Land Tax Reform Package

Draft Land Tax (Miscellaneous) Amendment Bill 2019

Submission

MASTER BUILDERS
SOUTH AUSTRALIA

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1. Background: Who we are and the importance of the building and construction industry to South Australia's economy

Established in 1884 as the peak body representing South Australia's building and construction industry, Master Builders SA is committed to building a highly productive industry and a prosperous South Australian community and economy.

Building and construction is the second largest industry in Australia. In 2018 South Australia's building and construction industry undertook $12.84 billion of work, contributing more than $1 for every $7 of economic activity within the state. Indirectly, more than one-quarter of South Australia's wealth is produced by the building and construction industry.

As at February 2019, there were 72,151 people directly employed in the industry across all sectors, including residential, commercial, civil engineering, land development and building and completion services. This represented 8.49% of total employment in South Australia, and our industry makes up 11.5% of total full-time employment. Indirectly, the industry supports tens of thousands more South Australian jobs.

Master Builders SA is proud of the industry we represent, the jobs it creates, the more than 11,000 homes built and extended for families last year, the outstanding health, education and sporting facilities it has constructed, and the offices it has built for South Australian businesses.

2. Overview

Master Builders SA wants to work collaboratively with the Marshall Government to help create a tax environment that incentivises people to invest in South Australia. This is a vital ingredient in creating a more vibrant and prosperous state. South Australia's economy continues to fall behind other states, particularly in the east where strong population and capital growth have gone hand in hand. The only way to turn around this trajectory is a relentless focus on creating a business utopia where people want to live and work. The completely unacceptable alternative is South Australia being swamped by a creeping malaise and deteriorating into a "cemetery with traffic lights."

Master Builders SA consulted with our members in good faith and with an open mind about the Marshall Government's land tax reforms. We went out to our entire membership base – commercial, residential, subcontractors, suppliers – and asked for feedback – good or bad - about the government's proposals. The proposals were considered by our policy committees and we also held information seminars for our members. The response we got was decisive. It has been a very long time indeed since one issue has so galvanised the industry.

Feedback has been overwhelmingly negative about the changes to aggregation. This is seen by our members as a blow to business and investment confidence in South Australia and especially the building and construction industry. Worst of all, this shock – there was zero consultation with Master Builders SA - has exacerbated the challenges of an industry slowdown.

Master Builders SA welcomes the increase in the tax-free threshold to $450,000 and the reduction in the top rate to 2.4%. However, the draft bill does not change the attack on a major job creating sector. A large portion of the 8% of individuals and 25% of companies the government admits will be worse off would generate significant, if not the most investment in South Australia. They are the ones who pay the bulk of the tax, are the big employers, those who invest, take risks, borrow money and are the developers of land and the state. The Marshall Government does not appear to have properly considered the consequences of targeting this group. As one member said:

"Are we in fantasy land? The less people there are who have to pay more and thus contribute to the government windfall, the more they have to pay. So how much more are these 25% going to pay? And this will be passed on and impact jobs, the number of rental properties, amount of rents and so on."

Master Builders SA urges the Marshall Government to return to its mandate of "backing business to grow the economy" through lower taxes, more jobs and stronger investment. As recently as May – one month before changes to land tax were announced – the March Quarter 2019 Sensis Business Index revealed South Australia had soared to its highest level of small and medium business confidence on record. Unfortunately, the following comment from a housing member is typical of current member sentiment:

"Since changes to land tax were announced in the budget our sales have just been getting smashed. We've had plenty of buyer interest, but when it comes down to putting pen to paper, they get cold feet. Everyone I'm talking to is saying the same thing: the market is spooked. This policy is absolutely killing confidence out there."

3. The solution: instead of trashing investor confidence, bring our bloated public sector in line with the national average

Master Builders SA understands and accepts that the GST write down of $2.1 billion over four years put the Marshall Government in a position where it had to make some tough decisions.

However, we do not accept that the government has a revenue problem. The government has an expenditure problem.

At 16.35% South Australia has the highest percentage of FTE public servants to total FTEs out of any state. We have compiled the following table from the 2017-2018 Workforce Information report (page 11) and the Australian Bureau of Statistics website (Full Time Labour Workforce – seasonally adjusted for each state for June 2018):

	Public Sector FTE(thousands)	Total FTEs (employed Seasonally Adjusted) (thousands)	% of Public Sector to Total FTEs
SA	89.434	546.9	16.35%
WA	110.373	899	12.28%
NSW	323.828	2773.8	11.67%
QLD	225.417	1690.7	13.33%
VIC	251.312	2220	11.32%
TAS	23.9	158.4	15.09%

The national FTE average for states is 13.34%. If South Australia was in line with that average that would translate to 72,962 FTEs. If we multiplied that number by the average public sector salary of $82,400, there would be a massive saving of $1.357 billion- recurring! This money could be used to (amongst many other things!) further reduce land tax rates and further increase the tax-free threshold. Imagine the confidence boost generated by such a strong message telegraphing that South Australia is open for business!

In particular, we cannot accept the need for a staggering 1353 government executives (employees who receive a total salary equivalent to $117,677 per annum or more), as recorded in the 2017/18 Workforce Information Report. All this taxpayer-funded largesse at a time investor confidence in a sector that is a major contributor to jobs and economic growth is getting hammered is completely unacceptable.

Master Builders SA believes bringing the public sector in line with the national average is a reasonable policy objective. We aren't calling it for the public sector to be wafer thin, just in line with other states.

It is reckless and totally unnecessary policy to blow up investor confidence and smash productive parts of the economy for a budget measure that collects only a tiny percentage of total revenue. As a percentage, changes to aggregation (the Marshall Government says this will be $86 million per year) only makes up 0.42% of total revenue and 1.81% of taxation revenue.

Given the obvious scope for savings in the public sector there is absolutely no need for changes to aggregation. The remainder of this submission details our members' numerous concerns about the aggregation.

4. Concern about revaluation

The Marshall Government claims that 92% of individuals and 75% of company groups will pay less land tax.

However, the timing of the Bill coincides with the implementation of a state-wide revaluation that is expected to result in marked increase to site values and therefore a significant revenue increase to the government. The revaluation is likely to negate any benefits of the increase in the threshold for many "mum and dad" investors. A sharp increase in land tax combined with related increases in council rates, water, sewage and ESL charges will leave many investors worse off.

Colliers International's analysis is that site values from the first stage of the revaluation process (including the local government assessments of Unley, Walkerville and the Adelaide Plains) have increased by up to 40 per cent. The Adelaide CBD is next with newly assessed site and capital values to be released for use in 2020/21.

Given the magnitude of these reforms Master Builders SA urges the Marshall Government not to commit to them them until there is certainty around the revaluation initiative. The government, investors and industry alike needs to know what they are dealing with.

Until then, and in the absence of any evidence to the contrary, we cannot with any confidence accept that 92% of individuals and 75% of company groups will pay less land tax.

5. Comparing jurisdictions

The Bill manifests a clear intent to tighten aggregation, grouping of related corporations, implement new trust surcharge, and adopt a model that is similar to New South Wales and Victoria.

Master Builders SA disputes claims the reforms will bring South Australia into line with other states.

Although the Government has committed to reducing the top rate from 3.7% to 2.4% by 1 July 2020, the top rate kicks in at a much lower threshold than other states. The top rate is also lower in Victoria (2.25%) and New South Wales (2%):

Comparison of top rates

NSW	***VIC***	***QLD (RES)***	***QLD (COM)***	***SA (NO)***	***SA (NEW)***	***WA***	***TAS***
2.00 %	***2.25 %***	***2.25 %***	***2.75%***	***3.7%***	***2.4%***	***2.67 %***	***1.5 %***

For example, somebody with three properties in Victoria at $400,000 each aggregated at $1,200,000 would pay $4575 in land tax whilst in South Australia it would be about $9600, more than double. Another person in Victoria holding $5,000,000 worth of property would pay approximately $70,000 whilst in South Australia under the new proposal it would be more than $100,000.

This completely goes against the theory that the changes will attract investment. It would still be far more attractive to invest in a place like Victoria with lower rates, lower vacancy rates, lower unemployment and larger, quicker capital growth.

In the words of two members:

"What the government doesn't seem to understand is that in South Australia we are more reliant on the investment stacking up from a return point of view as we don't get the same rate (in terms of time) with the upturn in growth. In 2008 the median house price in Melbourne was $385,000 compared to Adelaide at $362,000. 10 years later Melbourne was at $830,000 and South Australia was $470,000."

"In our case we already pay significant land tax as all our holdings are commercial. Our land tax will increase by more than 200%. My very real options will be to sell some properties in South Australia and invest in single holding properties in Victoria, New South Wales or Queensland. It won't pay for to invest in South Australia with holding properties and development not stacking up."

South Australia's economy is fragile. We are closer to Tasmania than Victoria, New South

Wales and Queensland. Again, Master Builders SA emphasises that bringing the public sector in line with the national average would provide plenty of scope to increase the attractiveness of our land tax regime by further lowering the top rate and increasing the tax-free threshold.

6. Impact

Master Builders SA rejects the unfortunate "class warfare" rhetoric that has accompanied the introduction of these changes. It is disappointing that this debate has often been framed in terms of only impacting a tiny minority of well-to-do individuals who can afford increases in their land tax bills.

In reality, the building industry is a major contributor to jobs and economic growth with tentacles right through the economy. Engineers, surveyors, earth movers, concrete suppliers, steel suppliers, plumbers, electricians, painters, tilers, joinery suppliers, bricklayers, labourers, carpenters and many more are telling us they are suffering from a reduction in business activity and jobs. What we keep hearing over and over again from our members is that their situation is due to a lack of investor and consumer confidence.

"Rational Choice Theory" is a basic principle of economics that individuals use rational calculations to make rational choices and achieve outcomes that are aligned with their own personal objectives. When the investment landscape changes, consumer behavior does not just carry on the same as it did before. Retrospectively changing rules that have been in place since 1936 has created a perception of sovereign risk in South Australia. A lack of confidence is strangling our industry. Members are telling us this policy will force them to scale back developments and make redundancies in their businesses.

The damage that is being done to South Australia's macro environment far outweighs the "benefit" of the $86 million revenue the Marshall Government says it will net as a result of changes to aggregation. As Winston S Churchill famously noted, nations (and states) cannot tax their way to prosperity. Master Builders SA believes declining confidence (and therefore investment) has contributed to the increase in the unemployment rate in recent months to a national high of 7.3% in August.

In the words of one member:

"The Treasurer needs to talk to frontline people in the building and real estate industry. We are seeing real evidence of a slowdown. For example, an industry supplier that handles many builders' selection interviews has had a sharp downturn in consultation numbers since the Budget. They had 104 consults in August this year, compared with 172 for August 2018."

Many of our members are facing a double whammy. Not only are they facing massively increased land tax bills but their sales are way down as well.

Look at the sales (actual contracts) of one of our residential builders this year compared with last year (and in particular since June's State Budget):

Jan 19	8	6	Jan 18
Feb 19	11	14	Feb 18
Mar 19	9	5	Mar 18
Apr 19	11	7	Apr 18
May 19	14	7	May 18
June 19	2	14	June 18
July 19	4	12	July 18
Aug 19	4	8	Aug 18

Year-to-date they are down 14%, but it has all kicked in since June's State Budget. They have also reported an increase in "prelim agreements" where owners ask them to organise footings reports to determine costs, but then they seem to take ages from that point to agree to commit. They have one client on their second allotment and fifth house plan and they still need to "sleep on it".

This feedback is very similar to what we have received many other housing members.

It is important to remember that the impact is being felt right throughout the industry. Here is some data from a well-known tiles supplier in relation to monthly builder client interviews.

	2018	2019
June	167	99
July	157	102
August	169	96

Here are a couple of other key areas of concern for our members:

6.1 Display Homes

The Marshall Government does not appear to understand what the impact of the changes will be on properties necessary to run a business in the housing industry. Many residential home builders have display homes they use as tools to help sell building contracts. The display homes are not a profit maker, but a "tool of the trade". Reflecting this widespread use and importance, Master Builders' annual Building Excellence Awards have four categories for outstanding display homes. However, proposed land tax changes will increase the cost of having houses for display, forcing many of our members to reconsider this method of marketing their products. This will have a negative impact on sales, jobs and the state's economy.

6.2 Housing Affordability

It is well known that the housing industry has faced some serious challenges over the past 12 months. 10 residential builders have ceased trading and gone into liquidation. Whilst none of these builders were Master Builders' members, the impact of these insolvencies on many of our subcontractor members has been severe. Many are owed tens of thousands of dollars. Such a debt can be crippling for a small operator. Home builders, trades and suppliers have also all been financially impacted by a decline in consumer confidence as a result of these insolvencies.

Since changes to land tax were announced Master Builders SA has regularly heard reports from private planners that they have lots of clients cancelling or holding back on developments. The reality is land developers supply finished allotments to the market so builders can build on them. Grouping of newly created residential building allotments will increase the cost of these allotments as the developer passes the cost on.

One member has advised their land tax bill will double from their current assessment of $117,000. For another member their land tax will go from $26,000 to about $130,000 per annum (it was more than $220,000 under the government's original proposal).

Increases like this are a direct threat to housing affordability. These massive increases in land tax will be passed on, making it even more difficult for first homebuyers to get into the market. It won't help create more work opportunities for tradies and apprentices on building sites. It's also important to note that this not a once off affair, the excessive land tax bills will be payable each and every year going forward. Here are some examples of typical feedback we have received from members:

"Builders facing large increases in land tax will either pass the cost on to consumers or reduce their staff. The loss of jobs becomes a real result of this tax change."

"We currently have four development sites on the books with approvals in place either about to start or in the final documentation stage. Most of the properties are in the $360,000 to $400,000 range and within ten kilometres of the city – affordable first home buyer range. We will be left with no option but to increase the sales price as I'm sure all other developers will. All the other hits like 7-star energy rating, revaluations and so on all add up. This has a flow-on effect to investment, approvals and rentals."

"The building industry is already struggling. Developers and clients are holding off and pulling out of proposed developments. As a small builder relying on where the next job is coming from to make ends meet, how are we supposed to absorb these proposed amendments in an already stagnant economy where consumer confidence and spending is already down?"

"I have spent hundreds of thousands of dollars setting up perfectly legal entities to run my business responsibly and now that is wasted. You should be aware of the pressure builders are under at this time with record insolvencies. If this tax is approved there will be many more, the Liberal Party will be responsible for these collapses."

It is important to remember a developer receives no income on vacant land.

6.3 Retirement

Master Builders SA has had many tradies tell us they are concerned about the aggregation measure. Most were your typical self-employed tradies in their mid to late 50s with no superannuation and no other benefits, but they have worked hard and invested in South Australia, owning two to three investment properties for their retirement. They are now faced with either having to find extra money to cover their increases or selling. Adding insult to injury they are being demonised for having been diligent investors. In the words of one member:

"As mum and dad investors my wife and I invested in the property market with the clear intention to become self-funded retirees. Land tax does not discriminate against debt. All the properties we own are mortgaged. We were prepared to work hard while we could so that we could enjoy retirement and not have to struggle. We took advice from industry leaders and professionals along the way when purchasing properties whether they were through trusts and companies, paid all the necessary fees and charges as we were required to. How can you just move the goal posts? Once you add the proposed amendments, our properties that are returning 5-7% will be closer to 2%. I can't see any other option but to sell up. Our retirement plans are in tatters."

What will the government do to manage the impact/impost of these changes? For example the builder or investor who will have to pay industry professionals to identify the trusts within the relevant group and determine whether the trusts fall within the category of Discretionary Trust, Unit Trust or Fixed Trust?

7. Grandfathering

Master Builders SA believes the best option to restore confidence and generate investment in South Australia's economy is to immediately reduce the top rate to 2.4%, increase the tax-free threshold, and drop the proposed changes to aggregation. This would send a clear message that South Australia is open for business.

A lot of the angst out there stems from the fact the Marshall Government has introduced the tax aggregation retrospectively in lieu of grandfathering it. In doing so the government has taken away an investor's option to make an informed decision when purchasing a property and factory in the aggregation (additional land tax) in the calculations in terms of returns, borrowings and whether its viable investment overall.

If the government insists on keeping its changes to aggregation, one option that has been suggested is grandfathering the tax into the tax regime, for example allowing land owners time (say three years) for market values to increase to an amount where they can recoup the cost of the new tax.

The main problem with this approach however is it will not generate a future environment as attractive for investment as our preferred option of scrapping the proposed changes to aggregation, reducing land tax rates and increasing the tax-free threshold. This is clearly more in South Australia's long-term interest. Grandfathering is a poor second cousin to abolishing aggregation changes completely.

8. Summary

The passionate feedback we have received from our members is that changes to aggregation are risky, unnecessary and contradict the Marshall Government's mandate to lower land tax.

Master Builders SA wants the complete abolition of the aggregation proposal that has badly damaged confidence in the building industry at a time when building approvals were already down, ten residential builders had recently gone under and the commercial sector was rapidly cooling.

Master Builders SA urges the government to think of the wide-reaching impacts of this dangerous policy as outlined in this submission. Will increasing a developer's land tax bill make housing more affordable? Increase the amount of building work? Opportunities for tradies and apprentices on building sites? Suppliers? Building industry professionals?

As we have clearly outlined, the government should rein in its excessive taxpayer funded spending before going after the private sector. Merely bringing South Australia into line with the national average would save the government more than $1 billion each and every year. Why instead single out a major job creating sector, a group that takes risks to generate significant, if not most investment in the state, for punishment, damage investor confidence, and introduce a complicated reform that is difficult to administer?

To the Marshall Government we say: listen to industry. We want South Australia to be the best it can be and we want to work together to achieve this. The feedback from the coal face contained in this submission should not be taken lightly. Our industry directly employs more than 70,000 South Australians and undertook nearly $13 billion in work last year. Bottom line: you can't have a strong economy without a strong building and construction industry, and right now many of them are hurting.