Intelligent Investment

Implications of tax reform on Victoria's property market

VIEWPOINT

A number of new taxes have been introduced in Victoria which will have implications for the property sector

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A number of changes to Victoria's taxation system will impact the commercial and industrial property market. This paper seeks to outline major changes and highlight their impact on the market.

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Land tax will be used as a lever to implement reform

Many of the changes to the taxation system that directly impact the property market will be implemented through changes to land tax. Base land tax rates have increased post-COVID (Table 1) with the absentee owner surcharge, COVID debt repayment plan and the proposed Commercial Industrial Property Tax (CIPT) increasing rates further.

Increased land tax costs are challenging for investors while increases are often passed on to tenants through outgoings which may limit rent growth going forward. These changes may also impact on Victoria's ability to attract investment if land tax is markedly different to other jurisdictions in Australia.

TABLE 1: Victorian land tax general rates (2023-24 v 2009-21 land tax year)

2023-24 TOTAL TAXABLE VALUE OF LAND HOLDINGS	2023-24 LAND TAX PAYABLE	2009-21 TOTAL TAXABLE VALUE OF LAND HOLDINGS	2009-21 LAND TAX PAYABLE
< $50,000	Nil	< $50,000	Nil
$50,000 to < $100,000	$500	$50,000 to < $100,000	Nil
$100,000 to < $300,000	$975	$100,000 to < $250,000	Nil
$300,000 to < $600,000	$1350 plus 0.3% of amount > $300,000	$250,000 to < $600,000	$275 plus 0.2% of amount > $250,000
$600,000 to < $1,000,000	$2250 plus 0.6% of amount > $600,000	$600,000 to < $1,000,000	$975 plus 0.5% of amount > $600,000
$1,000,000 to < $1,800,000	$4650 plus 0.9% of amount > $1,000,000	$1,000,000 to < $1,800,000	$2,975 plus 0.8% of amount > $1,000,000
$1,800,000 to < $3,000,000	$11,850 plus 1.65% of amount > $1,800,000	$1,800,000 to < $3,000,000	$9,375 plus 1.3% of amount > $1,800,000
$3,000,000 and over	$31,650 plus 2.65% of amount > $3,000,000	$3,000,000 and over	$24,975 plus 2.25% of amount > $3,000,000

Source: Victorian Government

Commercial and Industrial Property Tax

The Victorian Government announced in the 2023-24 Budget they are progressively abolishing stamp duty on commercial and industrial property and replacing it with an annual tax based on unimproved land value to be called the 'Commercial and Industrial Property Tax' (CIPT). The Victorian Commercial and Industrial Property Tax Reform Bill was introduced into the Victorian Parliament in March 2024, it has yet to be legislated.

What is it?

The Victorian Government is seeking to reform stamp duty paid on commercial and industrial properties from July 1 2024. Stamp duty for commercial and industrial buildings will be transitioned to an annual property tax called commercial and industrial property tax (CIPT). The rate of CIPT is 1% of the site value of the taxable land. The taxable value is the same as that which applies to land tax. Land used for Build to Rent developments will be subject to a reduced CIPT rate of 0.5%.

When will it be applied?

- The relevant contract of sale is entered into on or after July 1 2024;
- The property has a commercial or industrial use at the date of settlement;
- 50% or more of the property transacts;
- The transaction is not exempt from stamp duty.

How does it work?

The purchaser of a commercial or industrial property on or after 1 July 2024 will be the last person to pay stamp duty on that property. Thereafter, the property would be subject to CIPT. Once land has transitioned into the CIPT regime, exemptions from land transfer duty and landholder duty will apply to eligible subsequent transactions concerning the land, if it still has a qualifying use.

Generally, a property will enter the CIPT regime if 50% or more of the property is sold. The sale of a 50% or greater interest, directly or indirectly, on or after 1 July 2024, will cause the entire property to be subject to CIPT after 10 years.

The rate of CIPT will be a flat rate of 1% of the taxable value of the land for land tax purposes (which is usually the site value). Land that is eligible for a BTR benefit under the Land Tax Act 2005 attracts a concessional CIPT rate of 0.5%.

If a property under the CIPT regime is converted to a non-qualifying use, the owner will not be liable for CIPT in the following tax year. Instead, transfer duty or landholder duty will apply to any sale of the property while it is used for non-qualifying purposes. This aligns with the treatment of non-commercial and non-industrial properties under the CIPT regime.

If the change to a non-qualifying use occurs after a second or subsequent transaction of the property, the owner may be liable to pay 'change-of-use duty'. This duty is calculated based on the duty that would have been payable during the previous transaction, reduced by 10% for each year that has passed since that transaction.

If the property returns to a qualifying commercial or industrial use after being used for non-qualifying purposes, the CIPT will become payable immediately after the 10-year transition period ends, and there will be no refund of any change-of-use duty.

What assets are exempt?

Commercial and industrial property transactions that are currently exempt from stamp duty will not enter the reform. This includes transfers such as:

- Deceased estates;
- Transfer between spouse or partner;
- Purchases by charities and Friendly Societies.

Mixed Use properties will be subject to a 'sole or primary use' test to determine if the property enters the CIPT regime. This test is not relevant where the multiple uses are on separate and distinguishable land titles.

How does the introduction of the transitional loan work?

The introduction of the transitional loan program will reduce some of the barriers to entry for investors by allowing them to take out a government-facilitated loan to pay the final duty liability over ten years. The Bill does not contain details of the eligibility criteria; however it is anticipated that to qualify for the loan, the purchase price will be capped at $30 million. To qualify for this loan, the applicant must be:

- an Australian citizen, permanent resident or an Australian business;
- the first purchaser of a commercial or industrial property where settlement occurs for contracts entered into on or after 1 July 2024; and
- approved for finance from an Authorised Deposit-taking Institution or other approved lender for the subject property.

The loan will be issued by Treasury Corporation of Victoria at a commercial interest rate (Treasury bond rate plus a margin to be determined) fixed over the 10-year term of the loan. The interest will be calculated upfront and the amount comprising the stamp duty and interest will be repayable in annual instalments over 10 years.

If the property is sold or used for non-qualifying purposes within 10 years, the borrower must repay the remaining loan balance. The loan cannot be transferred to another buyer.

What will be the impact on the Victorian property sector?

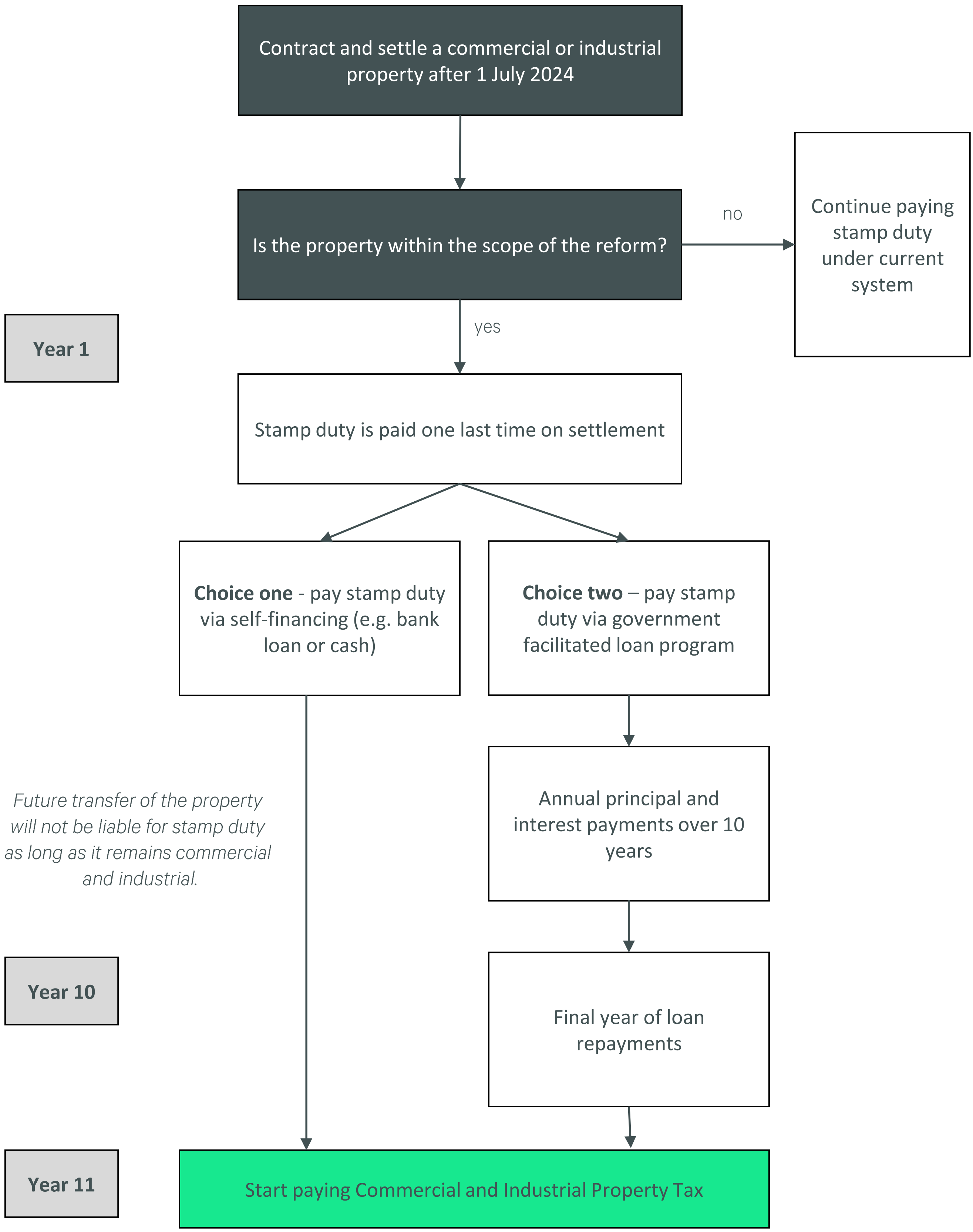
Abolishing stamp duty could have a number of impacts on the Victorian commercial and industrial property market. Freeing up capital early in the purchasing process, either through CIPT or the transitional loan, may help support investment. It could also increase the competitiveness of Victoria with lower barriers to entry encouraging business to relocate or expand.

However, the long-term benefit of paying CIPT will vary depending on the asset type, price and how long it is held for. The prosect of an additional land tax payment may be a barrier for some investors. Furthermore, it is important to note that impacts will take some time to filter through the economy with CIPT not payable until July 2034.

Government will benefit by having a consistent revenue stream rather than lumpy one-off payments from stamp duty. This will ensure a more predictable and reliable form of cash flow.

Source: Victorian Government

FIGURE 1: CIPT Reform Process



Source: Victorian Government

COVID Debt Repayment Plan

The Victorian Government introduced measures in the 2023-24 budget to help pay down the $31.5 billion that was borrowed during the pandemic.

This scheme consisted of increases to land and payroll tax to help paydown debt.

What is it?

From 1 January 2024, the tax-free threshold for general land tax rates will temporarily decrease from $300,000 to $50,000 of the unimproved value of the land. The COVID debt repayment plan includes temporary changes to land tax which are legislated to apply until 30 June 2033. This change is expected to recoup $4.7 billion over the life of the scheme.

How does it work?

From the 2024 land tax year, there has been a change to land tax rates and thresholds, for the total taxable value (site value) of landholdings:

- $50,000 to <$100,000 — a $500 flat surcharge will apply.
- $100,000 to <$300,000 (or <$250,000 for trusts) — a $975 flat surcharge will apply.
- ≥$300,000 (or ≥$250,000 for trusts) — a $975 flat surcharge will apply, plus an increased rate of land tax by 0.10 percentage points.

These increase have been incorporated in the applicable rates for the 2023-24 tax year.

What exemptions are available?

Land tax exemptions will continue to apply to the primary place of residence (i.e., family home), primary production land, land used by charities and residential care facilities.

Absentee Owner Surcharge

What is it?

The Absentee Owner Surcharge (AOS) is an additional 4% surcharge on land tax to all Victorian land owned by an absentee owner.

The surcharge was 2% for the 2020 to 2023 land tax years, 1.5% for the 2017 to 2019 land tax years, and 0.5% for the 2016 land tax year. AOS can apply to all types of taxable Victorian land (residential, commercial, industrial etc).

How does it work?

The tax is payable by individuals, corporations and trusts who are based offshore including those that are incorporated outside of Australia or have a controlling stake outside of Australia. The surcharge is calculated on the total taxable value of Victorian land owned and is included as part of the annual land tax assessment.

What exemptions are available?

The surcharge does not apply if the land is exempt from land tax or if the total taxable value of the land is below the threshold of $50,000 or $25,000 (if the land is held on trust and is subject to the trust surcharge rate).

The Victorian Government announced that from 1 January 2022 until 31 December 2031, eligible build-to-rent developments will receive a 50 per cent land tax concession for up to 30 years and a full exemption from Absentee Owner Surcharge over the same period.

The State Revenue Office (on behalf of the Victorian Treasurer) has the discretion to exempt companies and trusts from the AOS. However, this is rare with exemptions generally not granted for passive investment.

The exemption is intended to apply to absentee corporations and absentee trusts that:

- are Australian based
- make a significant contribution to the economy and community by conducting a commercial operation in Victoria that engages local labour and uses local materials and services
- exhibit good corporate behaviour.

Exemptions are typically not given to passive investors/landlords, but they may be granted if the absentee landowner actively contributes to the Victorian economy and community. Examples include having an active business on the land or engaging in significant development that creates local employment or involves local suppliers.

What will be the impact on the Victorian property sector?

As other the AOS is exclusive to Victoria, it may impact the ability of offshore investors to deploy capital. The ongoing costs will make investment in other Australian states a much more appealing proposition and may see a reduction in the attractiveness of the Victorian Property Market.

If costs are passed on to occupiers through outgoings, it may limit opportunity for net rent growth with gross rents paid by occupiers already increasing to incorporate this significant uplift in land tax. This further hinders the ability for growth and investment in the State.

Table 2 demonstrates the impact of the changes and the substantial differential in land tax paid by a local investors and absentee owners. The increase in land tax from CY23 to CY24 is also noteworthy. Furthermore, absentee owners are paying 154% more land tax for a $100 million asset and up to 563% more for a $1.9 million asset compared to local investors. As this surcharge is only implemented in Victoria, it could potentially deter investment in the state due to the added expenses involved.

TABLE 2: Modelled State Budget 2023/24 Land Tax Changes (excludes trust surcharge for holdings under $3m)

Forecast Site Value 1-Jan-23	Land Tax (SH)	COVID Relief Land Tax (SH)	Increase	Land Tax (SH - AOS)	COVID Relief Land Tax (SH - AOS)	Increase
	CY23	CY24	(%)	CY23	CY24	(%)
$1,900,000	$10,925	$13,500	23.6%	$48,925	$89,500	82.9%
$2,500,000	$20,225	$23,400	15.7%	$70,225	$123,400	75.7%
$2,750,000	$24,100	$27,525	14.2%	$79,100	$137,525	73.9%
$5,000,000	$78,975	$84,650	7.2%	$169,975	$284,650	67.5%
$10,000,000	$206,475	$217,150	5.2%	$403,475	$617,150	53.0%
$20,000,000	$461,475	$482,150	4.5%	$858,475	$1,282,150	49.4%
$50,000,000	$1,226,475	$1,277,150	4.1%	$2,223,475	$3,277,150	47.4%
$100,000,000	$2,501,475	$2,602,150	4.0%	$4,498,475	$6,602,150	46.8%

Source: CBRE Valuations, SRO

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