site/Unimproved Value	Gross Rental Value*

* The option of assessing council rates on more than one basis across different Local Government Authorities.

The table above, modified from Mangioni,[52] shows land value is taxed at the State level for all eight territories except Queensland which taxes only the raw value of land, excluding levelling and drainage (merged improvements). Local governments have a choice of methods with the exception of Australian Capital Territory. There is a growing preference for capital value, as evidenced by the high number of councils choosing capital value taxation in South Australia and Victoria. In Tasmania, despite the choice of tax methods, rental value is the preferred method.

The evolution of land taxation in New South Wales provides an insight into the challenges confronting all cities when imposing a land value tax in increasingly urbanised locations. These challenges have resulted in an additional layer of

[51] V Mangioni, above n 28, 86.
[52] Ibid.

Land value tax was adopted in New Zealand for the first time in 1878.[60] Public expenditure and immigration contributed to the boom in land value before 1870 and peaked between 1874 and 1878, coming to an abrupt end in 1879.[61] Liberal thinkers believed wealthy landowners had greater taxable ability but a low tax burden compared to the working class who were generating the bulk of government revenue through tariffs. However, when the land values began to fall, the counter argument was that it was unfair to tax a group who was receiving no special benefits and whose growth was important to the growth of the economy. This tax was repealed a year later by the Property Tax Act 1879 (NZ) which taxed capital value only and then a6 0 1 1.

the New Zealand context is nonetheless pertinent.[69] Therefore, the paper will now consider how the New Zealand environment will affect the implementation of a land value tax and its influence on the canons of efficiency and equity.

4. A LAND VALUE TAX: SOME NEW ZEALAND CONSIDERATIONS

This section sets out the factors which must be taken into consideration while implementing a land value tax in New Zealand.

4.1 Lack of tax revenue from property

Cheung observed that a favourable taxation system, immature capital markets, migration patterns and 'easy credit conditions' have made rental property an attractive investment option for New Zealanders.[70] The New Zealand Government under-utilises its ability to levy taxes on property.[71] As mentioned earlier,[72] local authority rates, which can be based on land, capital or rental values of properties, have been the major source of revenue for local government in New Zealand. Central government, on the other hand, earns only an estimated 5 per cent of its total tax revenue from property. This is well below the OECD average,[73] which is not surprising given New Zealand remains one of the last countries within the OECD which does not have a comprehensive capital gains tax (CGT). A partial CGT exists under subpart CB of the Income Tax Act 2007 but its application is rather limited mTr3 (r28]TJ /TT4 1 Tf -4.6 (m)178]T

New Zealand, however, has an existing land registry which records essential information in regards to all land in the country.[92] In creating the registry, nearly all land was surveyed, resulting in the records of parcel boundaries being reasonably accurate. Electronic conveyancing improves the operational efficiency and integrity of New Zealand's land register. The preexistence of such a registry2.6 (.674 -1.219 (e)5 ((r)8. ((r as water supply, sewerage and drainage. Ordinary rates can vary for different categories of land.[103]

4.5 Māori land

The existence of Māori Authorities is another unique consideration for the implementation of a land tax in New Zealand. Māori Authorities, created in 1939, are trustees administering communally-owned Māori property—often in the form of land following Treaty of Waitangi settlements—on behalf of the individual owners.[104] The imposition of a land value tax would adversely affect the negotiated settlements. Māori Authorities would be subject to an inequitable and disproportionate share of the tax burden and the monetary value of their land would also fall. 0 — R U L I U H H K R O G O is underdeveloped relative to general land, even after taking into account differences tax.[107] A land value tax is said to be neutral with respect to land use which promotes the development of land to its highest and best use.[108] Oates and Schwab's Pittsburgh study suggests that some cities gain the beneficial effects of greater tax neutrality, and land-value taxation alone was not the direct stimulus to the regenerative land uses in Pittsburgh, although it did assist to a lesser degree.[109] Further, their study of effects of Pittsburgh's tax system on housing development suggests that to induce new construction the property owners who redeveloped or renovated buildings on their land were not taxed for the first three years for the additional value from reconstruction.[110] The imposition of a land value tax will benefit rapid99 (d)104neran i4ne

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land tax by the national government and collection by the local government will encourage more intensive land use and will result in a higher level of improvements to the land.[1]Attach[2(e)19.8 Tm [(1A)11 (ha)-1.7TJ -0.01i

should it be adopted, will need to apply to all investment housing, not just foreign-owned property.[135] In the author's opinion, implementation of a land value tax is an impulsive reaction to the Auckland real estate bubble and could lead to an increased risk of significant political influences that would translate to exemptions as previously shown by the abolished land value tax in 1992.

Consequently, this study contributes to a call for further investigation into whether taxing all effective income from capital (real estate market) and stamp duty or transfer tax[136] payable by the transferee or purchaser at the time of conveyancing[137] will broaden the New Zealand tax base and therefore overcome the problem of equity and efficiency in the tax system. This points to a promising direction for future research.

[135] Foreign investors are merely one of the many symptoms of a broader problem of the fiscal privileges enjoyed by landowners.

[136] The most recent example is Vancouver, British Columbia which just imposed a 15 per cent transfer tax on purchases of real property by foreigners.

[137] Land Information New Zealand could act as the agent for collecting the transfer tax or stamp duty.