

Charter Insight

Understanding Property Tax Changes and how they apply to your property.

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Property taxes come in a range of contexts but may be categorised as either 'transactional' or 'immovable'. Transactional taxes result from transfer of ownership, the most obvious example being Land Transfer Duty (known as Stamp Duty). The latter relates to taxes on land and buildings which are 'immovable', such as Council rates or Land Tax. The comments below relate predominantly to 'immovable' property taxes.

Where taxes are proportionate to the value of a property, they are termed 'ad valorem' taxes. Council rates can only be classified as such to a limited extent because the total amount of tax collected each year is related to a predetermined municipal budget. Land tax on the other hand is a true 'ad valorem tax' – the higher the values the more tax is collected overall. In some jurisdictions – though not generally in Australia – the last sale price or an indexed derivative is used as the basis for tax calculation. Where the rate of tax increases as the value increases it is referred to as being a 'progressive tax', since the amount collected climbs exponentially as property values increase.

Property taxes are traditionally more the preserve of State and Local Governments and may be based on improved property values including buildings or on an unimproved basis, being the land value alone.

Governments strongly favour property taxes for a number of reasons, particularly:

- They are relatively inexpensive to collect.
- Because of its immobility / visibility, unlike financial assets, the capacity for tax avoidance by shifting between different jurisdictions or off-shore is eliminated.
- Efforts to move properties between ownership entities can be caught by the transaction taxes (i.e. Stamp Duty as referred to above) or higher tax rates for perceived tax shelters (e.g. trusts etc..).
- There is virtually no chance of defaults on tax owed as liability is generally mandated by statute as a first priority charge against the property which can often be sold at the behest of the authority with minimal legal process.
- The long term trend of increasing value of property relative to incomes means there is a natural growth in such taxes.

- Where the tax rates are progressive (as they usually are), increasing the amount of tax collected requires no policy re-set (with attendant political fallout), because the growth in property prices leads to exponential escalation in the tax base in any event.
- Property taxes can drive more efficient uses of land.

A shortcoming for governments is that ad valorem property taxes can be volatile, as they can decrease at relatively short notice when the economy may be in decline:

On the other hand, the downsides for property taxpayers include:

- Where market values are used, the assessment process can be susceptible to a degree of subjectivity, as valuation processes may be seen as being by nature a little arbitrary.
- Where market values are used / updated, it can be very difficult to budget as the precise effect of property price movements as measured in the assessment process may only come to light when the tax notice arrives.
- Though not always, dispute processes may be relatively expensive, particularly when they head for the courts.
- The capacity to pay tax is not always directly related to the income producing capacity of the asset, particularly where properties are undercapitalised with little income, but high land value.
- Where the tax burden becomes sufficiently heavy to trigger a need to dispose of the property, the effect can be seen as unreasonably punitive for an individual who has spent potentially significant time / effort accumulating the asset.

Many may carry the perception that property taxes have been rising at a greater rate than the incomes that service the burden. That governments have been becoming increasingly reliant on such taxes is a general hypothesis that would for instance be supported by analysis of the situation in Victoria.

The below graphs show discretely some of the major categories of Victorian State Government taxation (incl. Stamp Duty and Land Tax), setting out the percentage they represent of the total Victorian Government taxation revenues over time. It demonstrates amongst other things the increasing contribution that Land Tax is making as well as the increase and more recent volatility of Stamp Duty revenues.

There is only so much one can do to mitigate individual / personal property tax liability. Where possible, planning and diversifying ownership structures can enable advantage to be taken of tax free thresholds and the more modest tax rates in the lower range of the spectrum of a property's value. Continuing to maintain buildings adequately or where possible updating improvements can diminish the risk of the effects of undercapitalisation which can exacerbate liquidity issues.

Critically examining the valuations upon which the property taxes are levied and having a thorough understanding of the property's strengths and weaknesses - including considering how the market might view these - are strategies to ensure that the basis of assessment is fair / appropriate.

Confirm also that the data that informs the foundation of the valuations is correct - i.e. check land size, title details, zoning and any detrimental influences external to the property etc. Mistakes detected on this underlying property data can generally lead to reductions that will endure for the life of the property. Lastly, keeping track of value movements in the relevant market segment(s) will better enable you to know if / when it might be worthwhile to challenge a property tax assessment.

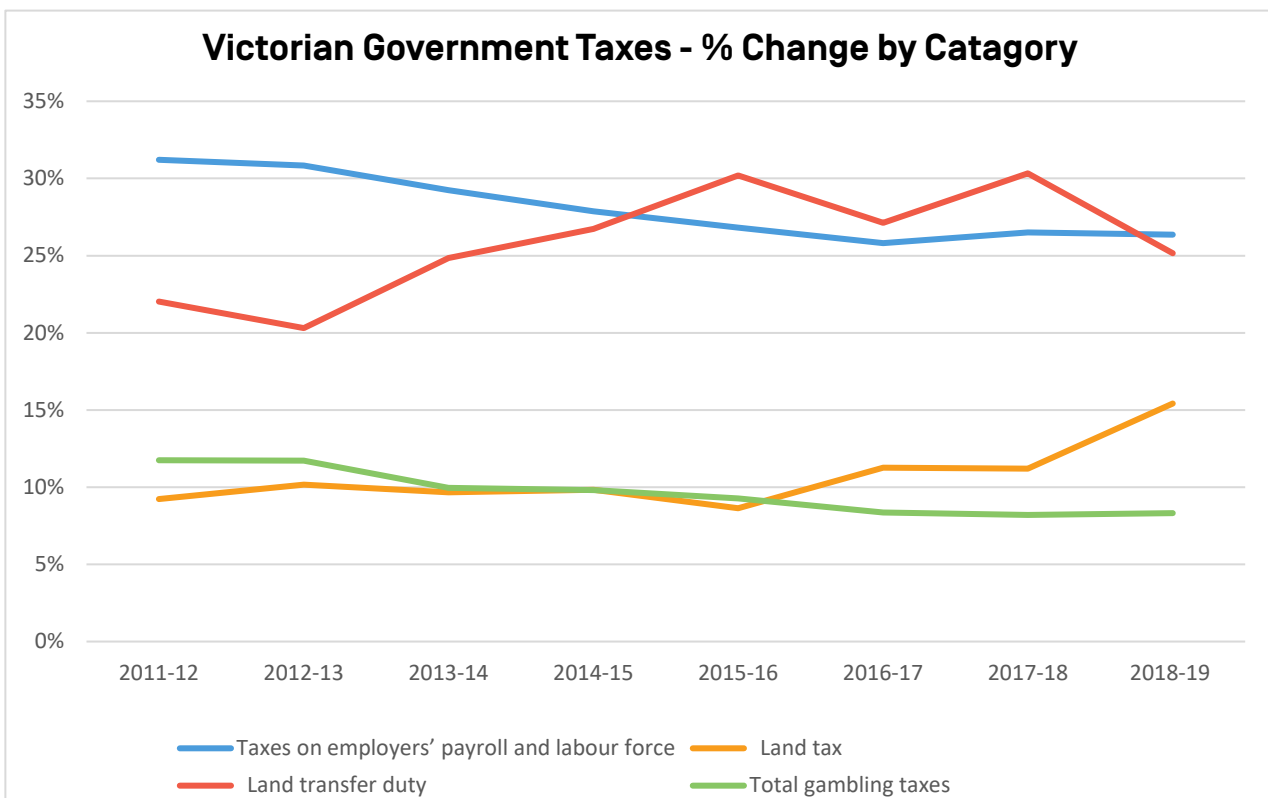
(Importantly, note also the prescribe timeframes in which Objection can be made to the property tax valuations - generally 60 days from the date of issue of the annual rate / tax invoice.)

Peter Fitzgerald leads the team associated with Property Tax review processes at Charter Keck Cramer and can provide expert advice on all aspects with either individual properties or portfolio holdings.

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